



## TRANSFERRING INTERNAL CONTROL KNOWLEDGE FROM LEGISLATION TO SCHOOL MANAGEMENT: THE CASE OF SLOVENIA

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### **Abstract:**

*The financial management of school principals in Slovenia is very high according to the Slovenian legislation. The school principal is usually accountable for setting the internal controls. The main thesis of paper says school management in Slovenia has no system developed to facilitate the transfer of internal control knowledge from legislation to school management. Internal controls are integral parts of financial management in schools. The most effective way of internal control in schools is risk management. The aim of the paper is to identify advantages and weaknesses in the area of internal controls and risk management in Slovenian schools. Experimental results indicate some advantages in school internal control and risk management. The school principals are aware the importance of the inventory check as one among the control mechanisms and they are wishing to acquire more knowledge of internal controls and risk management. There are some most common weaknesses in internal controls and risk management. For example school principals are not aware that internal control and risk management need to be treated as a necessary component of responsible school financial management. So they do not report in their financial plans and annual reports on internal controls and risk management. Based on research, the study reports on necessary contents of Risk Rules for internal controls and risk management as a tool for facilitating the transfer of internal control knowledge to school managers.*

*Keywords: internal control, risk management, school management, annual report, financial plan.*

# 1. THEORETICAL STARTING POINTS

Due to regulatory and forces, attention to an organization's internal controls has increased significantly in the 1990s. Although school management is ultimately responsible for ensuring internal controls are adequate, often lack of knowledge of internal control concepts are present. (Changchit, Holsapple & Viator, 2001, p. 275). Public institutions in Slovenia (as schools) instituted by a state or municipality in order to carry out or provide public services and activities of special social significance. Public service is a non-profit nature, the principal motive is not getting the greatest possible profit, but to meet broader societal needs, so their continued and smooth operation are in the public interest. Public sector accounts for externalities and public goods corrects economic systems as a regulator (Flynn, 1997, p. 1).

Financial management of schools under the Slovenian Law on Public Finance includes:

- Planning and implementation of the financial plan,
- Accounting and reporting and
- Safeguarding of assets against loss, injury and fraud, all with a view to achieving the objectives of the institute.

Internal control supervises the school financial management system, which comprises the setting up and implementation of planning, financial plans, accounting and reporting in order to achieve the set objectives and to assure the protection of assets from loss, damage and fraud.

## 1.1. Accountancy Act

Accountancy Act (hereinafter referred to as AA) provides a basic framework for public sector financial management. AA considers bookkeeping and preparing annual reports for public budget and public budget users. AA complements many of the accounting policies used by public budget users.

AA requires schools to keep accounting books and prepare annual reports in accordance with this Act, other regulations, accounting principles and the Code of Slovenian Accounting Standards. Public institutions like schools must keep basic accounting books, namely the general ledger and her diary, auxiliary books, such as cash book, a book of tangible fixed assets and the book trade receivables and payables. Schools in the conduct of the accounting books must take into account the uniform chart of accounts prescribed by the minister responsible for finance. One of the main internal acts / regulations of the public institution are the Accounting Rules prescribed in the AA, and otherwise is connected with 4th, 7th, 30th, 32nd, 40th, 42nd, 52nd and 55th Article of AA. Accounting Rules are just mentioned in AA, the content is not specified.

The school has no impact on legal and administrative texts, they must be applied consistently and take into account. The school has a major impact on accounting rules that it select and establish itself. This is determined in its basic internal act, so called Accountang Rules. Preparation of Accounting Rules is very important, as it should be in the school financial management consistently. Theirs content and scope are not exactly required. Among the legislation that determine the content of the Accounting Rules are the Slovenian Accounting Standards, in which those requirements are, what needs to be defined in an internal act. On school principal is to decide how and in what form will be prepared the Accounting Rules.

Content of rules should be followed the needs of the school, financial management and preparing annual reports and reporting of public institution.

Each school in Slovenia has organized its own accounts implemented on the basis of contracts with external providers (eg. financial services). Accounting Rules in detail regulate the operation of the school and formalises the legal provisions, procedures and rules to be followed. It is important that the essential provisions that are recorded and all related to accounting and finance, and are mentioned in an internal regulation, is known and respected.

