Enhancement of the internal control system: A case study of Shuguang Lantian Education Company (SLEC)

Thesis

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Executive Summary

I am a student studying Finance and Accounting at Rotterdam Business School. In this thesis the research to improve a company’s internal control system was conducted using Shuguang Lantian Education Company (SLEC) as the case study. SLEC is a private educational company located in Handan, Hebei province in China.

In recent years, the internal control system has become a necessary and important method in a company’s management and operations. The Chinese private companies that go bankrupt have a short life cycle and are usually managed through centralized authority and insufficient internal controls which can be key factors that lead companies to fail in business.

An insufficient internal control system in a company can bring an ambiguous management style, unclear delegation, and inappropriate budget method/plan. Coincidently, during the interviews with SLEC employees, they also mentioned that the company has the similar problems in their internal control system. Therefore, the company should establish suitable internal controls according to company’s business objectives and goals.

The main research objective of this thesis is to recommend possible solutions of enhancing SLEC’s internal control system which leads to the central research question, “What improvements can be done in regards to the control environment and control activities of the Shuguang Lantian Education Company?”

In order to answer and achieve the research objective, this thesis was designed in a logical way. First, this research introduces the concept of internal control; control environment, and the control activities in general. Next the organizational structure, leadership style, performance review, and the methods of budgeting are introduced including the disadvantages and shortages in company SLEC. Lastly, the research provides recommendations for the improvement SLEC’s internal control system.

The data and information were collected in two ways. The primary data were collected through interviews, with relevant employees from the finance department, while the secondary data were collected by desk research from SLEC’s financial statements. After analyzing the data and information collected, the gaps existing in SLEC’s internal control systems will be identified.

By combining the findings and discussions of this research, recommendations are listed as follows:

- Create a visible organizational chart
- Invite more staffs or chief administrators to express their opinions about company internal controls and to participate in the company’s management
- Prepare annual budgets from the divisions and upper management
- Regularly assess the financial performance by using systematic financial indicators
- Ensure employee's delegations and duties are clear.

Key words: Internal control, organizational structure, leadership style, performance indicators, budget
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Chapter 1 Introduction

This chapter introduces the background of this thesis. Section 1.1 describes the context of the thesis. Section 1.2 introduces SLEC’s current internal control system and the problem statement. Section 1.3 illustrate the research objective and research questions. Section 1.4 presents the blueprint of this thesis.

1.1 Background

In recent years, some companies undergo insufficient internal control system, which leads to negatively impacts on company’s financial integrity, operations, financial reporting and, ultimately company bankruptcy. For example, the company Giant Interactive Group Inc. ran its company with poor mismanagement, incorrect marketing strategy, overspending which lead the company to fail and file bankruptcy. Due to errors in a company’s financial reports and the leader’s autocracy, this example can show insufficient internal controls were the main reason for the bankruptcy of this company. Thus, it is crucial to improve internal accounting control in enterprises.

Internal control system is a crucial component in the company’s management and business. First, it controls company’s background to ensure a healthy internal environment and then makes the policies and procedure for a company’s operation, and lastly, reduces the risk of asset loss, finally protects company’s assets and maintains company’s profit (COSO, 1992).

Meanwhile, a stable internal control system can help companies present reliable financial reports to stakeholders, comply with laws and regulations, and have efficient and effective operations (COSO, 1992). For example, according to Hayes, Dassen, Schilder, and Wallage, (2002) controls can limit the number of activities that one employee completes in the company or requires management authorization or review of financial statements and reports.

With the rapid growth and development of China’s economy, the status of private enterprises in the national economy is increasingly important. However, a large number of private company’s failures are due to insufficient internal controls and hence, it is important for a company to improve their internal control system.

1.2 Problem statement

The purpose of this thesis is to recommend possible solutions of enhancing its internal control system by studying company SLEC, based on its existing restraints and insufficient
limitations of its internal control systems, which are unclear in their organizational chart, autocratic leadership style, improper budgeting method, un-systemic performance indicators and the unclear segregation of duties.

