



Recommended Checklist for Preparing Your Annual Financial Review
(for Small Mutual Water Companies)

Background

California State Law, AB 240 (2013) section 14306 requires a mutual water company board to take two affirmative actions:

- adopt an annual budget;
- hire a certified public accountant or public accountant to conduct an annual review of the company's financial records and reports.

In addition, sections 14306(c) and 14307(a)(1)(B) and (C) require a company to provide copies of the annual budget and accounting report to any eligible person, subject to reimbursement of copying costs.

To assist you in preparing for the required Annual Financial Statement Review, the California Association of Mutual Water Companies (CalMutuals) has developed this checklist.

What is an Annual Financial Statement Review?

An **Annual Financial Statement Review (Review)** is one in which your Certified Public Accountant (CPA) performs analytical procedures, inquiries and other procedures to obtain "limited assurance" on the financial statements and is intended to provide a user with a level of comfort on their accuracy.

Your CPA is also required to obtain knowledge about the mutual water industry and your mutual water company — including your business operations and the accounting principles and practices that you use — sufficient to identify areas in the financial statements where it is more likely that material misstatements may arise.

A **Review** is a less costly and less comprehensive review than provided through an **Audit**. In a Review the CPA conducts analytical procedures and makes inquiries to ascertain whether the information contained within the financial statements is correct. In an Audit the CPA corroborates the ending balances in the company's accounts and disclosures; which requires the examination of source documents, third party confirmations, physical inspections, tests of internal controls, and other procedures as needed. Thus, an Audit provides higher levels of assurance. *Please note that many funding agencies require several years of Audited Financial Statements as a condition of application for grant funds.*

Corporate Documents Needed for Your Annual Review

To facilitate your Annual Review your CPA will request for the following corporate documents:

- Articles of Incorporation
- Corporate By-laws
- Board of Directors and Committee of the Board of Directors Meeting Minutes
- Contracts and Agreements
- Communications from regulatory agencies

- Stock Transfer Book
- Annual Budget
- Year End Water Production

Note: CalMutuals provides cost sharing for Compliance Reviews of core corporate documents. Mutual water companies with 500 or fewer connections pay \$100 and CalMutuals pays the balance of \$299.

Basic Financial Statements Needed for Your Annual Financial Statement Review

Your Annual Review will rely on financial statements that you produce throughout the year, perhaps with support from a bookkeeper or accountant. Financial statements are key in determining the financial performance and sustainability of your company and include:

- The Balance Sheet
- The Profit & Loss Statement

Balance Sheet and Profit and Loss Statement templates are available online through the Rural Community Assistance Partnership *Financial Management Guide*. <https://www.rcac.org/wp-content/uploads/.../RCAP-Financial-Management-Guide.pdf>

Balance Sheet - Your company Balance Sheet (sometimes called a statement of financial position)– shows the balances of your asset, liability and equity accounts at a particular time. It is called a “balance sheet” because the numbers on the sheet must be in balance. Your Company’s **assets** should always be equal to your **total liability and equity** (Assets = Liabilities + Equity).

For your Review (and as a best practice) you will need to:

- Prepare comparative Balance Sheets and compare account balances for the current year with account balances for the past year, for significant increases and/or decreases in account balances, if any. For example, if you purchased equipment, there should be an increase in the Fixed Assets account.

Profit and Loss Statement –Your company Profit and Loss statement lists revenues and expenses and calculates the net income or net loss for a period of time, typically a year. The Profit and Loss Statement shows the financial performance of the Company during the period.

For your Review (and as a best practice) you will need to:

- Prepare comparative Profit and Loss Statements and compare account balances for the current year with account balances for the past year, for significant increases and/or decreases in account balances, if any. For example, if your Board of Directors approved a 3% increase in water rates, your water revenue account should show a corresponding increase in revenue.
- Prepare comparative Budget Profit and Loss Statements and compare budgeted revenues and expenses with actual revenues and expenses. The variances between actual and budget amounts reveal how the business is performing.

