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**8. Controlling the Finances  
of Primary Schools**

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# **Controlling the Finances of Primary Schools**

## **A Naturalistic Research Project**

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### *Abstract*

The reforms to school administration in New Zealand gave more control of school finances to members of the community and school principals and staff. I used a qualitative approach to examine the problems of providing control over these resources. It was difficult for schools to provide control over finances (internal control). This was not only because the organisations concerned were small and were run by people without business training. In addition, school management is characterised by confrontation with the central funding authorities.

This project was conducted to test new ideas in internal control as well as to examine school administration. I found that the 'culture of control' is not an effective means of control. However some features of running a school provide hope that control can be provided in alternative ways, based on new concepts of internal control.

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## **Controlling the Finances of Primary schools**

A naturalistic research project

by David Hay

### Part 1: Introduction

#### 1.1 Background

In the late 1980s, the New Zealand government made many changes to public administration [Martin and Harper, 1988; McKinlay 1990]. The reforms included Tomorrow's Schools, a programme that transferred administration of schools from central authorities to locally elected boards of trustees. This research project investigated the methods of control used by the boards.

#### 1.2 Accounting issues

My study was intended to examine the nature of internal control in organisations, particularly small, community organisations such as primary schools. Internal control is an accounting term describing the methods which managers use to control resources and ensure accurate accounting records.

The reforms increased the responsibility of local administrators for their school finances and accounting. Financial accountability to the government and local community included annual accounts which were audited by chartered accountants. Internal control in schools is thus relevant to local administrators, to auditors, and indirectly to the community and the government.

The organisations involved were small, and involved people who are not trained accountants and managers. As a result the methods of internal control that could be used were expected to be different from those used by business organisations.

#### 1.3 Nature of the project

I examined the management of primary schools and pre-schools using interviews, and field observations of events such as meetings. I also reviewed financial data. I concentrated my

work on organisations within one New Zealand city, and concentrated in particular on one school.

I have changed the names of the people and institutions I observed, to preserve the confidentiality of the people who provided me with information. References to news articles are only provided where they relate to schools generally, not to a particular school.

I tried to avoid holding preconceived ideas about good or bad business practice. As far as possible I described internal control in the participants' terms. The areas which I considered part of internal control included other elements in addition to the control procedures that accountants have traditionally been concerned with. I included 'control culture' and other means by which an organisation's objectives are achieved. This approach is in accordance with recent professional auditing statements. In this paper, when I have used 'internal control', it includes other ways of describing control.

A survey of primary and intermediate school trustees, principals, teachers and parents was conducted in October 1989, and the results were published during my study (the Wylie survey) [Wylie 1990]. Where possible, I have referred to the survey results in this paper.

#### 1.4 Significance

New administrative structures were being set up, by people without accounting training. The project is significant for the audit and management of primary schools in New Zealand and other countries. It is also relevant to other community organisations, including other public sector groups, voluntary organisations and small businesses. I also obtained information about the nature of internal control generally, and the concept of control culture.

#### 1.5 Summary of findings

1 Schools operate to some extent through confrontation with the central authorities. People associated with the school put its interests before those of the rest of the tax-payers. Many people in school communities did not trust the authorities. They considered it acceptable to try to get government money, in some cases by distorting the facts of a situation. These views

had implications for control over public funds, and for the control culture of the school generally.

2 Internal control in the form of organisational culture was not present. The organisational culture was not appropriate to be relied on to provide control. The school community was diverse and changing, and board activities sometimes appeared chaotic.

3 Control procedures to provide internal control were also missing.

4 It appears possible that internal control within schools could be improved in fairly simple ways. There was considerable concern about issues such as fund-raising and spending. Procedures to share information about these matters seem likely to be effective as a means of ensuring transactions are properly recorded and assets are safeguarded.

Some people expected that my study would develop a view of the school reforms generally. However the research project was not intended as an evaluation of the school reforms, but of internal control in community organisations. The study showed there were both favourable and unfavourable aspects to Tomorrow's Schools. While internal control in the new situation was not good, there is some evidence that it was better than under the old system.

