



Making Sure It All Adds Up

Financial Accounting for Small Systems

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At a time when many new regulations coming out of federal and state capitals are posing more stringent accounting and financial reporting requirements, it is imperative for utility systems to evaluate how their financial management measures up to meeting these new demands. Small systems face problems unique to their limited capacity and budgets. However, with thoughtful planning, most systems may find they're fully able to meet not only the regulatory requirements but the needs of the decision makers to whom they're most immediately accountable as well.

For many small systems, one, two, or three people may be all there is to manage the entire operation. In some cases, one person serves as the system operator, performs financial and reporting duties, and handles public relations.

In these situations, bookkeeping and accounting often get minimal consideration and are handled only on an as-needed basis. Little time or effort is spent on keeping data current, and no analysis is performed on what can be the most important information a system has for making both operating and strategic planning decisions.

With the help of some experts in the field, I have compiled ideas and suggestions for working with the most common financial management challenges small systems face. Each of the following practices is fundamental to not only efficient operations but to the longevity of the system. While implementation of one or more practices is better than not doing anything, it is the synergy of all that makes for true operational effectiveness.

Accounting Dos and Don'ts

Keep a separate, commercial checking account. Record all system-related revenues and expenditures in this account. I've heard hair-raising stories of operators running revenues and expenses through their personal checking accounts. This leaves the system wide open to fraud and embezzlement, at the very least.

Record financial information in a timely manner. Revenues and bills should be recorded at least monthly, if not more frequently. Failure to do so often leads to a loss of accuracy—or worse. When the time comes to record the information, much detail has been lost or forgotten. Revenues must be tracked and classified according to whether they are service fees, penalties and interest, or reconnection charges. Expenditures need to be entered into an accounting system that classifies and tracks them according to their nature as operating expenses,

capital asset acquisition, or reduction of liabilities. Often the only report provided to the governing board is a list of checks and the payees with no other information identifying the nature of the payments. Rate setting and long-range planning for capital improvements can only be done effectively with accurate, properly classified information on where the system is spending its money.

Use a consistent accounting basis. Most systems record all transactions on a cash basis. While this is easier to use and to understand than accrual accounting, it seldom reflects the system's true operating costs. Expenses, such as insurance and depreciation, are often booked only once per year, and it's difficult to analyze and set monthly rates if these types of expenses aren't amortized on a monthly basis. If revenues are received and booked after the expenses they were billed to recover, decision makers can't get a true picture of whether those revenues are sufficient to cover operating and capital needs.

Recognize the value of trained accounting staff. Many small systems can't afford a full-time accountant or they fail to recognize the value of having timely, accurate financial information. If the system is too small to support more than the operator and a clerk, every attempt should be made to pay for a monthly checkup from

Accounting Glossary

Accrual Accounting—A system of accounting in which revenues and expenses are recorded as they are earned and incurred, not necessarily when cash is received or paid.

Aged Accounts Receivable—The process of categorizing each account receivable by the number of days it has been outstanding.

Amortization—The process of cost allocation that assigns the original cost of an intangible asset to the periods benefited.

Capital Asset—A long-term asset that is not purchased or sold in the normal course of business. Generally, it includes fixed assets, e.g., land, buildings, infrastructure, equipment, fixtures, and furniture.

Cash-Basis Accounting—A system of accounting in which transactions are recorded and revenues and expenses are recognized only when cash is received or paid.

Chart of Accounts—A list of ledger account names and associated numbers arranged in the order in which they normally appear in the financial statements. The chart of accounts is customarily arranged in the following order: assets, liabilities, owners' equity, revenue, and expenses.

Depreciation—The process of cost allocation that assigns the original cost of plant and equipment to the periods benefited.

Full-Charge Bookkeeper—A person with comprehensive accounting skills, including compiling the data into the general ledger and preparing financial statements.



Liabilities—Obligations measurable in monetary terms that represent amounts owed to creditors, governments, employees, and other parties.

Operating Expenses—Costs incurred in the normal course of business to generate revenues.

a certified public accountant or other professional trained in full-charge bookkeeping skills. An annual audit or review may be necessary to satisfy many lenders' eligibility requirements.

Invest in a decent billing system. Often an untrained clerk makes the decision about what billing system to use. This is such a critical element of any accounting system that professionals should be making the decision after an analysis of the options, keeping in mind what is affordable for the system. Critical to revenue and billing management is a system that can generate an aged accounts receivable report that breaks out receivables and shows how much is due 30, 60, 90, or more days late. Ideally the billing system can classify and report revenues due from water versus sewer and other services provided. Without aged receivables, the board has no way of knowing whether or not the revenues collected reflect what is due and whether additional steps need to be taken to improve collections. It is this report that also helps determine whether and how much to book as an allowance for bad debts.

Recognize the importance of board training. Members of the utility oversight board, who are often volunteers, may need assistance in making well-informed decisions. They may need training to understand the big picture as well as how to use the information provided to plan for the best long-range interests of the system's customers. Board members can often find training through a state's department of health or environmental services and through non-profit organizations such as the Rural Community Assistance Program (RCAP).

Furthermore, complete and accurate minutes should be kept of all board meetings in the event that the board's actions are ever called into question and to have as a reference in reconstructing the age and costs of system upgrades and improvements. (See the article "Get on Board: Water System Management Training in Mississippi" on page 28 for more information about board training.)

Adopt an asset management plan. Even something as simple as putting paid receipts for capital acquisitions in a single file folder can help distinguish capital expenditures from operating expenses. Sources such as existing records, construction plans, work records, and the institutional memory of existing staff can be used to determine the actual age of meters, valves, water mains, hydrants,

pumps, motors, treatment plant equipment, and other assets. The more accurate the listing of the system's infrastructure, the more reliable the financial statements and the capital improvement planning of the small utility will be. With the implementation of Government Accounting Standards Board (GASB) Statement 34 requirements for small towns and their enterprise funds, asset management has become even more important as it has been incorporated into many regulatory



Software Solutions

Accounting software usually provides a draft of a chart of accounts that may be tailored to fit the system's individual needs. Even inexpensive, off-the-shelf small business software now offers the procedural tools that allow the small utility to keep a purchase order system that will help control costs. Intuit makes two affordable accounting programs: *Quicken* and *QuickBooks*. *Quicken* is designed for managing personal finances and is not recommended for businesses that must manage balance sheet accounts, such as cash, inventories, accounts payable, and loans outstanding. *Peachtree*, owned by Best Software, is an affordable package that has both a basic inventory function as well as job cost to help the system begin to track fixed asset and construction costs. In addition, anyone with basic skills in using a spreadsheet program, such as *Excel* or *Lotus*, can devise a tracking system that is easy to manage for small systems that don't have extensive asset lists.

Some affordable billing systems to consider include: RVS (see www.RVSSoftware.com or call 800-227-9195); and Greentree Applied Systems, Inc. (see www.greentreeky.com or call 800-928-6388). A system that provides a rate-testing capability based on average usage by rate code for at least the preceding 12 months will let you test different rate scenarios to calculate revenue generated by proposed rate changes. Whatever you choose, be sure to invest in proper training for the staff who will be using the software.

requirements. (See the article "Taking Care of What You Have: Asset Management from Theory to Reality" on the facing page for more information about asset management.)

By examining each of these potential problem areas, decision makers may find that solutions aren't hard to find or afford. The key is to get started now. Failure to keep records and evaluate available information can lead to problems beyond the scope and capability of those responsible for providing a safe, reliable service to their constituents.

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