Normally, efficient internal control systems can set a tone for an organization and ensure that the company has a reasonable control environment. Such control systems can help identify and analyze relevant risks to the company, help to correct policies and procedures, and to ensure that proper guidance and directions are put into place in order to meet the company's operational goals and objectives.

However, with some private enterprises, mismanagement within an organization, a centralized leadership style and misuse of company capitals, can all lead to a company's failure, which can account for a poor internal control system. Consequently, an unacceptable and deficient internal control system in a Chinese company leads to an insufficient and ineffective business. For this reason, SLEC has proven to have an unreliable internal control system.

In addition, the separate authority for budget planning and execution, the inappropriate performance management methods used at SLEC, has cost the company a large amount of money. For example, a large variance of budgeting and the actual budgeting results have also shown that the internal control system of SLEC is not sufficient.

The limitations and weaknesses identified it is no doubt that whether the current internal control system is suited for SLEC.

1.3 Research objective and questions

1.3.1 Research objective

This paper’s research objective is to take Shuguang Lantian Education Company (SLEC) as a case study, through an analysis of the insufficiencies of SLEC's internal control systems, which are related to control activities and its control environment. Recommendations will be based upon the theories of internal control system and to enhance the control environment and control activities to be put in place at SLEC.

In order to achieve the research objective, the following research questions will be asked.

1.3.2 Main question:

“What improvements can be done in regards to the control environment and control activities of the Shuguang Lantian Education Company?”
1.3.3 Sub-questions:

Theoretical questions:
1. What is the framework of internal control system?
2. What is the key point when designing the internal control environment?
3. What are the categories of internal control activities?
4. What are the functions of the internal control activities’ categories?
5. What are the tools in using in company performance reviews?

Empirical questions:
1. What are the weaknesses of SLEC’s current control environment as regards to organizational structure?
2. What are the weaknesses of SLEC’s current control environment as regards to leadership style?
3. Does the current budgeting method work well in SLEC’s performance measurement?
4. Are the current performance indicators sufficient and effective in SLEC?
5. Are the finance employees’ duties separate and clear to meet the company internal control activities?

1.4 Blueprint of the research

Chapter 1
This chapter introduces the context of the research and the problem statement, followed by the research objective, research questions, and the blueprint of this research.

Chapter 2
In chapter 2, the theoretical framework will be discussed. Firstly, it will define the Committee of Sponsoring Organizations of the Treadway Commission (COSO) internal control framework, control environment and control activities in COSO framework. Then this chapter will present the method for making a budget, financial indicators and non-financial indicator as control activities in performance reviews, followed by the segregation of duties in control activities.

2. Organizational structure and leadership style of control environment in COSO Framework.
3. Performance reviews and segregation of duties of control activities in COSO Framework.

Chapter 3
The research methods will be explained in Chapter 3. The research strategy and research design will be illustrated at the beginning of this chapter, followed by the research methods that involved with the documentary review and structured interview.
In terms of documentary review, it focuses on the theoretical study and analysis of SLEC’s company financial statements. For the field research, interviews are conducted to help the research gather company data and information.

**Chapter 4**
Chapter 4 focuses on the introduction of SLEC’s control environment and control activities. By using the suitable research methodology, the findings of the field research will be presented in the company’s current control environment and control activities. In details, the organizational structure and leadership style are the two main points in control environment while the performance review methods and segregation of duties will be analyzed under control activities.

**Chapter 5**
This chapter is Discussion, which relates to the findings based on the problem definition; the problems that were identified in previous the chapters; and how to solve the problems and answer the research questions.

**Chapter 6**
This chapter is about the conclusion of this thesis and suggestions will be presented in this chapter.

**Chapter 7**
The researcher’s reflection about the research will be illustrated in this final chapter.

1.5 Summary

This chapter shows the general information about the problem of the target company: SLEC. With the current limitations and weaknesses to the company, it is questionable whether the current internal control system is suitable for SLEC.

Followed by the research objective of this thesis, it is important to analyze the insufficiencies and issue in the internal accounting control, system which relates to the control environment and control activities. In addition, the relevant factors that may provide negative effects to the internal accounting control will also be identified and researched.