## Part 2: Research methods

I was interested in primary schools as a research setting, and their internal control as an issue to be researched. Since this area was new and uncertain, it was not appropriate to use a survey or other conventional research method. I used qualitative social research methods to interpret the management and accounting processes and the views of control held by the people involved. I believe that this approach was the most likely to provide useful information, particularly because administrative procedures were changing and because control culture was likely to be an issue.

Naturalistic research (or qualitative social research) is a method for analysis of social settings developed by symbolic interactionists. The method has much in common with those used by ethnographers [Blumer 1969; Emerson 1983; Lofland and Lofland 1984; Perkins 1988]. There

are many other terms for this type of research, such as fieldwork, qualitative methods or interactionism [Chua 1988].<sup>1</sup>

The method involves processes of exploration -- investigating a social setting to obtain a clearer understanding of the problems to be researched -- and inspection [Blumer 1969 p 40-44]. Inspection represents an intensive focused examination of the analytical elements used to understand the setting. This method is used by sociologists to understand an organization, when their existing knowledge of the situation is not enough to identify relevant problems and hypotheses. The problems and hypotheses are discovered during the research [Becker et al, 1961 p 190-1].

The methods I used included interviews, observations of group activities and analysis of documents such as local newspapers and accounting information. The interviews were lengthy and unstructured. I taped them and transcribed them in detail. I also took detailed notes of other activities.

Studies using qualitative social research techniques are sometimes criticised because they appear to lack validity and reliability. Three strategies to attend to these issues are:

Substantial length of time in the field;  
Multiple methods and observations; and  
Appropriate behaviour while in the field [McKinnon 1988].

This study involved my immersion in the field I studied. It was supported by examining other groups, and by referring to another type of study. It involved my acceptance by the group studied due to an unusual combination of the roles of researcher and auditor.

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<sup>1</sup> Lofland and Lofland [1984 p 3] describe this area as a 'terminological jungle'. The different terms are sometimes associated with different social theories, from behaviourism to Marxism.



I observed other schools and pre-schools besides the particular school on which my study was based and I referred to Wylie's survey of primary schools. I also studied five local newspapers and two Sunday newspapers over the period concerned.

I accumulated substantial quantities of data. I commenced in early March, and by the end of August my notes included 300 items -- interviews, field observations, school notices and newspaper items, on nearly 700 pages. They included discussions with approximately 75 people from 25 schools, pre-schools and other organisations.

There has been an increasing recognition of the need to study accounting within its organisational context [Hopwood 1978; Hopwood 1983]. However, problems in getting access to the research situation are often reported by researchers in social science [eg Lofland and Lofland 1984] and business researchers [eg Hopwood 1983; Choudhury 1987]. In my situation, I found it easy to 'get in'. Community organisations are accustomed to volunteers helping and taking an interest. The reforms created many administrative difficulties, and my accounting qualifications helped me to be accepted.

I was also involved in other ways. My being a parent, and potential auditor of the school had good points and bad points. It may have led some people to be reticent about discussing some issues with me. But there were corresponding advantages, since it gave me access and the opportunity to examine documentary evidence. I believe that these outweighed the disadvantages of my position.

### Part 3: The nature of control and internal control

I carried out this study to find out about internal control. There are some recent developments in professional views of internal control on which the study shed some light. Auditors were once concerned with internal control as it related to safeguarding cash, and checking the clerical accuracy of accounting records [AIA 1951]. More recently, professional statements have been concerned with 'the procedures and records for safeguarding assets and the reliability of financial records' [AICPA 1973]. However, a much broader concept of internal control structure has evolved, after some controversy [Hay 1990]. The broader concept of internal control is concerned with good management, not just good book keeping. The

authoritative American Institute of Certified Public Accountants recently introduced the term internal control structure, and defined it as:

"The policies and procedures established to provide reasonable assurance that specific entity objectives will be achieved." [AICPA, 1988, p 4]

Internal control structure is effectively synonymous with 'control'. The AICPA's statement points out that the area of internal control which is relevant to an audit concerns the reporting of financial data. The statement also refers to safeguarding assets. Another term for the area of internal control structure that concerns auditors is 'controlling finance and resources'. (Most auditors still use the term 'internal control', not 'internal control structure').