Best Practices in Maintaining Financial Statement Accounts

In a typical financial review, your CPA will review your assets and liabilities and the internal controls that are in place. The following are the types of assets and liabilities you will need to report and questions about them you will likely be asked during your annual review. The questions reflect financial management best practices that we recommend you adopt for your company.

Additional guidance for Basic Financial Management Best Practices for small systems is available online through the Rural Community Assistance Partnership <https://www.rcac.org/wp-content/uploads/.../RCAP-Financial-Management-Guide.pdf>

Cash and Cash Equivalents (Current Asset) – bank account balances at the reporting date and investment instruments with an original maturity of three months or less.

- Are bank reconciliation statements for all bank accounts prepared every month?
- Are customer receipts deposited on a regular basis?
- Have checks written been mailed? If checks written have not been mailed, they should be classified as liabilities.

Accounts Receivables (Current Asset) – amounts owed to the Company for water delivered but not yet collected at the reporting date.

- Are customer billings and receipts reconciled with the general ledger?
- Are accounts receivable aging reports reviewed on a monthly basis to ensure that customers are paying you on a timely basis? For past due accounts, what steps are taken to collect on long-outstanding balances?

Inventory (Current Asset) – value of materials that will become available for use in the water system, such as unused pipes, meters and replacement parts.

- Are physical inventory counts performed to confirm the accuracy of the inventory listing at the end of the reporting period?

Prepaid Expenses (Current Asset) – costs that have been paid in advance but not yet used or have not yet expired.

- Do you review expenses for items that have been paid in advance but not yet used or not expired at the reporting date? For example, if the Company pays for annual insurance premiums at the start of the policy, at the end of the reporting period you should determine the portion of the policy not yet used or have not yet expired.

Investments (Current/Non-Current Asset) – investment instruments that have original maturity dates of more than three months.

- Do you review investment statements on a monthly basis to ensure that investment earnings are recorded?

Fixed Assets (Asset) – cost to acquire tangible water distribution and treatment assets used in operations, with a useful life of more than one year, such as wells, reservoirs, pipeline, motors, pumps, etc.

- What are the criteria for capitalizing expenditures? As an example, capitalize fixed assets with a cost equal to or greater than \$1,000.
- What method is used in depreciating fixed assets? The most common depreciation method is straight-line.

What estimated useful lives are used for each fixed asset category, such as 15 years for PVC pipes, 5 years for motors and pumps, etc.

Do you have a fixed assets listing that provides information on cost, accumulated depreciation, depreciation expense, acquisition date and estimated useful lives of your fixed assets?

Do you review your fixed assets listing for assets that are no longer used by the Company?

Accounts Payables (Current Liability) – amount owed to vendors who provide goods and services but did not require immediate payment in cash.

What is the approval process for ordering goods?

How are invoices processed and approved for payment?

Are accounts payable aging reports reviewed on a monthly basis to ensure that vendors are paid on a timely basis?

Accrued Expenses (Current Liability) – expense that has been incurred but invoices or the proper documentation have not been provided for, such as accounting fees for the current reporting period that are yet to be billed by your accountant.

Do you review vendor invoices recorded after the reporting period, for services rendered for the period under review?

Do you accrue for payroll-related expenses, such as payroll for the current reporting period paid after reporting date, unused vacation time, etc.?

Notes Payable (Current and Long-Term Liability) – balance of principal due on a loan.

Are loans properly classified as current and/or long-term? Loan balances that are due within the next year are classified as current.

Is the Company in compliance with loan covenants?

Common Stock (Equity) – amount shareholders invested in the Company.

How many shares of common stock have been authorized?

What is the par value of the common stock?

Do you have a listing of common stock issued and outstanding which records the shareholder name and number of shares owned?

Revenue – amount earned from providing water service to customers.

When you compare your current year's water sales with last year's water sales does it reflect water rate adjustments and/or customers' consumption behaviors for the current year under review? As an example, an increase in water rates will show a corresponding increase in water revenues.

Expense – costs incurred in operating your water system.

Are expenses recorded in the correct reporting period?

When you compare current year's expenses with prior year's expenses, does the variances reflect significant operational activities for the current period?