In order to achieve the research objective, the main research question is “What improvements can be done in regards to the control environment and control activities of the Shuguang Lantian Education Company?”

Based on the main questions, the theoretical questions and empirical questions are established.
The blueprint of the thesis is introduced, which includes introduction, theoretical framework, research methodology, empirical framework, discussion, conclusion, and reflection. After introducing the background of this research, Chapter 2 will discuss the theory.
Chapter 2 Theoretical Framework

This chapter provides an overview of the theoretical framework and each theory and concepts that are used to support the theoretical questions. The readers could gain a clear understanding of the theoretical research. The theories and concepts start as an introduction and explanation, following with the motivation of each particular theory.

Firstly, section 2.1 describes the general introductions of the concept of COSO Framework.

The COSO Framework includes five components, which are the basic concepts for the case company SLEC.

Then section 2.2 will start with the concept of the control environment, which is broken down into two sub sections. First, the organization structure in section 2.2.1 will introduce the different kinds of organizational structure. Secondly, the concept of leadership will be introduced in section 2.2.2.

Followed by the section 2.3, it will illustrate the concept of control activities by performance reviews, budgeting discussed in section 2.3.2 while the performance indicators in section 2.3.3. Then the control activities by segregation of duties in section 2.4 will be analyzed one by one.

2.1 COSO Internal control framework

Internal control is a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories (Hayes, Dassen, Schilder, and Wallage, 2007):

- Effectiveness and efficiency of operations, relating to effective and efficient use of the entity's resources;
- Reliability of financial reporting, relating to preparation of reliable published financial statements;
- Compliance with applicable laws and regulations and safeguarding of assets against unauthorized acquisition, use or disposition.

The COSO Framework published in 1992 is regarded as the leading guidance for designing, implementing and conducting internal control and assessing its effectiveness. In the year of 2013, this Framework was updated and expected to help strengthen organizations design and improve then implementation of internal control in light of many changes in business and operating environments since the release of the original framework, broadening the application of internal control in addressing operations and reporting objectives, and clarify
the requirements for determining what constitutes effective internal control (Bodnar & Hopwood 2012).

Based on the definition of COSO, the internal control has five components (Fig.1), including:
1) The control environment;
2) Risk assessment;
3) Control activities;
4) Information and communication; and
5) Monitoring.

Motivation of using this theory

Imperfect and absent internal control systems are likely to counteract any positive effects that are inherent in SLEC. The internal control system should identify and manage the SLEC’s risks.

SLEC should have well-designed internal control system that can give reasonable assurance for SLEC’s internal control job. And to achieve the objectives in the following:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, relating to preparation of reliable published financial statements;
- Safeguarding of assets against unauthorized acquisition, use or disposition

Figure 1. COSO Model
Sourced by: The COSO Framework, 1992
2.2 Control environment

Control environment, a component of the internal control system, means the overall attitude, awareness, and actions of directors and management regarding the internal control system and the importance of the company (Hayes, R, et al, 2007).

“COSO report” (2003) defined that the control environment sets the tone of an organization, influencing the control consciousness of its people and so impacting the people’s actions. It is the foundation for all other components of internal control, providing discipline and structure.

Firstly, “ISA 315” describes a company’s organizational structure as being ‘the framework within which an entity’s activities for achieving its objectives are planned, executed, controlled and reviewed’. (International Standard on Audition 315, 2009) It means that the company’s organizational structure could be a guide to achieve company’s goals.

Secondly, Root (2010) described that a leadership's approach can have an influence on the productivity of her staff and the rest of the organization. Organizational efficiency is dependent on each department, led by its manager, performing its job and contributing to the success of the company. Thus the way in which a manager makes decisions, delegates’ responsibility and interacts with employees can affect the entire organization (COSO Framework, 2003).

The following sections will discuss these two factors in detailed.

2.2.1 Organizational structure

An organization’s structure is defined by the patterns of authority and responsibility that exists within the organization; and the formal organizational structure is often denoted by an organizational chart (Myers, 1996).