Internal control structure includes factors such as 'control culture' and management philosophy, as part of the 'control environment'. The accounting system and the control procedures used by an organisation are also part of internal control structure. However it is recognised that they are likely to be more effective within an appropriate control environment [AICPA 1988 p 5; National Commission on Fraudulent Financial Reporting (Treadway Commission) 1987 p 28].

Also in the US, an enquiry into company reporting, the Treadway Commission, described control culture as part of the 'atmosphere' in which internal control procedures are applied. It noted that it had a pervasive impact on internal control and financial reporting. The Commission also associated control culture with the ethical tone established by top management [National Commission on Fraudulent Financial Reporting 1987 p 27-8].

#### Part 4: The school reforms

The changes to school administration were part of a number of reforms in the public sector. The school reforms were seen as a major change, partly because the previous system was very centralised and had been stable for many years. Many negative views of the reforms were published in news reports. However these reports may have overstated the opposition of school communities to the reforms.

#### 4.1 Background to the reforms

Before the Tomorrow's Schools reforms, the system of school administration had been centralised and stable for more than 100 years [Administering for Excellence, 1988 p 6]. The Picot report presented the results of a study that led to the reforms. It saw the education administration system in 1988 as 'a creaking, cumbersome affair' [Administering for Excellence, 1988 p 22]. It was considered that school administration gave too much power to teachers, teachers associations, and the Education Department, and was very slow to react to local needs [Barrington 1990 pp 195-199].

The changes were meant to provide more community involvement. They gave schools control over their resources (within guide-lines). The operation of each institution was put into the hands of a board of trustees, representing the educators and the community [Tomorrow's Schools, 1988].

The reforms were politically controversial. Many observers saw the changes as more significant than a simple overhaul of an old-established administrative system. Some educationalists<sup>2</sup>, saw the education reform changes as imposed by an international group called the 'New Right' (using a 'standard set of ideological strategies', which included 'propaganda'). The Treasury was described as 'the political thought police of the New Right revolution' [Lauder 1990 p 2].

The reforms could also be explained as giving power to the people. When he was deputy Prime Minister, Geoffrey Palmer described them as 'a model which empowers the government and community at the expense of the bureaucracy' [Palmer 1988 p 5].

News reports gave an impression of widespread opposition to the reforms.<sup>3</sup> Many commentators suggested that the reforms either had been simply intended to mislead the community; or that they had started off as well-intentioned, but were later distorted. People

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<sup>2</sup> for example Lauder [1990 p 1] and Bates [1990 p 44].

<sup>3</sup> within a three week period, similar criticisms were presented by Nash [1990]; The Press [1990, April 14]; Salmond [1990]; and Kennedy [1990].

who were more closely involved with the system than these opinion leaders appeared more satisfied with the reforms. My interviews and observations, and local news items that quoted teachers or principals, showed that people thought the reforms were sensible, and professionally satisfying, despite their disadvantages. The principal of one school said that 'it's worthwhile getting the parents and the community involved'.

#### 4.2 The implementation of the reforms

However, some people disagreed with the way reforms were implemented. The reforms were intended to allow communities more influence, by decentralising school management. Schools were required to provide consultation with the community as well as changing their management procedures. It was ironical that to many people, it seemed as if the decentralising process itself was imposed on schools by the government, with little consultation. According to the Wylie survey [1990 p 63], 47% of the school principals who responded viewed the implementation of the changes as too rapid.

#### 4.3 Impact on the financial statements

The process of change had a direct impact on the trustees' views of the annual accounts and audit. Many trustees told me they resented the first audit as an unnecessary requirement imposed on them by the Ministry. An accounting firm partner responsible for a large number of school audits also reported that many people in primary schools held this view.

### Part 5: Financial concerns in schools

Managing a school involves financial concerns with two types of revenue (government grants and local fund raising) and decision making, which is related to spending.

