Basics of Accounting Policies and Procedures

Presented by James Conrad, CNAP

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Learning Objectives

- Define processes and procedures within your organization’s accounting manual
- Determine the adequacy of your policies and procedures for your organization
- Identify and analyze policies and procedures in your accounting manual that are sufficient and deficient
- Discover relationships between your policies and procedures and an organizational audit

A Few Things…

- Today's presentation is designed to be an introduction
  - Consult with an accounting professional or your auditor if you have specific company-related issues
- We can't cover every type of policy or procedure in this presentation
  - We <u>will</u> be reviewing common policies and procedures that nearly every company of every size should have
- There will be a short Q&A if time allows
  - Please submit your questions in the Q&A window

Policies and Procedures – Who Needs ‘Em?

(Spoiler: You Do)

- Every company, commercial or nonprofit, should have policies and procedures
- The policies and procedures act as:
    - Instruction booklet
    - Company accounting rules
    - Protective guardrails
- Every company will have different policies and procedures
- There is no “right way,” but there are several “wrong ways.”

Policies and Procedures – A Comparison

- Compare and contrast these two entities:
  - **Church** with three employees, $250,000 annual revenue
  - $100 million annual revenue manufacturing **factory**
- Each entity has their own <u>different</u> challenges
  - The church has few employees, so one person may wear many hats which could lead to misappropriation (i.e. stealing)
  - The manufacturing facility has inventory, partially-completed products, expensive machinery
- Each entity will have policies governing <u>similar</u> activities
  - How are bills paid? When is a large purchase placed into fixed assets? When and how are the books closed each month/year?

Policies and Procedures – Examples

An accounting policies and procedures manual may contain internal rules and methodology on the following:

- Basis of Accounting
- Budgeting
- Cash Disbursements
- Cash Receipts
- Credit Cards and Expense Reports
- Bank Reconciliations
- Capitalization
- Book Closing
- Internal Controls
- Reserve Policy
- External Reporting
- Other items important to the operations of your company

This list is not all-encompassing! Remember, there is no one-size-fits-all solution. As a company changes, so do the policies and procedures!

Two Basic Policies: Cash Disbursements and Cash Receipts

Basic Policies – Cash Disbursement

How vendors are paid

Best Practice Items:

- Who can sign checks, and for how much
- How many signatures
- Who prepares materials for the signers

Cash disbursements

The positions authorized to sign checks are the Business Director, Board President, and Board Treasurer. Only one signature will be required on checks. Anyone signing a check must review and initial the supporting invoice or other documentation. Individuals may not sign a check payable to themselves.

The Accountant will maintain the accounts payable system. Prior to payment, the Accountant will code each invoice, prepare the checks and organize the documentation.

- Some companies utilize third-party Accounts Payable and Reimbursement systems
  - Bill.com
  - Quickbooks Bill Pay by Melio
  - Expensify
  - Nexonia
- These systems utilize approval workflows that eliminate the manual check assembly process and can automate entry into your accounting software
- These approval and payment workflows would appear in your policies and procedures

Basic Policies – Cash Disbursement

Common Pitfalls

- Petty Cash/Cash on Hand
  - Who controls it?
  - How often is it counted?
  - Are receipts tracked?
- Checks without documentation
  - If there is a Purchase Order system, is it attached?
  - Was the payment authorized by department head/manager?
  - Is there an invoice attached to the payment stub?
- Third-party workflows
  - Were there edits made after payment?
  - Do you have a W-9 on file?

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These policies are meant to safeguard against check fraud, cash theft, and embezzlement.