Myers (1996) claimed that organization chart helps company build and design the organization structure to meet the company’s objectives, and organization chart guide the employees to know their rights and responsibilities. It means that organization chart could make organizational structure clearly and transparency. Also it shows the relationships between the company’s staffs, and help separate the functions of the company clearly.

Divisional structure
Kinicki and Williams (2003) highlighted that the divisional structure is grouped by similarity of purpose. In a divisional structure, people with diverse occupational specialties are put together in formal groups by similar products or services, customers or clients, or geographic regions.
Then Kinicki and Williams (2003) explained that divisions work well because these structures allow a team to focus upon a single product or service, with a leadership structure that supports its major strategic objectives. Also, a division's focus allows it to build a common culture and esprit de corps that contributes both to higher morale and a better knowledge of the division's portfolio.

However, Gillikin (2005) claims that the divisional structure also has weaknesses. Divisions can bring compartmentalization that can lead to incompatibilities.

Hierarchical organization
A hierarchical organization is a group of entities structures to be subordinate to a central idea, person or group of persons. The person or department in charge sits as the top of the pyramid. Each department sits below the top in descending order of subordination. The flat bottom of the pyramid is filled with the bulk of the population of the organization. (Keuning, Bossink & Tjemkes, 2010)

Keuning, Bossink, and Tjemkes (2010) claimed that hierarchy organization usually are centralized, it is rely on one individual to make decisions and provide direction for the company. See Figure 2.

![Hierarchy Organizational Chart](chart.png)

**Figure 2. Hierarchy Organizational Chart**
Sourced by: Keuning, Bossink, & Tjemkes (2010)

Then Bianca (2008) claims that the hierarchical structure establishes clear lines of communication. Employees receive their policy directions and day-to-day assignments from their direct manager, who interprets orders from the top. This structure makes it easy to plan and implement business strategies.

On the contrary, Bianca (2008) defined a major disadvantage to the hierarchy is that it doesn't encourage people to collaborate and share information across the reporting structure.

Motivation of using this theory
The organization structure is a part of control environment, which will help reader
understanding company environment clearly and deeply. Meanwhile make a contribution to allow the better evaluate the company’s control environment.

2.2.2 Leadership style

Conger (1992) describes leaders as individuals who establish direction for a working group of individuals, who gain commitment from these group members to this direction, and who then motivate these members to achieve the direction’s outcomes. Thus the style of leadership will definitely influence the company environment and accomplishing the important tasks.

The two-leadership style will be explored in the following sections.

**Autocratic leadership**

Keuning, Bossink and Tjemkes (2010) claimed that an autocratic leadership typically allows for quick decisions making, and ignores the “how and why” the things happen.

The leader is concerned with their own power and status; however, it perhaps reduces the Chance to get the different opinions and suggestions from other people.

Hamilton (2007) claimed that autocratic or authoritarian leadership style is similar to the traditional organization model. Under the authoritarian leader, the team research a solution quickly, often makes a few errors, and gets more work accomplished than groups that get bogged down in detailed discussing. Also large groups often need an autocratic leader to maintain control.

In the organization, autocratic leaders often leave fear and mistrust in their wake. Others in the organization tend to protect their position and distrust other people’s ideas and motives (Hamilton, 2007). Everyone has her own sphere, and protects it at all costs. Communication tends to go in only one direction, up, as a result of which rumor can become the standard way of spreading news in the organization. Meanwhile, Nayab (2011) claimed that autocratic leadership is a classical leadership style marked by leaders having complete authority with leaders issuing commands without explaining the rationale, and followers obeying instructions of the leader without questioning.

**Democratic leadership**

Keuning, Bossink and Tjemkes (2010) defined that democratic leadership invites the participation of staff members and others, not only in decision-making, but also in shaping the organization's vision. It allows everyone to express opinions about how things should be done, and where the organization should go. By bringing in everyone's ideas, it enriches the organization's possibilities. But it still leaves the final decisions about what to do with those ideas in the hands of a single person. (Keuning, Bossink & Tjemkes, 2010)
Also, democratic leadership, with its emphasis on equal status, can encourage friendships and good relationships throughout the organization. (Keuning, Bossink & Tjemkes, 2010) It helps people feel valued and equal when their opinions are accepted, and even more so if those opinions are incorporated into a final decision or policy.