Close to regulations of accounting, there are other the mandatory internal acts of the school: regulations of the movement supporting documents, rules on the inventory and associated manuals and reports on inventory.

## **1.2. Internal controls**

Control activities are tools to help prevent risks to achieving the objectives and mission of the organization (Twinning project, 2004). School principals are responsible to establish control in the context of processes and implement of controls as necessary (Twinning project, 2004). Risk analysis is one of the systematic ways of assessing internal controls.

From the literature and practice, several types of internal controls are known. They can be found in the following internal controls in school management:

1. Organizational control: Schools should have plan of the organization that defines and allocates responsibilities, reporting lines and defined clearly defined delegation of powers and responsibilities.
2. The demarcation of duties: No person shall be responsible for processing and recording of the whole business event. By involving more people reduces the risk that there will be an intentional manipulation or accidental errors, and increase the possibility to check the work done. It is advisable to separate the following functions: approval, implementation, security and recording, specially in the case of a computerized accounting system and developing the daily processing of data.
3. Physical controls relating to physical protection of assets and records. Include procedures that are designed in order to restrict access by unauthorized persons.
4. Authorization and approval: All transactions should be approved by the responsible person (the school principal). If there are restrictions on the authorisation they must be specified.
5. Mathematical accuracy and accounting: The checks are in the process of recording, verifying whether they are processed and recorded data approved by all involved, properly recorded and accurately processed. Such checks include verification of mathematical accuracy of records, maintenance and verification of totals, reconciling control accounts and trial balance, and responsibility for the documents.
6. Personnel: There must be procedures to ensure that the tasks are assigned and carried out by competent people. The criteria to achieve this include appropriate procedures for recruitment, promotion, training and rewarding.
7. Control: Responsibility for monitoring must be clearly defined (eg. in Accounting Rules).
8. Managerial control checks are carried out by management (school principals) in addition to the daily routine procedures in the system. These include the overall supervision, review reports for internal purposes, to compare plans and other specific review procedures.

The most important objectives of internal control in the area of school financial management are (Guidelines for Internal Control, 2004):

- Operating with laws and regulations;
- Processing and storage management of reliable financial and other information as well as accurate, fair and transparent reporting;
- The effective performance of schools;
- Rational use of resources and their protection against loss due to negligence, abuse, mismanagement, errors, fraud and other irregularities.

Internal controls must be given assurance that:

- Financial transactions are in accordance with the approved financial plan;
- The acquisition procedures and contracting are in accordance with relevant regulations;
- Financial transactions are supported by the contracts concluded and the general binding rules;
- Accounting data and information are authentic.

No individual shall not be liable for more than one of the following tasks:

- Commit to pay,
- Authorization of payment,
- Billing and recording payments.

### **1.3. Risk management**

Risk management is an integral part of school financial management. Unexistence of risk management is irresponsible. Each organization is faced with various risks and must be assessed. Risk assessment means the identification and analysis of relevant risks that may arise in achieving the objectives. Risks are grouped by priority and steps to address them. In doing so, we can help by arranging risks in a document, so called Risk Rules. Risk Rules are not a document drawn up and forgotten.

The risks are stated by (Gostiša, 2008):

- Responsible own findings on general and business objectives (goals reflect the mission of the organization and the reason for its existence);
- Indicators of risk (reorganization, staff turnover, changes in objectives, external influences, ...);
- Questionnaires;
- Reports of internal audit services
- And other external sources.

Steps in establishing Risk Rules are as follows:

- Define and review the business objectives of existing documents;
- Identify risks which may endanger the achievement of objectives;
- Estimate risks in terms of likelihood, the consequences of occurrence, importance, and identifying priority risks;
- Identify activities and measures to improve;
- To set the person responsible and the time of implementation activities;
- To monitor if the risks change and if risk management is necessary to introduce additional measures;

- To set the registry administrator of the risks and to adopt rules regarding the management and updating the rules.

The most common method for identifying risks in school are:

- On the basis of interviews: Principal with a group of employees shall address all the financial activities of the user in relation to the objectives and identify the risks involved.
- Based on self-assessment: Using questionnaires or workshops, where experts encourage school principals and teachers to identify risks within their organizational units or activities.

