

Encumbrance and Contract Execution Policy 21-01

*From the Office of State Procurement, Department of Administration and Accounting Services Division,
Minnesota Management and Budget*

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Approval: Alice Roberts-Davis, Commissioner, Department of Administration
Jim Schowalter, Commissioner, Minnesota Management and Budget

Reason for the policy

To ensure the state does not spend money that it does not have available or obligate the state for services that were not authorized. To accomplish this goal, the policy defines the executive branch requirement for encumbering funds and executing contracts.

Policy

Generally, agencies must **encumber** funds prior to incurring an **obligation** of the state and fully **execute** contracts prior to authorizing contractors to start work. For multi-year contracts, agencies must encumber the current year's obligation. These requirements help ensure compliance with M.S. 16A.15 and 16C.05. The commissioners of Administration (Admin) and Management and Budget (MMB) may specify situations in which certification of encumbrance is not necessary or make exceptions for low-dollar procurements. See "Authority" section below. Specific exceptions are noted below.

Definitions

Obligation

An action creates an obligation if it will result in a cost to the state. Examples of actions that can create obligations include:

- Ordering a product
- Authorizing a service
- Attending training or a conference, or being registered for training or a conference without canceling prior to a refund deadline

Encumbrance

For purposes of this policy, an encumbrance sets aside money in the state's accounting system (SWIFT) for a specific purchase of goods or services or potential purchases of similar goods/services (with blanket encumbrances), making those funds unavailable for any other expenditure and ensuring those funds are

available at time of payment. Funds are encumbered when a purchaser or buyer enters a purchase order in SWIFT and it is electronically approved. An encumbrance can only be processed by staff with the proper permissions to enter purchases into the accounting system. Consult with your agency's financial department to confirm who has this authority in your agency or division.

Contract

"Contract" means any written instrument or electronic document [including purchase orders] containing the elements of offer, acceptance, and consideration to which an agency is a party.

Execution

Contracts are considered fully executed when funds are encumbered and all required parties have signed the contract.

Purchasing

With limited exceptions (see below), if an item or service has a cost, state agencies must first encumber (set aside) funds before entering into an agreement to purchase an item or a service. Common situations when an agreement to purchase occurs include:

- Ordering goods
- Authorizing services
- Registering for training or conferences

For **information and telecommunications technology projects**, a state agency may not encumber, expend, or transfer funds to Minnesota Information Technology Services (MNIT) for the project until it has followed MNIT's Project Initiation Policy and Standard and received approval from MNIT. If MNIT does not approve the information or telecommunications technology project, the unencumbered balance of any appropriation allotted for the project will be canceled.

Additionally, if an **information and telecommunications technology project** is estimated to cost \$5,000,000 or more and has received MNIT's approval, an agency must work through MNIT to contract with an entity outside of state government to conduct a risk assessment and risk mitigation plan. During this time, an agency cannot spend more than 10% of the project budget other than the money spent on the risk assessment and risk mitigation plan. The agency may spend more than 10% after MNIT approves the risk mitigation plan.

Exceptions

The following are exceptions to the general policy that funds must first be encumbered before incurring an obligation:

- For fiscal year 2024, a purchase or obligation made or incurred in the first two months of the fiscal year, provided that funds are encumbered no later than August 31, 2023.
- For fiscal year 2025 and thereafter, a purchase made or incurred in the first month of the fiscal year, provided that funds are encumbered no later than July 31 of that fiscal year.

- An agency needs to reserve space or services for an event in a future fiscal year (e.g., conferences; training) to ensure the space or services are in place, and encumbers funds no later than August 31, 2023, for fiscal year 2024, and July 31 for each fiscal year thereafter.
- Funds were encumbered for the purchase, but the final cost or invoice amount *exceeds* the amount previously encumbered by not more than 25%, up to a **\$5,000 increase**. This exception only applies to costs that exceed encumbrances, *not* for failure to encumber or the addition of goods or quantities not covered in the original encumbrance, and applies regardless of the invoice amount. The *increase* between the original amount encumbered and the final invoice amount must be \$5,000 or less for the exception to apply.
- Employee business expenses, advances, and relocation expenses paid to any employee through Statewide Employee Management System (SEMA4).
- An encumbrance that is canceled in error before the invoice is received.
- Sub-system payments processed through Statewide Integrated Financial Tools (SWIFT) using the IF0407 Payment Interface where a purchase order to a specific vendor cannot be referenced. Agencies must ensure there is a sufficient allotment available when committing these funds.
- [Imprest cash payments](#), including the establishment and reimbursement of accounts and increases to accounts.
- Payment of [revenue refunds](#).
- Payments for expenditures within the 410-PAYRLL Account Group. The funds budgeted within this account group are, in effect, reserved because of the control at the allotment (PAYRLL/NONPAY) level. Agencies are responsible for ensuring that they have sufficient funds budgeted within the PAYRLL allotment.
- Non-Discretionary Payments, including
 - [Agency indirect costs and statewide indirect costs](#) (as defined in Statewide Operating Policy 0105-01) (Account Classes 42000 and 42010)
 - Office of Administrative Hearings costs
 - Attorney General costs (Account Class 42020)
 - Formula grant payments authorized by statute or session law to units of government
 - Payment of State Employee Group Insurance Program claims
 - Debt service payments (Account Class 44010)
 - Legal settlements and mediation agreements
 - Payment of workers' compensation claims
- Interest paid to vendors on late payments (Account 430008)
- Payments made under laws providing for assistance to individuals (Account Classes 44100 and 44110)
- All nonsalary expenses incidental to the sale, printing, execution, and delivery of bonds issued by state entities.