**Motivation of using this theory**

The leadership style is the part of the control environment in internal control. The style of SLEC’s leadership is reflected in both the nature of that organization and its relationships with the community. The leadership will effect on SLEC’s control environment and the people who working in SLEC.

### 2.3 Control activities by Performance reviews

Control activities, also a component of the internal control system, falls into five categories (Hayes, R, et al, 2007):

1) Performance reviews
2) Information processing: proper authorization of transitions and activities and General Controls;
3) Information: accuracy, adequate documents and records and application controls;
4) Physical control over assets and records;

However, the following research will only explain the details about the two categories chosen which are performance reviews and segregation of duties.

Performance reviews is a technology that provides an understanding of the company’s status of performance that reflects from the basic financial statements (Hayes, R, et al, 2007). Additionally, performance reviews are independent checks on performance by a third party with no direct involvement in the activity (Hayes, R, et al, 2007). This is sometimes called internal verification.

Also, performance reviews are accomplished by comparing actual results with prior-period performances (Bodnar & Hopwood, 2012). Comparisons between actual results for this year and last year’s results are comparing the same items actual expense for this year and last year.

Cardy and Leonard (2011) claims that performance review is a step involved in performance management. It contributes to company evaluate and review performance from various perspectives.

that performance management is a recurring cycle of activities that includes strategy setting, planning, budgeting, forecasting.

The performance management and measurement, budgeting and indicators both financial and non-financial will be explained in this section.

The next part will discuss performance management first.

### 2.3.1 Performance management and measurement

Cardy and Leonard (2011) defined that performance management can be a very broad domain and encompasses many functions and levels in an organization. When considering the entire process of performance management, it is clear that much more is involved than simply evaluation and feedback. For example, it shows that in a company performance management, the more employees attend to the process, the more feedbacks and suggestions will get from the participators.

In addition, Cardy and Leonard (2011) states that performance management that includes defining performance, diagnosis, evaluation, which refers to review, feedback, and improving performance. It means that setting the target is the first things, which the company would do with performance measurement. Then to judge, execute, review, evaluation and final get comments from the reality and improving in the future.

Similarly, Pollitt (2011) defined that performance measurement in finance and accounting is a tool to achieve the objectives of the resource management within which the budgeting and management activities of company take place. In other words, the performance review is a component or a method of performance management to help company allocate the resource and evaluate the actual performance.

Also, Campos and Pradhan (1996), and Schick (2001) mentioned that performance management including improving the efficient usage of company resource to achieve goods and service delivery succeed and maintain the fiscal discipline. That means the performance management ensure the company's resource allocation sufficient and regularly.

In detail, Merchant and Van der Stede (2007) in the book *Management Control System Performance Measurement, Evaluation and Incentives* mentioned that accounting based measure can be part of company performance management. Accounting based measure can be defined in either accounting profit measure (residual term), or the accounting return measure (ratio term). The accounting profit measure, for example, includes income, operating profit, or residual income. And the ratio measure for example return on assets, return on equity (Merchant & Van der Stede 2007).

It should be noted that accounting based measure has several advantages. First, Merchant and Van der Stede (2007) claimed that in a short time, accounting performance could
measure adequately and objectively. Second, accounting based measure matches the company’s goal which is to maximize profit and minimize the cost (Merchant & Van der Stede 2007).

**Motivation of using this theory**

In order to have an overview of SLEC’s performance measurement, it is necessary to understand the definition of performance management and measurement.

**2.3.2 Budgeting**

Budgeting is a component for company performance management. Merchant (1984) pointed that a budgeting system is a combination of information flows and administrative processes and procedures that is an integral part of the short-range planning and control system of an organization. That means if a company does not have a budget or a plan to help manager make decision or contribute to the profitability of the company. This will lead to managers having an unclear vision of the company’s business goals and objectives.

Libby and Lindsay (2003) mentioned that budgeting is aimed to facilitate responsibility distribution and is used to evaluate performance.