#### **1.4. Internal Auditing**

Internal auditing is the assessment of the correctness of internal control and reliability of its operations (Guidelines for INTOSAI Internal Control Standards, 1995). The internal audit professionals are the so-called internal auditors.

The school can provide internal audit in the form:

- Own internal audit services;
- Joint internal audit services over budget spending;
- Internal audit by external contractors.

In Slovenia, AA in the 53rd Art. imposes mandatory internal review of all legal persons of public law, therefore, schools, in which a founding role of the state or local community is more than 2.083 million or the amount of appropriations for the financial year amounted to more than EUR 416,666. Such monitoring takes place every year. For the other users, which amounts founding role not be less so, is to perform internal audit at least once in every three years.

#### **1.5. Planning and Reporting**

Internal controls and risk management are as part of school financial management closely linked to the financial planning and reporting process. Two of the main products of school financial management are the financial plan and the annual report.

If the school has no financial plan, there is a risk that the funds for the action of the school are not properly planned and harmonized with the school's work program.

Slovenian regulations tentatively define the integral elements of the financial plan and they have to comply with the school's work program.

The financial plan has to show separately all revenue and expenditures that schools obtain or pay under the head of public service and under the head of selling goods or services on the market or by market activity (Rules on Drawing up Annual Reports for the Budget, Budget Spending Units and other Entities of Public Law, 2004).

The proposed financial plan is prepared by an accountant or the person who is responsible for accounting in the school, and it is signed by the school principal who is accountable for the regularity of the financial plan by his/her signature. The financial plan is adopted by the school council.

The adopted financial plan for an individual year is the basis for assuming school's obligations. The planned financial resources can be used only for the purposes provided by the financial plan (Rules on the Preparation of Financial Plans for the Indirect Users of the State and Municipal Budgets, 2000). The school principal is accountable for the regularity, entitlement and the intended purpose of used funds and full collection of revenues.

Reporting can be divided to annual reporting, as required also by the Slovenian legislation, and other types of reporting. We will focus on the annual report as the main mandatory reporting document. Schools prepare annual reports for the financial year equal to the calendar year.

The school annual report reflects the realization of our plan that we had foreseen for the following year (work program), according to that fulfilment or non-fulfilment of the set objectives that derive from school's long-term orientation. Reports have to explain the established facts, especially non-fulfilled objectives and tasks.

The annual report is the annual presentation of achievements of school management and its management. The annual report is the report for the public and also for the internal school participants on the accomplishments in the past year.

Reporting on internal controls and risk management in annual report is required by Slovenian financial legislation (Instruction on the Presentation of the State and Municipal Budget Accounts and the Methodology for the Preparation of Report on the Achieved Objectives and Results of Budget Indirect and Direct Users, 2006).

## **2. THE RESEARCH AND RESULTS**

The paper examines transferring internal control knowledge from legislation to school management. The main thesis of paper says school management in Slovenia has no system developed to facilitate the transfer of internal control knowledge from legislation to school management. For this purpose observation method was used among 150 Slovenian school principals during school principal trainings in Januar and Februar in 2011. Using inductive method of concluding and theoretical starting points, necessary contents of Risk Rules are prepared.

Among the expected results of the survey were:

- Identifying key areas of content strengths and weaknesses of internal controls and risk management;
- Preparing guidelines for the establishment of internal controls and risk management under the law and good practice to assist principals.

The survey showed that, according to the school principals there are 5 of the most common weaknesses in internal controls and risk management:

- School principals are not aware of their responsibility for establishing internal controls and risk management;
- School principals are not aware that the internal auditor is not and shall not be responsible for establishing and maintaining internal controls and risk management;
- School principals are not aware of, despite the legislation in force from 2002, internal control and risk management need to be treated as a necessary component of responsible school financial management;

- Where internal controls and risk management are set up, the main reason is formal compliance with legal provisions;
- School principals do not report in the financial plans and annual reports on internal controls and risk management.