Contracts and Grants

Unless an exception applies (see below) no state employee may authorize a contractor to start work prior to their contract being fully [executed](#) and funds being [encumbered](#).

Contract Execution

Fully executing contracts protects the state and contractors from legal and financial risks. Contractors who start work prior to full contract execution put themselves and the state at risk because the terms of the contract are not yet in place. **Other than the exception noted below, contracts must be fully executed prior to contractors being authorized to start work.**

Exceptions

- The commissioner of Administration has granted approval for an agency to authorize work to begin prior to full execution of the contract in an emergency.
- Work supplemental to a highway construction project may be authorized before execution of a supplemental agreement/change order, as permitted by M.S. 161.32, Subd. 7.
- Work supplemental to a project funded by a building appropriation, within the limits of the appropriation.

Grant Agreement Execution

Granting agencies should use current Office of Grants Management (OGM) Grant Shell Agreements that incorporate minimum requirements and appropriately cite M.S. 16B.98 Subd. 5 and Subd. 7. Capital project grants subject to M.S. 16A.695 or 16A.86 should follow policies and use the grant agreement forms established by MMB, including the Capital Grants Manual and After the Bonding Bill memo.

Contract and Grant Encumbrance

Other than for the exceptions noted below, funds to cover contract and grant costs must be encumbered prior to authorizing contractors and grantees to start work.

Exceptions

- For fiscal year 2024, services or other obligations related to a contract or grant issued during the first two months of the fiscal year, provided that funds are encumbered no later than August 31, 2023.
- For fiscal year 2025 and thereafter, services or other obligations related to a contract or grant issued during the first month of the fiscal year, provided that funds are encumbered no later than July 31 of that fiscal year.
- An agency needs to reserve space or services for an event in a future fiscal year (e.g., conferences; training) to ensure the space or services are in place, and encumbers funds no later than August 31, 2023, for fiscal year 2024, and July 31 for each fiscal year thereafter.
- A grant agreement not encumbered upon execution, but encumbered before the grantee begins work.

- A grant agreement with a specifically named, legislatively appropriated, noncompetitive grant recipient may incur eligible expenses based on an agreed-upon work plan and budget for up to 60 days prior to an encumbrance being established in the accounting system per M.S. 16B.98, Subd. 11.
- Formula grants authorized by statute or session law to units of government.
- A grant which is a pass-through of federal funds, and the federal program authorizes reimbursement of expenses incurred prior to the authorized start of work.
- Capital project grants subject to M.S. 16A.695 or 16A.86, which provide an option to the granting agency to reimburse the grantee for project costs paid prior to grant execution but no earlier than enactment of the authorizing legislation.

Roles & Responsibilities

Agency staff are responsible for understanding and following this policy and completing the 16A.15-16C.05 Reporting Form when they are responsible for failure to follow this policy.

Agency accounting, purchasing, and contracting staff are responsible for understanding and following this policy and identifying failures to follow this policy when they occur.

Agency CFOs or primary agency financial managers, or their designees, are primarily responsible for ensuring that corrective action is taken on all reported failures to follow this policy, reporting such failures to the Office of State Procurement (OSP), reviewing and providing additional information on quarterly reports, and working with OSP and MMB to prevent and address deviations from this policy. Agency purchasing and accounting professionals may also play a role in these tasks.

OSP will compile a quarterly report, maintain information on reported failures to follow this policy, and work with agencies to prevent and address deviations from this policy.

MMB will review the quarterly report and work with OSP or agencies to prevent and address deviations from this policy.

Agency Procedures

Agencies must have written internal procedures that document how the reporting, approval, and submission of reports of deviations from this policy, as defined above, are to occur. Procedures should include a log to track any such deviations.

Authority

(As of June 9, 2023. Statutory language is subject to change pending legislative enactment.)

Per M.S. 16A.15, Subd. 3, "The commissioner [of management and budget] shall determine when the accounting system may be used to incur obligations without the commissioner's certification of a sufficient unencumbered balance."