#### 5.1 Government funding

Government grants were the major source of funds. Obtaining central government funding depended partly on pupil numbers and partly on information supplied by the school. Many trustees had a confrontational approach to obtaining money from the authorities.

Government funding included operating grants, and other special grants. Teaching staff and school buildings were separately provided, from central funds. The number of pupils attending

the school was the most important factor in establishing the operating grant. The number of teachers provided also depended on the number of pupils. The population of children was falling, and most primary schools in this area had some empty classrooms. As a result, attracting and keeping pupils was an important issue that was regularly discussed. A news report recorded that a secondary school in another city used a radio advertising campaign to encourage pupils, and others advertised by distributing leaflets through letterboxes.

The Ministry of Education had considerable discretion over other funding. Some trustees believed it was important to undertake lobbying of various kinds to ensure they received as much government funding as possible (particularly for capital expenditure on the school). Procedures used included contact by the chairman with the local Member of Parliament, and regular contact with the Ministry of Education property officer.

The funds that schools obtain are public money, and some authorities expect a high degree of circumspection. The Audit Office suggested that each transaction of the school should be subject to this test:

'Bearing in mind that the funds of this organisation have been obtained from the public in a compulsory manner, is this action by the auditee the sort of use which a reasonable member of the public would expect his rates or taxes to be applied?' [Audit Office 1990 p 26].

However the people involved in primary schools saw themselves as managing their school as a separate entity. They attempted to maximise the funds they received for their school.

School communities often acted as if they saw the central authorities as potential adversaries. For example, a board chairman suggested that 'we don't want to make the school look too good' by voluntary cleaning and maintenance work. This might jeopardise the possibility of receiving additional money from the Ministry.

Another trustee said that it would be easy for schools to pass the responsibility of maintenance work on to the Ministry. They could do this by ensuring that individual jobs cost more than \$500. (Work which cost this amount or more was to be paid for by the Ministry). Two ministry staff disagreed. They said 'trustees will not do that because they would appreciate that this is a partnership between schools and the Ministry'. They also believed

trustees would resist this temptation because 'funds for the whole of New Zealand were limited to the amount allocated by Parliament'. The trustee disagreed: 'I think that is naive. People will take advantage', he said.

However it appeared that it would not be acceptable in the school community for this cynical approach to be taken too far. A national scandal developed when questions were asked in Parliament about a polytechnic that had 'duped' someone to record children at the institution's child care centre as polytech students. The increase in student numbers led to more funding for the institution, and salary increases for its top executives. Later, the chief executive officer of the polytech was reported as unrepentant, saying 'we have to try to get as many resources as possible from the government for the good of the wider community'. Other polytechnic heads were reported as defending his 'altruism'. But the students at the polytech petitioned for his sacking, and later he was arrested for fraud. This situation was widely discussed, with some amusement and shock, in the community I was studying.

## 5.2 Community fund raising

People concerned with the school were also concerned with raising funds directly from the community. Although the amounts raised were small, they were seen as very important. These activities depend on the support of local people, and aid in keeping boards accountable to their local communities.

While some trustees believed in raising as much as money as possible through local fund raising, others were more cautious. Some of them did not want to put pressure on local people, or did not believe that there should be a need to raise funds locally. Some people did not trust the government not to take away any money they raised.

Both the Board of Trustees and the Parent Teachers Association spent a considerable amount of time discussing fund raising from the community. But it was not a large source of revenue. Surbiton school's budget for the 12 months to 31 January 1991 included government operating grants of \$131,000, and locally raised funds of only \$6,500.

Methods of raising money used by Surbiton school included selling children's t-shirts and lunches; occasional events such as a garage sale; and renting the school hall. Larger schools were reported as using more unusual methods, including building a house with voluntary labour, and sponsorship from a pharmaceutical company.

The school also raised funds by requesting donations from parents. This was a sensitive issue. Several trustees were opposed in principle to asking parents to pay, and concerned about not putting pressure on people who might not be able to afford the \$25 requested. In the previous year, only 42% of families had paid the \$22 asked for. (This year the response increased to 49%). This response rate was similar to those reported by the treasurers at two neighbouring primary schools. Of the schools responding to the Wylie survey, 66% asked for fees in 1989, but only 29% of those asked for more than \$20. However, only 10% of schools reported receiving payment from less than half of the parents [Wylie 1990 p 47].