Redburn, Shea and Buss (2007) mentioned that budgeting is the annual process by which organizations estimate their resource needs and allocations for the future. Additionally, budgeting focuses on how performance measurement information can be used to assist budgeting formulation and review (Redburn, Shea and Buss, 2007).

Hansen (2003) and Samuelsson (1999) state, that when using the budgeting for performance evaluation, the conditions and circumstances must be stable in order to be capable set realistic targets.

Gustafsson and Parsson (2010) defined that budgeting is aimed to ensure that companies act in the best way in order to reach their goals. The planning purpose of budgeting is used to plan for instance sales, expense, and for financial issues. Thus the budgeting type will be the following section to discuss the content of budget.

**Budget content-Operating budget**

Penner (2004) defined that operating budget is an itemized summary of the revenues and expenses generated by a program department or services (operations). Operating budget is among the most frequently used reports for financial activities in company settings. It should be note that data summarized from the statistics budget are included as a line in many operating budgets and are used in many of the operating budget calculations.

Penner (2004) pointed out that two parts are involved in operating budget, which is operating
revenue budget and operating expense budget. In detail, operating expense budget includes all of the line items and their dollar estimated associated with the operating costs. That is to say, the operating expense cost represents the “expense” side of the company operating. The expenses are including company’s direct cost and indirect cost. For example, the housekeeping is indirect cost.

Then, operating revenue budget is the other part of operating budget. It is included service revenue and non-service revenue. Some companies set revenue as either gross or net. Gross revenue represents the total amount charged for goods and services before any reductions are applied. While net revenue represents an entity’s income minus cost of goods sold and service, expenses, interests and taxes for an accounting period (Penner, 2004).

After discuss the budget content, followed by will be the method of making a company budget.

**Budget method**

**Incremental budgeting**

Incremental budgeting is a tool for company performance reviews. Gruen (2005) defined that incremental budgeting is a traditional budgeting method, which is popular used approach to budget in both public and private sectors. Incremental budgeting evolved by taking the previous data as a starting point and concentration on adjusting the figures to reflect the changes in planned activities levels and in costs and prices between the two years. This involved taking into account any change in planned activity as the level of inflation and projected pay rises.

Meanwhile, Riley (2012) concluded that incremental budgeting method prepared using a previous period’s budget or actual performance as a basis with incremental amounts added for the new budget period. The allocation of capital and resources are according to allocations from the previous period.

In depth, the characteristics of incremental budgeting are explain in the following paragraphs. Gruen (2005) pointed out that first, it is a sample method, widely used in public and private company, simple to understand by user and calculate the result. Then the incremental budgeting method does not require much time to complete the budget. Third, this method can also be used when company income increase at a marginal rate.

To the contrary, Gruen (2005) concluded that if the previous year’s data is incorrect, and then the simply adding to the previous year’s data would be insufficient. Another drawback is that this method is actually encourage manager to adopt a “use it “attitude. It is because the budget is there; manager could spend money until the end of year.

In conclusion, the incremental budget method is based on the assumption that the existing level of revenue and expenditure is correct. However, in fact the assumption of company’s
business activities may be exceed or underestimated.

**Top-Down budgeting**

Top-down budgeting is a tool used in company performance reviews. Top-Down budgeting is the term given to a budgeting process based on estimation the cost of higher level tasks first and using these estimated to constrain the estimated for lower level tasks (Ljungman, 2009).

Also, Kinney and Raiborn (2012) defined that top-down budgeting can called imposed budgeting, which the top management prepares with little or no input from operational personnel. That means the top manager level does the top-down budgeting method, and the data and information passes from the top to the bottom in the company budgeting work.

In addition, the features of top-down budgeting method will be mention in the following part. Florin (2011) discussed that top down budgeting could be an efficient process, that manager allocate resources and budget to each stage of the project. However, it could be an ineffective method because by using this method, it is necessary that a manager have accounting and financial experience. It should be notice that only the members of management team and manager are sufficiently trained and fully experience, the top-down budgeting could be effective and sufficient. Drury (2004) also claims that top down budgeting can lead to negative attitudes among workers.

