

## AAM 30. ENCUMBRANCES

<a href="#">30.010</a>	Introduction to Encumbrances	08/05
<a href="#">30.020</a>	Management Encumbrances	
<a href="#">30.030</a>	Outstanding Encumbrance Review	
<a href="#">30.040</a>	Year-end Review	

### **AAM 30.010 Introduction to Encumbrances (08-05)**

Encumbrances are commitments related to unperformed (executory) contracts for goods or services. Encumbrances represent "valid obligations" or amounts that the state may be legally required to meet out of its resources. Authorizations are obligated by purchase orders, delivery orders, contracts, and other documents.

The use of blanket encumbrances is prohibited. A "blanket encumbrance" is the practice of encumbering the remaining authorization balance without substantiating the existence of a valid obligation.

In those cases where an agency has a large volume of small dollar amount transactions, management may establish a single encumbrance to cover the total amount outstanding at any given time. However, management must be able to substantiate the amount of the encumbrance based upon prior experience.

Encumbrances must be recorded for the following:

1. Leases, contracts, or other purchasing agreements estimated to cost \$5,000 or more;
2. Valid prior year obligations during the reappropriation period, if not already encumbered; and
3. Scheduled payments resulting from a contract or lease.

### **AAM 30.020 Management Encumbrances**

Some items cannot be encumbered from purchase orders, leases, and contracts. Unencumbered balances of authorizations may be overstated if charges for such items were made at the time invoices were submitted for payment. In order that unencumbered balances on accounts and reports show the condition of authorizations, agencies may establish management encumbrances for obligations that the agency considers necessary to encumber to assist in the management and control of activities.

At year-end, management encumbrances must be reviewed and liquidated if they do not represent valid obligations. They may only be reappropriated in the accounts for the new fiscal year if they represent valid obligations as of June 30 of the prior year.

<b>AAM 30.030</b>	<b>Outstanding Encumbrance Review</b>
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Encumbered items should be periodically reviewed by agencies to determine if they are still valid. Appropriate follow up action should be taken on questionable items.

#### Encumbrances Terminating on June 30

As a rule, encumbrances reporting to "one year appropriations" are not allowed to carry over more than one subsequent fiscal year and are terminated immediately following that subsequent fiscal year. In extraordinary and unusual circumstances, the Division of Finance may grant a request to reestablish a terminated encumbrance when it can be clearly demonstrated that it is in the best interest of the state to do so. At least one of the following conditions must be satisfied before a request will receive approval.

1. A liability exists (as opposed to an obligation). The goods or services must have been provided, but not yet paid. In these cases, the Division of Finance may require that a liability be established to satisfy the future settlement rather than using an encumbrance.
2. A contingent liability exists. Items that are likely to become liabilities as a result of conditions undetermined at a given date, such as guarantees, pending law suits, judgements under appeal, unsettled disputed claims, unfilled purchase orders, and uncompleted contracts.
3. A legislative appropriation for a specific project, which was not part of the governor's operating budget request, cannot be completed within the allowable time frame. However, such appropriations cannot be carried on indefinitely and the Division of Finance will reevaluate the carry forward if the project has not been completed. The Division of Finance will not allow reestablishment of this type of appropriation when insufficient funding is the reason for not completing the project.

Agencies that have legitimate reasons for continuing a terminated encumbrance must submit a "Request to Reestablish a Terminated Encumbrance" to the Division of Finance. The request must be submitted in sufficient time to allow the Division to review the request and, if approved, record the encumbrance prior to August 31.

**AAM 30.040    Year-end Review**

During July, each agency is required to review all outstanding encumbrances as of June 30. Some may require liquidation, some should be encumbered against authorizations of the new fiscal year, and some should remain as encumbrances against authorizations of the prior year.

Management encumbrances established by an agency during the prior year for increased internal control, must be liquidated unless they represent valid obligations of the prior year. By August 31, the only encumbrances that may remain against prior year authorizations are those that represent valid obligations.