Other primary schools were less circumspect than Surbiton. The treasurer of Norbiton school told me that the members of his school council phoned parents to remind them to pay their donations. He said some of those he had called were out of work, and were 'quite genuine cases'. But others simply told him 'I've been paying my taxes', and the treasurer did not regard that as a genuine reason not to contribute.

Many trustees believed there was only a fixed amount of community money available. At another meeting, a trustee said 'it's not how much work you do, it's how much money is in the parents' pockets'. The school treasurer at another school and I found out from the school secretary that in the past, previous school principals had arranged for the children to take part in a fund raising event for a national charitable organisation. In 1989 the school had raised \$1190, and about \$200 was returned as its share of the money. The treasurer was shocked. She said 'I don't think the school should be raising \$1000 for an outside organisation'.

The confrontational view of the authorities also affected fund raising. Many people were worried that if they raised more money, the government would give them less next year. The PTA president told me that the board and PTA had decided that there should not be a formal agreement allowing the board access to funds raised by the PTA. She said 'they're scared the

government will give them less money if they have access to other funds'. (There was no evidence that these fears were justified).

Wylie [1990 p 46] reported that nearly all schools conducted fund raising in 1988-89, but only 19% raised more than \$12,000. Fund raising was the most common form of parental involvement in schools, and many parents had also been involved in voluntary repair work for their school.

The importance of fund raising, and the number of people involved, provides potential internal control. If accounting information that provides sufficient information is available, it will be clear whether all fund raising activities have been correctly included and the amounts are reasonable. Voluntary fund raising also puts the board under the control of its community to some extent. If the board loses public support for its school management, it will be less able to raise funds.

If there is a maximum amount that the community can contribute, it might be expected that total fund raising each year will be fairly constant, even if the particular activities used vary. Schools that regard donations as very sensitive, and treat them as confidential will find it more difficult to provide internal control by procedures such as reminders.

### 5.3 Decisions

Decision-making was a complex process, which was shared. The school's written objectives were not the same as the objectives used for decision-making. Making cost savings was also a source of funds for other purposes. In some expenditure areas, such as heating, the school was successful in reducing its costs.

In the past, decisions concerned with spending money had not been a major concern. The principal said 'we just asked for things and we got them. Now we have got to look much more closely at what we do'. The Picot report [Administering for Excellence 1988] had suggested that schools would be able to manage some resources better. The report suggested that school heating costs (which were previously refunded, no matter how much was spent) were an area where savings could be made. It was correct. Surbiton school saved money by



using a special blend of coal for its boiler, and turning the heat off when it was not needed. News reports showed other schools were making similar savings [Christchurch Star, 1990, 12 July]. This 'cost control' also represented a form of internal control.

Many people had different views of funds from different sources. The treasurer of Norbiton school, was adamant that funds raised from the community should be used for special purposes, such as projects to build playground equipment. He believed the government funding should be adequate to meet general expenses. 'It's up to the wider community to pay for the power bill', he said. This opinion was widespread. Surbiton school's trustees did not share this viewpoint: the chairman explained to a PTA observer at a board meeting 'we need to raise \$2000 just to balance the books'. Isolating particular funds and relating them to individual projects gives community members more involvement in funding and spending decisions, and appears to be a way of providing internal control. This approach helps to ensure funds are spent on the projects they were authorised for.

Decision making seemed to be a shared process, and did not appear to be based on formal established criteria. The principal said that the school worked on 'shared responsibility' and this seemed to describe the process used. Many people, including trustees, teachers, and parents were often involved in discussing particular decisions. If a group did not support a decision, they would grumble openly about it.

Wylie's [1990 p 54] results also showed that decisions were shared. She had asked principals for their perceptions of the parties involved in decision making. Wylie concluded 'few decisions are made by one or even two parties'.

