

# Documentation of Accounting Policies and Procedures

The original recommended practice was developed by the Government Finance Officers Association (GFOA). Some aspects of the practice have been revised by the Financial Management Capacity Building Committee (FMCBC) for use by Nova Scotia municipal governments. The original GFOA recommended practice is *Documentation of Accounting Policies and Procedures*, approved by the Committee on Canadian Issues in May 2003 and an updated version was approved by the GFOA in 2007. Other sources used are footnoted in the text.

## Recommendation

GFOA recommends that every government should document its accounting policies and procedures. The FMCBC agrees with this recommendation. Traditionally, such documentation has taken the form of an accounting policies and procedures manual. With advances in technology, more effective methods are now also available for this purpose.

## Purpose

The central long-term benefit of having an updated accounting policy manual is cost savings. A well-designed and properly maintained system of documenting accounting policies and procedures enhances both accountability and consistency. The resulting documentation can also serve as a useful training tool for staff and enhance the audit process. (See *Appendix I* for a more extensive discussion on the benefits of an accounting policy manual.)

## Background

Communication is an essential component of a comprehensive framework of internal controls. One method of communication is formal documentation of accounting policies and procedures. Municipalities in Nova Scotia follow accounting policies and procedures that are stated in the Canadian Institute of Chartered Accountants *Public Sector Accounting Handbook (CICA PSA Handbook)*. In addition to that, it is the municipalities' own responsibility to adopt policies and procedures that are considered appropriate. (See *Appendix II* for some examples of areas where formal policies are desirable.)

## Considerations in Policy Development

There are a number of considerations that should be made by a municipality when documenting and maintaining accounting policies and procedures (a deeper discussion of the considerations can be found in *Appendix III*):

- 1) Consider the importance of *senior management support*
- 2) Plan for *periodic reviews and updates*
- 3) *Assign an employee* to oversee the process
- 4) Make the policies and procedures *readily available*
- 5) Clarify *employees' responsibilities*
- 6) *Document the actual procedures*
- 7) Clearly *state the purpose* of the policies
- 8) Create and communicate a *policy approval procedure*
- 9) Consider the *structure* of the *policy manual* and the *policy statement*
- 10) Construct a *user-friendly format*

## Appendices

Appendix I: Benefits of an Accounting Policy Manual

Appendix II: Examples of Desired Formal Accounting Policies and Procedures

Appendix III: Considerations in Policy Development

## **Appendix I: Benefits of an Accounting Policy Manual<sup>1</sup>**

As earlier mentioned, the central benefit with an accounting policy manual is cost savings.

Policies that clearly articulate the process to be followed, who should carry out the action, and the safeguarding of the assets save an administrator from having to seek management direction on a particular transaction. An accounting policy manual limits the time that has to be spent by management on internal discussions each time a transaction for which no specific policy is clearly stated appears.

An accounting policy approval process stated in the manual gives management formal control over who can determine accounting policy. The formal control also gives management an opportunity to assure that the policies conform to generally accepted accounting principles (GAAP) and the Public Sector Accounting Board's (PSAB's) recommendations.

Management has an opportunity to improve current accounting policies and procedures while reviewing the accounting system in the organization.<sup>2</sup>

Auditors are able to assess the organization's accounting control and procedures in an easy way by reading the accounting policy manual. Transactions that do not comply with policy are thereby easier to detect. Documented policies that are adhered to should reduce the amount of tests of control that an auditor will undertake during an audit, which may result in savings.

## **Appendix II: Examples of Desired Formal Accounting Policies and Procedures**

The following list contains some examples of areas where formal accounting policies and procedures are desirable (See *Nova Scotia Model Policy Manual for Municipalities*). There are many more areas other than those shown in the list that are in need of formal accounting policies and procedures.

- Purchasing
- Tendering
- Credit card use
- Accounts payable
- Travel expenses
- Tax collection
- Expenditures
- Internal control
- Procurement
- Valuation allowance
- Reserve policy
- Inventory
- Capitalization of capital assets
- Inter fund transfers

## Appendix III: Considerations in Policy Development

### 1) Consider the importance of senior management support

Accounting policies and procedures should be actively supported by an appropriate level of management to emphasize their importance and authority. Management's support for the manual is essential for its actual impact and legitimacy in the organization.

### 2) Plan for periodic reviews and updates

The documentation of accounting policies and procedures should be reviewed periodically according to a predetermined schedule and updated if needed. Changes in policies and procedures that occur between these periodic reviews should be updated in the documentation promptly as they occur. Each policy should have its own specific date for review.

### 3) Assign an employee to oversee the process

A specific employee should be assigned the duty of overseeing the documentation process. The employee will be overseeing the accounting policy process and the writing of the policy manual. Adequate knowledge and effective communication with managers in the organization are necessary for the function.<sup>3</sup> It is management's responsibility for ensuring that this duty is performed consistently.