Per M.S. 16C.05, Subd. 2, "A contract and amendments are not valid and the state is not bound by them and no agency, without the prior written approval of the commissioner [of administration] granted pursuant to subdivision 2a, may authorize work to begin on them unless...(3) the accounting system shows an encumbrance for the amount of the contract liability, except as allowed by policy approved by the commissioner and commissioner of management and budget for routine, low-dollar procurements and section 16B.98, subdivision 11."

Per M.S. 16B.97, Subd. 1, "(a) A grant agreement is a written instrument or electronic document defining a legal relationship between a granting agency and a grantee when the principal purpose of the relationship is to transfer cash or something of value to the recipient to support a public purpose authorized by law instead of acquiring by professional or technical contract, purchase, lease, or barter property or services for the direct benefit or use of the granting agency."

Per M.S. 16B.98, Subd. 5, "(a) A grant agreement is not valid and the state is not bound by the grant unless: (1) the grant has been executed by the head of the agency or a delegate who is party to the grant; (2) the accounting system shows an encumbrance for the amount of the grant in accordance with policy approved by the commissioner [of administration] except as provided in subdivision 11; and (3) the grant agreement includes an effective date that references either section 16C.05, subdivision 2, or 16B.98, subdivisions 5 and 7, as determined by the granting agency.

(b) The combined grant agreement and amendments must not exceed five years without specific, written approval by the commissioner according to established policy, procedures, and standards, or unless the commissioner determines that a longer duration is in the best interest of the state.

(c) A fully executed copy of the grant agreement with all amendments and other required records relating to the grant must be kept on file at the granting agency for a time equal to that required of grantees in subdivision 8.

(d) Grant agreements must comply with policies established by the commissioner for minimum grant agreement standards and practices.

(e) The attorney general may periodically review and evaluate a sample of state agency grants to ensure compliance with applicable laws."

Per M.S. 16B.98 Subd. 7, "Payments to the grantee may not be issued until the grant agreement is fully executed. Encumbrances for grants issued by June 30 may be certified for a period of one year beyond the year in which the funds were originally appropriated as provided by section 16A.28, subdivision 6."

Per M.S. 16B.98 Subd. 11, "Notwithstanding subdivision 5, paragraph (a), clause (2), or section 16C.05, subdivision 2, paragraph (a), clause (3), agencies may permit a specifically named, legislatively appropriated, noncompetitive grant recipient to incur eligible expenses based on an agreed upon work plan and budget for up to 60 days prior to an encumbrance being established in the accounting system."

Per M.S. 16C.10, Subd. 2, "The solicitation process described in this chapter is not required in emergencies. In emergencies, the commissioner [of the Department of Administration] may make any purchases necessary for the repair, rehabilitation, and improvement of a state-owned structure or may authorize an agency to do so and may purchase, or may authorize an agency to purchase, goods, services, or utility services directly for immediate use."

Per M.S. 16E.03, Subd. 3. “A state agency may not undertake an information and telecommunications technology project until it has been evaluated according to the procedures developed under subdivision 4. The chief information officer shall give written approval of the proposed project. When notified by the chief information officer that a project has not been approved, the commissioner of management and budget shall cancel the unencumbered balance of any appropriation allotted for the project.”

Per M.S. 16E.0465, Subd. 2.(b), “The commissioner of management and budget may not authorize the encumbrance or expenditure of an appropriation of state funds to a state agency for any phase of a project, device, or system subject to this section unless the Office of MN.IT Services has reviewed each phase of the project, device, or system...”

Related Information

Procedure

[Encumbrance and Contracting Policy Reporting Procedure](#)

Statutory References

[M.S. 16A.15 Accounting System; Allotment And Encumbrance](#)

[M.S. 16C.05 Contract Management; Validity And Review](#)

[M.S. 16C.10 Exceptions Authorized](#)

[M.S. 16B.97 Grant Management](#)

[M.S. 16B.98 Grants Management Process](#)

[M.S. 16E.03 State Information and Communications Systems](#)

[M.S. 16E.0465 Technology Approval](#)

MMB Policies

[0802-01 Payment Request, Preparation, and Approval](#)

[Capital Grants Manual](#)

[After the Bonding Bill Memo](#)

Admin Policies

[Authority for Local Purchase \(ALP\) Manual](#)

[Professional/Technical Contract Manual](#)

[Grants Policy 08-04](#)

[Grants Policy 08-08](#)

MNIT Policies

[Project Initiation Policy](#)

Contact

Department of Administration contacts:

- Questions about purchasing requirements can be directed to Luke Jannett, luke.jannett@state.mn.us.
- Questions about contracting requirements can be directed to Rachel Dougherty, rachel.dougherty@state.mn.us.
- Questions about grant requirements can be directed to Naomi Munzner, naomi.munzner@state.mn.us.

Minnesota Management and Budget contact:

- Questions about encumbrances in SWIFT can be directed to Adrienne Schmidt, adrienne.schmidt@state.mn.us.