The distinction between matters which were the concern of the board, and those that should be left to professional staff was very difficult. The reforms were intended to make trustees responsible for 'governance', while the school principal and staff dealt with 'administration'. The treasurer of a neighbouring school told me 'we find, if it's something controversial, the principal says "that's administration, leave it to me". But if it's not important, "that's ok, that's governance."' His board had voted to move a class out of an old prefabricated building. They wanted to put it in a block that the principal had set aside for Form 1 and 2 children.

The parent representatives argued that this was 'a heating costs issue', while the teachers saw it as a teaching issue. (Opposition to the move from the teachers was so strong that the board gave way). It appears that it can be hard to distinguish between governance and administration.

Shared responsibility has internal control implications. Since more people are involved in decisions, this reduces the risk of improper spending (or other impropriety). However, the lack of clear responsibilities for decisions also increases the risk of errors and inappropriate decisions.

#### 5.4 The objectives of the school

Although the school had goals set out in its charter document, these did not seem to represent its real goals. There appeared to be both written and unwritten objectives. The school charters, which were a central part of the reforms, were not usually seen by school communities as important in practice. Few people took part in consultation over the charter at the primary schools and pre-schools I examined. The charter documents themselves were largely established by the Ministry (only eight out of 38 pages of the Surbiton school charter were locally written). The charter was required to include a mission statement, local goals and local curriculum goals. Surbiton's local goals were very general, for example 'to retain a child's enthusiasm and enjoyment for learning'. In practice, the charter goals were not frequently considered.

The school's curriculum goals recorded in the charter were to emphasise reading, maths and language. Those goals were used very infrequently as criteria for making or justifying decisions. The real objectives, which the school board used as a standard to assess decisions, appeared to be:

Obtaining 231 pupils by mid year. This level would prevent a teaching position from being removed.

Raising funds. This was discussed often. The issue was how to get funds from the community, not whether it should be done.

Improving the school premises. Surbiton school's buildings were old and dilapidated, and considerable importance was given to negotiating for them to be improved or replaced.

Buying computers for classroom use. The treasurer mentioned several times that 'buying computers is the school's project for this year'. Many other schools in the area also gave computers a high priority.

Internal control is concerned with the schools' means of ensuring their objectives are achieved. Having two sets of objectives -- a formal, but vague, set in the charter and a specific set of unwritten objectives -- is likely to make control more difficult.

### 5.5 Discussions about internal control

Internal control was not a term that was commonly used in the school community. There were two situations in which it was raised: my discussions with other auditors, and discussions of the Ministry of Education's requirements. In the first situation, internal control for schools was usually discounted as not feasible; in the second situation, a rather distorted image of internal control was discussed.

I had several discussions with employees of the government Audit Office, who expressed considerable relief that they were not responsible for school audits. (The audits were put out to tender among chartered accountants). The Audit Office staff thought that the people administering primary schools were inexperienced, would resent the auditors, and there would be no internal control. An audit manager said 'we could say that we are subcontracting the school audits because we want to allow the local community to be involved. But it isn't really that, it's that we don't want them'.

Ministry advisers suggested inconvenient ways to introduce internal control. As a result, some boards deliberately reorganised their affairs to avoid the need for control procedures. At a meeting of school treasurers and secretaries, an intermediate school secretary explained that her school had a tuck shop, operated by pupils and handling a lot of small cash sales. 'We couldn't keep records of that'. An adviser for the Ministry suggested 'perhaps you could get the PTA to run it, or contract it out, so that it is out of the board of trustees control'. Then internal control would not be necessary. She also reported that her school had separate bank accounts for the cooking and sewing teachers to use to buy class materials. To avoid having to provide controls over those accounts, and so that she would not have to keep records, she closed the accounts and gave the teachers a cash advance of \$400 each.

## Part 6: Findings -- internal control in the school

I had not expected strong formal controls over transactions. But controls were much weaker than I had envisaged. I had hoped that the culture of the school community might make up for these weaknesses in some way. I was unable to support this view, although there were some potential areas where internal control could be effective.

