



State of New Jersey

DEPARTMENT OF EDUCATION
PO Box 500
TRENTON, NJ 08625-0500

JAMES E. MCGREEVEY
Governor

WILLIAM L. LIBRERA
Commissioner

HOTLINE

TO: Chief School Administrators
School Business Administrators/Board Secretaries
Public School Accountants

FROM: Richard Rosenberg 
Assistant Commissioner, Division of Finance

SUBJECT: Year-End Encumbrances

DATE: September 16, 2003

For the current 2002-03 fiscal year audit as well as future audits, all public school accountants are asked to give utmost consideration to encumbrances on the school district's books at June 30, 200X through a thorough review and analysis of open purchase orders.

Open purchase orders at June 30, 200X should be classified into the following two categories for review and reclassification:

1. Category one represents purchase orders for which the goods have been received or the services have been rendered at June 30th that have not been paid. These purchase orders must be expensed in the current audit period, the related encumbrances reversed, and a liability (accounts payable) established. If the invoice has not been received the amount must be estimated. In accordance with GAAP, an expenditure is recorded when goods are received or services are rendered.
2. Category two represents purchase orders which will be honored in the subsequent year. These purchase orders will be rolled over into the next fiscal year and will be shown in the June 30th general fund balance sheet as a reserve for encumbrances. Per NCGA Statement 1, paragraph 91 "encumbrances outstanding at year-end represent the estimated amount of the expenditures ultimately to result **if unperformed contracts in process at year-end are completed. Encumbrances outstanding at year-end do not constitute expenditures or liabilities.**"

These purchase orders must be checked for validity, which means, the purchase orders must have a valid contractual agreement (i.e. contain an actual order of goods or services) in place at June 30, 200X. Blanket purchase orders do not constitute valid purchase

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orders. As a general rule, for other than construction contracts, the liquidation of these orders should be within 60-90 days of year-end.

In reviewing the 90-day cut-off period during the year-end audit, purchase orders that existed at June 30, 200X but were not liquidated by September 30 should be canceled and not included in the June 30 reservation of fund balance, with the exception of capital or other long term projects. Open purchase orders for items that are: 1) no longer considered necessary; 2) not substantiated with a valid contract; or 3) aged (regardless of materiality) and have been on the books for over 90 days should also be canceled and not included in June 30 reservation of fund balance.

In addition, per review of the agreed upon procedures performed by several accounting firms for the Abbott school districts that were recently concluded, on several occasions it was noted that expenditures for 2003-04 were being improperly encumbered in the 2002-03 fiscal year. Districts may not have open encumbrances for items related to the next year such as salaries, insurance premiums, etc.

District's account payable, accruals and year-end expenditure cut-off should be thoroughly reviewed with attention given to ensure that valid expenditures for the current year are captured and expenditures for the subsequent year are recorded in the proper accounting period.

For further guidance on year-end reporting and encumbrances please review, Section I – General Compliance, Chapter 5, “Bids & Contracts/Purchasing” and Chapter 8, “Year-End Procedures” of the 2002-03 Audit Program.

Any question related to this hotline memorandum should be addressed to Beth Brooks of the Office of Fiscal Policy and Planning at 609-633-2766, or via email at beth.brooks@doe.state.nj.us.

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c: Gordon MacInnes
Albert A. Monillas
J. Michael Rush
Judith Weiss
Glenn Forney
Beth Brooks
County Superintendents
County School Business Administrators