

Checks & Balances

Internal Control for Small Water Systems

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If you run a small water system, as with many small business owners, you have the responsibility of managing the finances as well as the operations of the business. And like most small business owners, you probably feel most comfortable about your real business: keeping safe drinking water running throughout your community.

However, you probably feel a little less comfortable about finances. If you are also a board member or the manager, in addition to being the operator, you are held accountable for the financial end of the system. This article is designed to help you gain more control, resulting in less worry and a better night's sleep.

Internal control is an accounting term defined as a plan of organization and all the methods and measures that a business uses to monitor assets, prevent fraud, minimize errors, verify the correctness and reliability of accounting data, promote operational efficiency, and ensure the established managerial policies are followed.

Simply put, internal control is a system of checks and balances designed to ensure that no one person receives the money, deposits the money, and spends the money and that there are different safeguards in the system to properly account for all money and payments.

Which type is your town?

Naturally, the smaller the number of people who run the system, the more difficult implementing a system of checks and balances is. However, this does not mean it can't be done; it just means you have to use all the possible resources at your disposal to make it happen.

For now though, my guess is your town falls into one of three types with respect to internal control. The first is "We already have it!" In which case, you still might want to read the article to make sure there are not some things you have overlooked.

The second type is "I do everything, and everyone trusts me to do it, and we have never had any problems." To this person, I say congratulations for doing a great job and being trustworthy to that degree. But I also would remind you that it is almost impossible to go forever without getting someone angry with you, even for something completely unrelated to your work with the water system. So you might want to try to implement at least some of these controls as a kind of "get out of jail free card" in case you are ever accused of wrongdoing. Unfortunately, I can tell you after 20 years of helping many small business owners, you never know who will turn on you and over what.

The third type is "We have a bookkeeper/office person who takes care of all that stuff and they have it all under control." To this person I say please, please, please, read this article and take it to heart. You may have the most loyal, trustworthy, and competent person in the world, but you are putting that person and yourself at risk if you do not implement some of the controls discussed here. The number one reason someone becomes a thief is because of opportunity and temptation. I learned this the hard way.

I had a person whose job I saved over and over again because I thought she was doing a great job and I could trust her. That was right up until the day I went into

the office to do the bank reconciliation because the person finally took a vacation. I found that there was a \$7,000 deposit that was carried as a deposit in transit. I started looking at how long it had been in transit. As the months went back, my stomach added another knot, until seven months went by, and I was sick to my stomach realizing I had allowed this money to be taken.

It turned out the person had a gambling habit, and she had taken a deposit and lost it gambling, and then took another deposit to try and get back to even, and so on, and so on. She had figured out some other ways to steal, as well, and that \$7,000 was only the tip of the iceberg. The moral of the story is, had I put in place a few of the items mentioned in this article, it would have been more than enough to keep both of us out of trouble.

Internal Control for Money Received

Ideally, basic internal control involves using four different people. The duties of each person take varying amounts of time and expertise and are described below. This is not the only way to insert internal controls by any means. However, it will give you a reasonable example that will get you headed in the right direction.

Person 1—receives the money, whether via mail, phone call credit payments, or walk-in payments. His or her duties involve sorting the mail into payments received or accounts receivable and invoices to be paid or accounts payable. This person should have a method of recording who the payment was from, what it was for, and the method by which it was paid. This can be done on a spreadsheet, by numbered receipts, or a handwritten list. The point is to have a record to refer to and use as a cross reference. This is the beginning of what accountants call an audit trail.

Person 2—gets the money and the recording sheet from person 1, makes sure that all the items on the recording sheet match the money, prepares the deposit slip, and takes it to the bank.

Person 3—records the money into the accounting system and verifies that the deposit was made in accordance with what was received.

Person 4—does the bank statement reconciliation, matching the bank deposits actually made with the bank deposits that were supposed to have been made.

Please note the separation of duties so that everyone has someone else looking at what they have done to ensure no mistake has been made or any money is missing.

Internal Control for Money Spent

Again, this is best as a four-person system.

Person 1—is the one who needs to purchase items to keep the system up and running, also known as the person who spends the money. Naturally the board will need to develop policies and adopt a budget so this person spends in accordance with some parameters and rules.

Person 2—writes the checks, after making sure the funds are available to cover them and ensuring that the bills being paid are approved under the established policies.

Person 3—signs the checks. They must also double-check to ensure that funds are available and the bills are being paid according to policy.

Person 4—does the bank statement reconciliation ensuring the check signatures are authorized, that the bills paid were authorized properly, and that the funds shown in the accounting system match with the bank statement.

Implement Internal Control

I know there are systems out there run by one person who does it all and frequently is an unpaid volunteer to boot. However, most (if not all) systems have a board of directors who should be used to implement these procedures. This is an excellent way to get the board involved in their jobs and to learn more about the system.

Implementing controls is also a way to use some of those folks who don't want to fix pipes and don't know anything about fixing things, but could open mail and record information for you. Be creative about who fills the different spots in your checks and balances and try to use this as another tool in having your water system run as effectively and efficiently as possible.

Lastly, having a regular audit by a certified public accountant is a great way to make sure your internal control is working—and another way to ensure yourself a good night's sleep.💧

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