### 6.1 The confrontational perspective

The perspective that school trustees held of the Ministry of Education appeared to include the following elements:

Sometimes we will be granted money if we complain, but get nothing if we do not;

If we raise too much money, the government will give us less;

Other people mislead the authorities and get more money than we do;

So we ought to make sure we get as much money as we can, if necessary by distorting information.

I discussed this 'cynical perspective' of government funds with two accounting academics who were involved with schools. Both suggested that this was a normal, common sense approach. Even if this is the case, a finding that is taken for granted by the people in the research setting can be very important to a social researcher [Whyte 1984 p 27].

The views and actions I observed were consistent with the findings of other studies of people in organisations. Studies of local authorities and government organisations in the US and Sweden have noted that confrontation over funding between central authorities and local operating units is a basic principle of these organisations [Wildavsky 1974; Jonsson 1984]. Birnberg et al [1983] reviewed earlier studies reporting methods of distorting the information system that may be used by subordinates in an organisation to achieve their desired ends. These ranged from 'smoothing', to 'illegal acts'.

The confrontational perspective also has implications concerning the Treadway Commission's identification of 'control culture' with the ethical tone of management, and the Audit Office's statement regarding spending of tax-payers' money. However this perspective follows from, and supports, the AICPA's definition of internal control structure. Internal control structure

was identified with the organisation's objectives. Since minimising expenditure of public funds was not an objective of the schools, their internal control was not directed towards doing so.

## 6.2 Internal control procedures

The conventional forms of internal control were not applied. Sometimes -- for example in appointing the school treasurer -- the school acted in accordance with internal control precepts. In others, such as collection of revenue or maintaining computer records, internal control did not appear to exist.

Internal control includes appropriate training and experience for those involved with accounting, finance and other resources. The board was concerned to have someone with appropriate skills as treasurer. The treasurer was co-opted to the board for her financial expertise, which was not extensive. Wylie [1990 p 12] reported that 26% of co-opted trustees were responsible for finance in their schools.

Management review of financial reports is another means of internal control. But many trustees resisted becoming involved in accounting. When I asked if we could get the board to tell us what format they would like for their accounts, one treasurer said 'they won't. All they do is thank you and move on to the next item'. Another treasurer reported that 'their eyes glaze over' at school board meetings when he brought up financial matters.

Control over computer systems is frequently a particular concern for auditors. Again, in this area of school management, internal control or any equivalent idea did not exist. The school selected a new system without considering its feasibility, or the alternatives. The system was untested, and contained bugs and had data security problems. When the accounting records became too messy, the treasurer gave up and set up a complete new set of accounts. Some schools using the same system became so desperate to overcome its faults that they had gained access to their data using other computer programs, and directly altered the records.

Control over revenue was also limited. During my study, minimal controls over cash received by teachers were introduced. Teachers were required to complete a form showing the nature of cash received. Even this basic requirement was difficult to introduce.

### 6.3 The lack of control culture generally

I had hoped that the 'culture' of the school community and organisation might provide internal control over the school's own finances and resources. My hopes were not supported by data from the first board meeting I attended. It was noisy, and it ran from 7 pm to midnight. Trustees from other primary schools recognised the signs -- long meetings, and trustees becoming emotional -- from their schools. Two trustees later asked me if I felt the meeting had seemed 'out of control'. They recognised that the meeting had looked badly run, and later meetings were far more orderly. However, if the meeting was in danger of being 'out of control', it is difficult for me to suggest that the trustees could exercise internal control over the school's financial resources.

Questions about the culture of communities in New Zealand were also being asked in the context of the school reforms. The Picot report was criticised for assuming that New Zealand consisted of communities in the form of harmonious, homogeneous groups centred around schools [Moss 1990 p 140-2]. The groups I observed were not like that. Surbiton school had experienced problems over introducing a bi-lingual (Maori and English) class, which divided the community over how much of the school resources should be devoted to bi-cultural issues. Renwick [1986 p 53] had noted that 'signs of cultural strain' and 'differences over the aims of education' had been apparent since the late 1970s. The School Trustees Association claimed that, in rural areas, school administration was a source of conflict that was splitting communities [Star Sunday, 1990, 2 September].