Basic Policies – Cash Receipts

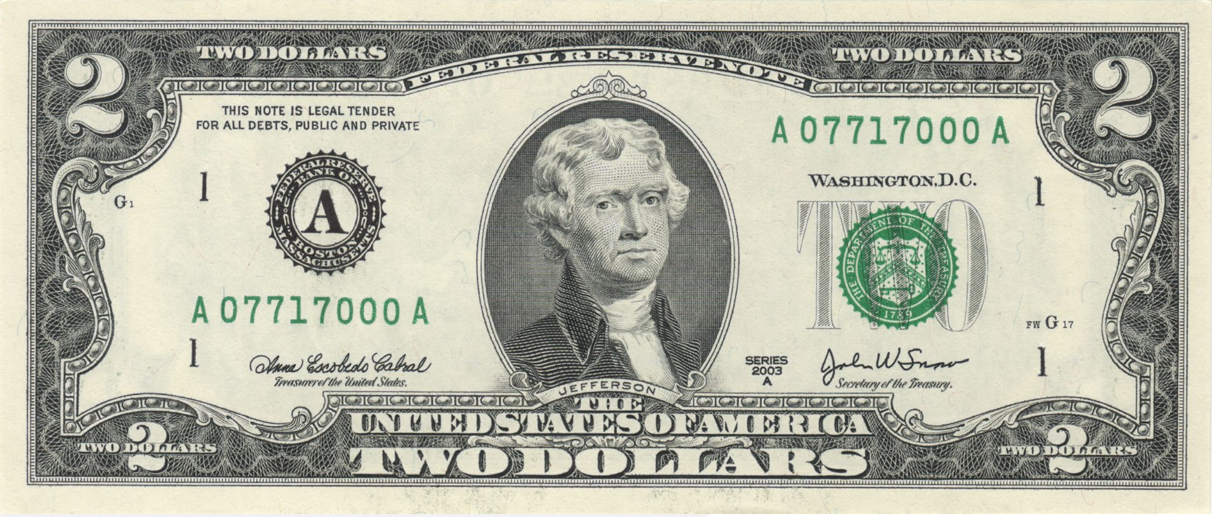
How your company gets paid

Best Practice Items:

- Who opens the mail?
- Who assembles the bank deposit?
- What happens if you are paid with cash?
- Who reconciles the ledger balance to the bank statement?
- Is there a separate system that requires reconciling customer balances to the accounting ledger?
- Nonprofits: are you sending donor acknowledgment letters?

Cash receipts

All grants and projects are invoiced each month to ensure a regular healthy cash flow for the organization. Electronic or online giving should be encouraged to strengthen controls and reduce administrative time. Receipts not received electronically should be deposited weekly.



(Fun Fact: the two dollar bill is real and is still being produced!)

Basic Policies – Cash Receipts

Common Pitfalls

- A single person opens the mail, collects the payments, creates the deposit, and takes it to the bank
    - Think back to the church example – one admin employee?
    - It's easy to slip a $20 bill in your pocket when no one is watching you
- That same person can also reconcile the bank account to the bank statement, and no one will be the wiser to cash going missing

Cash receipts

All grants and projects are invoiced each month to ensure a regular healthy cash flow for the organization. Electronic or online giving should be encouraged to strengthen controls and reduce administrative time. Receipts not received electronically should be deposited weekly.

Much like the policies regarding cash disbursements, these policies are meant to safeguard against fraud, external theft, and internal embezzlement.

Concept: Internal Controls

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- Internal controls are rules and regulations put in place at an organization to mitigate risk, promote ethical conduct, and ensure management decisions are being carried out
  - Prevent or detect problems
  - Formal rules and informal tone and trust
  - Manual or automated
- Internal controls are not perfect. Fraud and errors can and will still occur, even with great controls
- Much like individual policies, not all companies will have the same internal controls

Common Internal Controls

- Separation (Segregation) of Duties
  - Certain tasks are to be completed by different people
  - No single person should control an entire workflow
  - Risk is mitigated because there are multiple sets of eyes
- Physical Security
  - Putting cash in a safe or taking it right to the bank
  - Locking up valuable equipment
- Reconciliations
  - Using a third party (e.g., a bank, an external accountant, etc.) to verify that transactions occurred and match the ledger

Back to the Church and the Factory

Church

- The church locks up the weekly offering in a safe that requires two different keys to open
- The offering is counted by the office administrator and one of the clergy
- The church utilizes an outsourced accountant to reconcile their bank accounts and prepare financial statements, but does not allow the accountant to pay bills or handle funds
- There is a donor database to track who has received donor acknowledgments

Back to the Church and the Factory

Factory

- Payments from customers arrive via check or are directly deposited into the bank. No cash is handled.
- Purchase orders must be approved by management. Frequent violations will result in disciplinary action
- Tools and fixtures are tagged and logged into an asset program
- Passwords for computers that access the local accounting and ERP systems are changed regularly

Internal Controls Analysis

- How often are policies and procedures reviewed and updated?
- What responsibilities do management or the board of directors have?
- Is an audit mandated, either by law or by board directive?
- Who is authorized to make financial decisions on behalf of the company?

<u>Think about it:</u>

Is there too much authority vested in one person? If so, how can that authority be spread out?

More Policies

More Policies – Basis of Accounting

- Common bases are Cash and Accrual
  - Cash Basis: Revenues and Expenses hit the books when the cash is received or paid, respectively
  - Accrual Basis: Revenues and Expenses hit the books when the revenue is earned or the expenses are incurred. Cash does not need to change hands
  - Financial statements following Generally Accepted Accounting Principles (GAAP) mainly use Accrual Basis
  - Internal-use financial statements can be other bases – whatever is important for the end user
  - Income taxes do not neatly follow either basis

Basis of accounting

The accounting principles of [redacted] will be consistent with all applicable laws and Generally Accepted Accounting Policies.