### 4) Make the policies and procedures readily available

The documentation of accounting policies and procedures should be readily available to all employees who need it.

### 5) Clarify employees' responsibilities

The documentation of accounting policies and procedures should indicate which employees are to perform which procedures, especially who has the authority to authorize transactions and the responsibility for the safekeeping of assets and records.

### 6) Document the actual procedures

Procedures should be described as they are actually intended to be performed rather than in some idealized form. The acceptance of the manual by management can be poor if the accounting policies and procedure are changed radically.<sup>4</sup>

### 7) Clearly state the purpose of the policies

The documentation of accounting policies and procedures should explain the design and purpose of control-related procedures to increase employee understanding of and support for controls. This can be done in the introduction of the manual and as a short explanation for each policy statement (see section 9b, below).

### 8) Create and communicate a policy approval procedure

An accounting policy approval procedure should be created and communicated throughout the organization. This process can be formal or informal but should not be burdensome to the degree that managers do not raise issues that need to be addressed

by the assigned employee. The process for approval should be documented in the accounting policy manual.<sup>5</sup>

### **9) Consider the structure of the policy manual and the policy statement**

Some possible ways to organize an accounting policy manual are by:<sup>6</sup>

- *Type of transaction*: for example, different sections for cash receipts, sales on accounts, etc.
- *Type of accounting document or record*: for example, different sections for procedures related to the preparation of input documents (cash receipts, invoices etc.), recording events in the books of original entry, procedures related to the entries in the ledgers, and so on
- *The accounting cycle*. The manual can be organized to follow the normal pattern of transactions: for example, from sales to receivables to cash receipts to cash disbursement
- *Time sequence*. The transactions are divided after their time sequence: daily, weekly, monthly, quarterly, annually, recurring unscheduled, and nonrecurring

A policy statement should be written in a clear and understandable style. One way of structuring the policy statement is the following<sup>7</sup>:

- *Subject*. A short descriptive title for the accounting area covered in the policy statement
- *Background*. Definition of the subject including an explanation of any technical information essential for understanding the policy statement
- *Policy*. The policy statement that is intended to provide guidance in accounting for the subject under consideration
- *Effective Date*. The date on which the statement becomes binding on the organization
- *Pronouncements*. References to PSAB and GAAP that support the policy
- *Review Date*. The date on which the statement will be reviewed for eventual update

### **10) Construct a user-friendly format**

There are several elements that can increase the user-friendliness of an accounting manual<sup>8</sup>:

1. An explanatory introduction that explains the structure of the manual;
2. A detailed table of contents;
3. A detailed subject index with cross indexing of related subjects;
4. Labelled index tabs;
5. Colour-coding, for example, policy statements have one specific colour and policy procedures another one;
6. Index numbers that inform the reader if the information is relevant to all departments or a specific department;
7. Pictures that illustrate what has been stated in the text can often reduce misunderstandings;

8. A chart of accounts, codes for classifying account information, and an explanation of accounts;
9. Definitions of terms if they are not commonly used or can have more than one meaning; and
10. Material of only nominal or theoretical value should be excluded.

## References

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## Notes

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<sup>1</sup> Adapted from Smedberg, David G. “The Accounting Policy Manual: An Effective Tool for Documentation and Internal Control,” *CPA Journal* 52, no 3 (1993): 31-33.

<sup>2</sup> Chi Hing Yeung, Samuel. “Management by the Book,” *CA Magazine* 126, no 11 (1993): 39-40.

<sup>3</sup> Smedberg, 1993.

Graber, Dean E. “How to Prepare a Company Accounting Manual,” *The Practical Accountant* 13, no 3 (1980): 53-58.

<sup>4</sup> Graber, 1980.

<sup>5</sup> Smedberg, 1993.

<sup>6</sup> The methods are adapted from Graber, 1980.

<sup>7</sup> The structure of the policy statement is adapted from Brown, Jr., James F. “A Strategic Aid to Internal Control—The Accounting Policy Manual,” *Mid-South Business Journal* 5, no 1 (1985): 16-18. The “Review date” have been added and the contents of “Pronouncements” modified.

<sup>8</sup> Points 1, 4-7 are adapted from Boyle, Keith P. “Getting an Accounting Handbook to Fly”, *Government Finance Review* 6, no 5 (1990): 19-23. Points 2, 8-9 are adapted from “A Practical Look at Defining and Improving the Accounting Manual” *Journal of Accountancy*, 156, no 5 (1983): 54-64. Point 10 is adapted from McNarin, William N. “Three Ways to Wake Up a Procedures Manual” *Management Adviser* 10, no 3 (1973): 33.