The confrontational approach to the authorities was also part of the organisation's control culture. The Treadway Commission [National Commission on Fraudulent Financial Reporting 1987] associated control culture with ethical tone at the top of the organisation. This model implies that the confrontational approach to the central authorities by the trustees will also lead to a poor environment for internal control in other parts of the school organisation.

Negative views of accounting also contributed to the difficulties of providing control. One accountant suggested to me that, in a school environment, 'people with financial skills are treated like lepers'.

#### 6.4 Potential internal control through control culture

There are some potential controls that make use of the wide community involvement in the school, and extend existing control procedures.

Control procedures that were used by the school included monthly financial reports to the board. In addition, a bar chart displayed on the staff room wall indicated the percentage of the budget spent so far in each account category. These control procedures showed a concern with financial resources, and a means by which errors or irregularities might be detected. In addition, the teachers and community were usually aware of spending decisions (and grumbled about those they considered inappropriate), and this helped to ensure that only authorised expenditure took place.

Control might also be provided by community scrutiny of the annual accounts. However little effort appeared to be made by the authorities to present financial statements as information of benefit of the community. A seminar presented by an audit firm concentrated on telling schools they must prepare accounts 'that look like the example in the manual' and that 'meet the Ministry's requirements'. Ensuring the community had regular access to appropriate reports on information of concern might improve internal control. For example, lists of fund raising projects and the amount raised, or expenditure by category might provide accountability. The wall charts appeared to meet this need.

#### Part 7: Conclusion

I expected that internal control in a small community organisation might not be present in the form of conventional control procedures. But there could have been other means by which a school achieves its objectives. I had hoped that there might be a form of social internal control that might compensate. I did not find this form of internal control to any more than a small extent.

### 7.1 The lack of internal control

There were two distinct areas in which internal control could apply. These included firstly the community's control over government resources provided to the school, and secondly, its control over resources within the school. In the first case, internal control was not relevant: the objective of school management was confrontational. They wanted to obtain as much central funding as possible. As far as funds held by the school were concerned, trustees and the school community were concerned that they should be properly managed. However their ideas regarding administration did not appear to include a concept of internal control that would require them to use appropriate procedures. In some circumstances, the existence of an appropriate 'control culture' might compensate. But the confrontational approach to the Ministry and other authorities did not help to provide an appropriate control environment.

### 7.2 Effects

The risks of schools mismanaging their resources, or deliberately gaining resources they are not entitled to are likely to be high, and these organisations will be difficult to audit. Bad decisions, due to the lack of management skills, or breakdowns of the accounting system are probably more likely to occur than other risks such as outright fraud. These risks do not indicate that the Tomorrow's Schools reforms were not effective. The previous system has not been examined by this study; and it was also subject to many criticisms. The new system has also allowed cost savings to be made (in areas such as heating costs), and has improved internal control over cash receipts (particularly over the separate bank accounts that were previously maintained by principals).

### 7.3 Conclusion regarding the definition of internal control

The results supported the AICPA's 1988 definition of internal control. Where the school's objectives were clear and well supported (fund-raising, for example) internal control appears feasible. Where most people did not support an objective of controlling funds or limiting spending, such as with the government grants, it seemed unlikely that the organisation could provide control.



#### 7.4 Recommendations

There appear to be several ways in which the features of a school situation could be used to improve internal control. These include:

Schools should have clearly specified organisational objectives, which are supported by the school community. These should represent the real and concrete goals for which the school is run. For example, if increasing pupil numbers is an objective, this should be included.

The trustees should have some financial awareness. They should be able to interpret reports, and be aware of issues such as conflicts of interest.

Some kinds of simplified financial reporting will help to provide internal control. These controls could include charts showing income and expenditure (as Surbiton school used). Lists of the amounts raised by various fund raising projects could also provide control over these resources.

The schools appear to see the distribution of government funds as capricious, and able to be manipulated by their lobbying efforts. A system in which a greater proportion of the grants paid to schools are based on objective measures may ensure that schools receive a fair distribution with less confrontation or lobbying.

8 November 1990

## Part 8: References

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