

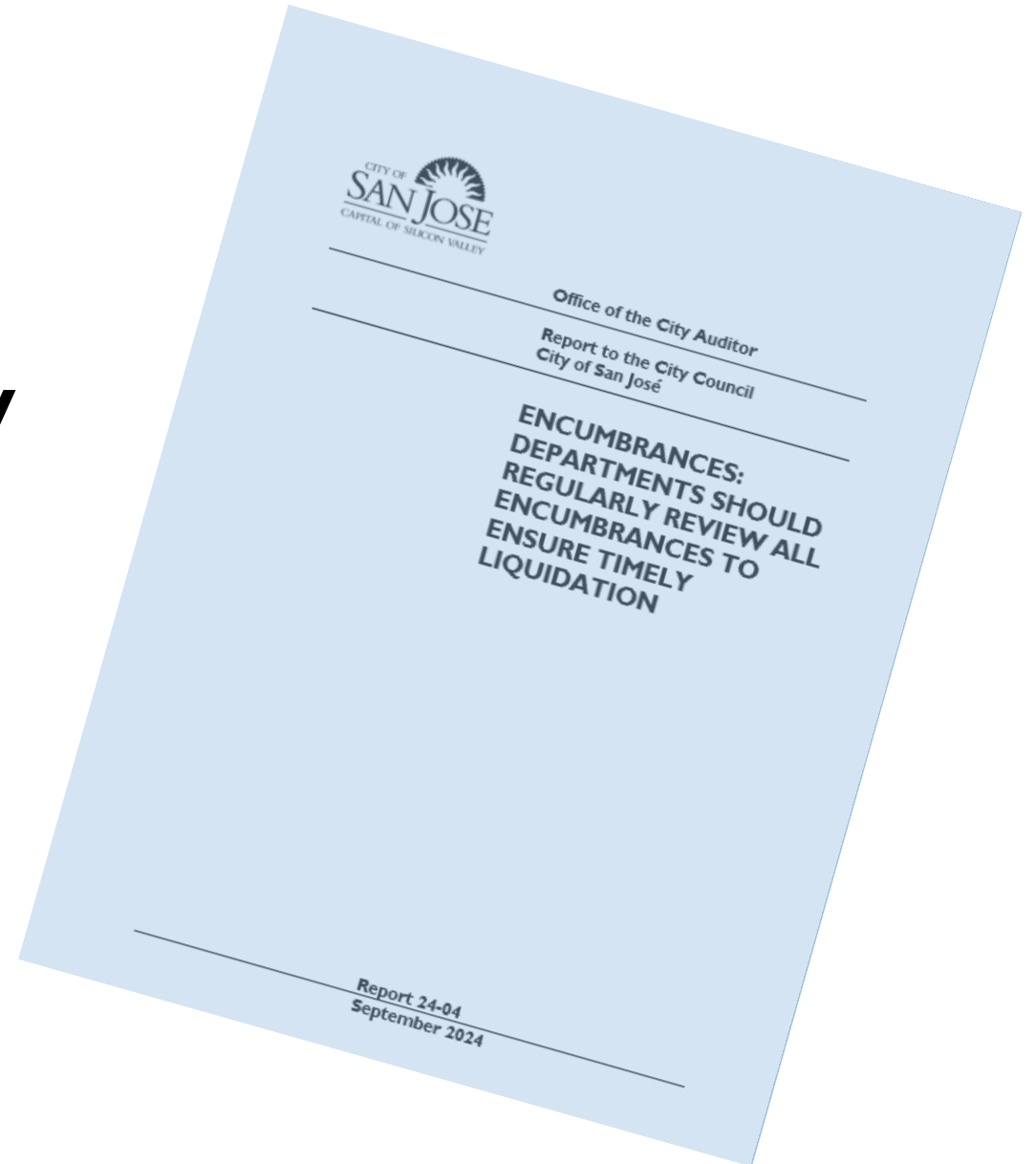


Encumbrances: Departments Should Regularly Review All Encumbrances to Ensure Timely Liquidation

A Report from the City Auditor
Issued September 2024
<http://www.sanjoseca.gov/auditor>

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Public Safety, Finance and Strategic Support Committee
Agenda Item (d) I



Background

- In FY 2024-25, the General Fund had \$84.5 million reserved for encumbrances (5 percent of total General Fund uses).
- The City Policy Manual includes an Encumbrance Policy.
- Departments are required to liquidate encumbrances six months after the term of the agreement ends or when the encumbrance is no longer needed.

An **encumbrance** is an amount of money set aside to pay the estimated expense for contracted goods or services.

Timely **liquidation** ensures that funds are released promptly to pay for other City needs.

Finding I: City Staff Should Review Expired and Unused Encumbrances

- More than one third of the 3,500 operating fund encumbrances should be reviewed for liquidation or correction.
- Up to \$30 million in encumbrances may not still be necessary or are inaccurately reported.
- Some encumbrances are fully liquidated and reported erroneously.

Reason to Review	Should be Reviewed (June 2024)	
	<i>General Fund Only</i>	<i>All Operating Funds</i>
Purchase order ended 6+ months ago.	362 purchase orders, \$2.8 million	619 purchase orders, \$7.3 million
No recent recorded activity for the encumbrance.	325 contracts, \$8.4 million	525 contracts, \$19.1 million
No spending of the encumbrance.	76 contracts, \$2.6 million	154 contracts, \$3.5 million
Total	763 encumbrances, \$13.8 million	1,298 encumbrances, \$30.0 million

Finding I: City Staff Should Review Expired and Unused Encumbrances

In a limited sample of older encumbrances totaling \$1.38 million:

- 21 (\$950,000) needed to be liquidated.
- 5 (\$325,000) had already been liquidated and were included erroneously.
- 2 (\$109,000) were still valid.

Recommendation: To address potentially outdated encumbrances, the Administration should:

→ Immediately require departments to review encumbrances to liquidate or correct as needed.

Finding 2: Consistent Monitoring and Accurate Reporting Tools Would Facilitate the Timely Liquidation of Encumbrances

- Some department fiscal staff were unaware of the Encumbrance Policy.
- Further guidance to staff and requiring regular reviews would improve encumbrance management.
- The primary reporting tool on encumbrances from the financial management system has inaccuracies, which can make monitoring difficult.

Recommendations: To improve encumbrance monitoring, the Finance Department should:

- Require regular year-end reviews of encumbrances that haven't been used recently.
- Update training for department staff about monitoring encumbrances.
- Update reporting tools to allow for streamlined monitoring.

Conclusion

The report has five recommendations to improve management and liquidation of encumbrances.

We would like to thank the Finance Department, the Information Technology Department, and the City Manager's Budget Office for their time and insight during the audit process.

The audit report is available at www.sanjoseca.gov/auditor

Audit staff: Alison Pauly