More Policies – Capitalization Policy

- When is an expense not an expense? When it is capitalized!
  - Property and equipment (and other big purchases) may be subject to capitalization and subsequent depreciation or amortization
  - Generally, a dollar amount is used, either as a single purchase or a group of similar purchases in a short period of time
  - Under this amount: expense it. Over this amount: capitalize it.
  - Purpose: to spread the expense of your purchase over the period you expect to use it

Property and equipment

The firm's threshold for capitalization is $3,000. All property and equipment are recorded at cost, or if donated at fair market value. All property and equipment are depreciated using the straight-line method over the use life of the asset.

The firm maintains a property and equipment ledger that details the date acquired, description, cost, useful life, annual depreciation, depreciation to date, and location of the item.

More Policies – Capitalization Policy

- Nonprofits and commercial companies may have vastly different policies
  - Income taxes can be heavily influenced by depreciation (think of the Factory – lots of expensive machinery)
  - Since nonprofits generally have little to no income tax, capitalization policies are usually simpler than a commercial policy
  - Several different acceptable methods of depreciation are available for use

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More Policies – Bank Reconciliations

- Why Reconcile?
  - Cut off cash flow problems at the pass
  - Identify stale checks
  - Find duplicate deposits that artificially inflate ledger balance
  - Bank errors – they do happen! (but you probably can't keep $200)

Bank reconciliations
The bank statements are to be reconciled by the Director of Finance on a monthly basis no more than one month after receipt of the statement. The general ledger and the reconciled bank statements will be adjusted to agree monthly.

The treasurer will access the monthly bank statements online and review the checks and electronic disbursements for unusual items or changes. The treasurer also compares selected deposits on the bank statement to the copy of cash receipts logs and reviews any account transfers.

More Policies – Bank Reconciliations

- Reconciliations should be performed with some frequency; at minimum monthly
  - Some organizations perform interim reconciliations daily due to tight cash balances
- Reminder: anyone who has authority to write checks or make bank transactions should not perform the reconciliation
- An authorized person should review and sign off on the rec
- Procedures for the sign-off process should be found in your monthly/annual close policies and procedures

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More Policies – Closing the Books

- Finalizing (closing) the books and generating financial statements should be done on a regular basis
- Management should review these reports
  - Boards of Directors will also view them at nonprofits
- Monthly or Quarterly interim closes are the most common
- A treasurer or manager with financial knowledge should review
  - Accounting staff should be able to easily answer questions

Year-end close and reporting

The Treasurer will contact the independent accountants as soon as the Treasurer signs the audit engagement letter to begin planning the scheduling and work needed to complete the audit

The Accountant will be responsible for preparing as many of the schedules which the auditors will use as possible. The completed monthly reconciliations for December will partially fulfill this requirement.

Some of the information which needs to be organized and made available includes: the complete general ledger for the year, a chart of accounts, all bank statements and cancelled checks, all paid invoices, all cash receipts logs, Board minutes for the year under audit through the most recent minutes available, grant contract files, printouts of the donor database, including all restricted donations, lease agreements, insurance policies, documentation for fixed assets capitalized and documentation for donated services or donated assets recorded in the general ledger.

The Treasurer and Business Director will be available at all times throughout the audit to facilitate the work of the independent accountants. The Treasurer and Business Director will schedule some time to meet with the independent accountants as needed during the audit.

It’s Audit Time – Now What?

It’s Audit Time – Now What?

- Did You Know: an audit performed by an independent CPA isn’t “just about the numbers.”
  - Accuracy of financial statements is analyzed, but there’s more
- Auditors perform risk and internal control analysis
  - Fraud inquiry (“Are you aware of any fraud?”)
  - Significant Estimates (allocations)
  - Walkthroughs (auditors watch a specific process)
  - Sample Testing (checking deposits, bills)
  - “Going Concern” – is the company going to go out of business?

It’s Audit Time – Now What?

- Part of the testing includes looking at your policies and procedures
  - How recently have they been updated?
    - For example: still lists a paper PO system after transitioning to an electronic system
  - Are they robust and mitigate risk to acceptable levels?
    - Significant Deficiency – merits attention, but not severe
    - Material Weakness – more severe and needs immediate correction
  - Deficiencies and weaknesses reflect poorly on the reliability of your company
    - Donors may have contingencies in their funding agreements
    - New donors may avoid your company because of perceived sloppiness
    - Publicly-traded companies have to follow SEC rules

In Review

- Policies and Procedures act as both a roadmap and guardrails for the accounting-related activities at your company
- P&P's are not one-size-fits-all, and adequacy of P&P's depend on size of the company, commercial vs nonprofit, and more
- Your P&P's should have adequate internal controls that mitigate the risk of fraud and accounting errors
- Auditors will review and analyze your processes and procedures to see if they are up-to-date, adequate, and are performed as stated


Question Time

THANK YOU

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