The survey showed that, according to school principals, there are 5 of the most common best practice on internal controls and risk management:

- School principals are aware of the importance of internal audit and its assistance in establishing the correctness of financial management;
- School principals are aware of the importance of the on inventory check as one of the control mechanisms;
- School principals seeking to have financial transactions in accordance with the approved financial plan;
- School principals are aware that they must shown in the annual report dedicated spending (that is, the division of assets in funds from budget resources and the commercial activity);
- School principals are wishing to acquire knowledge of internal controls and risk management.

Information obtained show school principals need guidelines for preparing internal controls and risk management. The main thesis is confirmed. In order to establish internal controls and risk management is the responsibility of the school principal.

### **3. GUIDELINES FOR PREPARING OF RISK RULES**

Precondition for effective risk management is that we must have a relevant responsible person for each risk separately. In the area of school financial management, based on observation method was used among 150 school principals the following risks are identified:

- Implement the national program,
- The implementation of profit / non-profit activities,
- Financial and accounting activities,
- The purchase and related activities,
- Relationship with parents and other debtors,
- Physical protection and security of digital data,
- Investment activity,
- Management of assets,
- Other.

The risks are defined in more detail in the Risk Rules. The task of school principals and other responsible persons are continuously monitoring of risks from the Risk Rules, and if necessary amending or adding new ones. All the risks should introduce measures which they can manage it. The risk is not enough just to define, but it is also necessary to estimate its importance. The research among school principals shows that they use a subjective valuation of risk. After the identification and risk valuation, are established so-called Risk Rules, which contains a list of risks and assessment of the importance of individual risk. Risk valuation means the likelihood that there will be a certain of irregularities in the realization of individual processes.

Internal controls and risk management are mutually supportive. The school principal must use the internal controls to reduce the possibility that risks happened. Based on observation

method was used among 150 Slovenian school principals during school principals trainings in Januar and Februar in 2011 detailed notes were prepared about:

- Types of risks,
- Their probability,
- Action to be done,
- The responsible persons and
- Time limits.

Using inductive method of concluding guidelines for school principals and responsible persons was prepared. Recommended contents of guidelines for the preparation the Risk Rules are shown below.

**Table 1:** Possible Risks and Their Identification Through the Risk Rules

<b>Risks</b>	<b>Probability</b>	<b>Action</b>	<b>The Responsible Person</b>	<b>Time limit</b>
The implementation of the national program	High	Finding alternative sources	The school principal	Quarterly
The implementation of profit / non-profit activities	High	Review of transactions and calculations	The accountant	Six months
Financial and accounting activities	Middle	The demarcation of authorization of payment, billing and recording payments	The school principal, the accountant	Monthly
The purchase and related activities	Middle	Check the suitability of procedures for the selection of the supplier, monitoring the implementation of contractual provisions	The school principal, the secretary	Quarterly
Relationship with parents and other debtors	High	Regularly issue warnings, recovery procedures	The school principal, the accountant	Monthly
Physical protection and security of digital data	Low	Verification of start-up regime alarm systems, locking cabinets, passwords	The accountant	Six months
Investment activity	Middle	Subsequent internal control: the current monitoring the implementation of investment	The school principal	Quarterly
Management of	Low	Review and	The school	Six months



assets		establishment of records generated claims	principal	
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Environment and the school objectives are changing. These changings must be followed by identifying and estimating risks and, of course Risk Rules should be kept up to date.

#### 4. CONCLUSION

We have pointed out internal controls and risk management as the most important parts of knowledge of school financial management in Slovenia, which are mainly funded from the national budget effort. Professional knowledge of school principals mostly derive outside of the sector of economy or finances and accounting. Slovenia has no system developed to facilitate the transfer of internal control knowledge from legislation to school management. Guidelines for preparing the Risk Rules is one of the important tools for internal controls and to assist the school principle as responsible person. The risks identified and controlled in the Risk Rules are the integral part of the main school 's financial documents, such as accounting rules, financial plan and annual report. Unanswered question in research is, if school principals understand, why Risk Rules are necessary-in school financial management. There is a dangerous practice if the rules become a copy-paste document. Risk Rules are just one of the important tool for improvements in financial management. In future some other tools should be developed. The awareness of school principals and professional help are even more important, as well as additional trainings and guidelines for the preparation of useful internal control rules. Different trainings are needed to transfer internal control and risk management knowledge from legislation to school management.

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