By analyzing the financial indicators and non-financial indicators, the budgeting results and the company’s performance would be evaluated.

**Motivation of using this theory**

In order to help SLEC control performance, understand the current budget method of SLEC evolved in SLEC’s performance reviews, assess expense improvement or deterioration, finalized the weakness of SLEC’s performance reviews. Therefore shortfall in SLEC’s budgeting methodology could be identified, as these could indicate accounting information errors and ineffective internal control activities.

**2.3.3 Performance indicators**

Milost (2000) claimed that performance ratios can be defined in a narrow or broad sense. In a broad sense they include absolute and relative figures, in a narrow sense, they include only relative figures. An absolute figure can be a particular figure, difference or mean value while relative figures are: participation rate, index and coefficient.

Milost (2000) mentioned that performance ratios can be subdivided into financial and non-financial. The two kinds of indicators will discuss in the following parts.
Financial indicators
Kaplan (2000) claims that it is important to monitor financial performance, for instance profitability ratios to measure the company profit in the fiscal year. Gitman (2012) defined the financial indicator analysis is a term, which involves methods of calculating and interpreting financial ratios to control, and review the firm’s performance. Then Gitman (2012) mentioned that the net profit margin is a term, which measures the percentage of each sales dollar remaining after all cost and expenses, including interest, taxes, and preferred stock dividends have been deducted; the “pure profits” earned on each sales dollar. The formula describes as follows: net profit margin = net profits / sales. It indicated that the higher operating profit margin is preferred. Meanwhile,

Annual growth rate is a common rate to evaluate growth, which means the annual growth of a company's revenues, earnings, cost and expense. It is take the previous year as the basic for expressing percentage change from one year to the next (Farris, Bendle, Pfeifer & Reibstein, 2010).

In addition, Ministry of Education (2012) mentioned operating surplus measures company's performance. The operating surplus is calculated as the difference between total revenue and total expenditure. In general, schools should have a small surplus each year to have sufficient reserves available to provide for any unexpected expenditure. According to Ministry of Education (2012), operating surplus for multiple consecutive years indicates sound financial management but schools can report an operating deficit in one year due to unexpected or unforeseen expenditure.

Pandey (2009) defined that the operation expense ratio is a term, which means the rate of expense to the revenue. It is calculated that the company’s expenses divided by the company’s gross operating revenue. The manager using this ratio in performance measurements could compare each expense through payroll, insurance and to revenues.

Another indicator is the budgeting variance. It is accomplished by the variance between actual results with prior-period performances (Bodnar & Hopwood, 2012).

Non-financial indicators
Chow and Van Derstede (2006) pointed out that the non-financial indicators usually measures company performance from three perspectives, internal operating measures, employee-oriented measures and customer-oriented measures.

Meanwhile, Kaplan (2000) claims that Non-financial performance indicators (NFPIs) will reflect the long-term viability and health of the organization. The management of human resources is one of the areas that particularly important for ensuring the success of a business and where the use of NFPIs plays a key role (i.e. staff turnover).

Wua, Lin, and Chang (2011) mentioned that they introduce some performance indices on the non-financial perspective in the education centers. From the customer perspective, one is
customer satisfaction, related to the satisfaction of customers to products and services. The other is expanding of new customers, related to the increasing of new customers. From the employee perspective, the employee turnover should be taken into consideration. Basu (2010) defined that the annual employee turnover rate is the ratio of total separations to the average number of employees; it includes retirements, resignations, dismissals and layoffs. Also Basu (2010) claims that turnover rates may affect profitability and staff morale.

In conclusion, Milost (2000) mentioned that by using financial indicators, company compare value-expressed amount, while non-financial ratios are descriptive. Financial ratios can be expressed as absolute and relative figures; on the other hand, non-financial ratios are expressed as absolute (e.g. customer satisfaction) or relative.

**Motivation of using this theory**

The purpose of financial and non-financial indicators analysis is focused on the accounting performance and nonfinancial performance of the company. By understanding the meanings of different indicators, it could provide a guide to evaluate SLEC’s performance in both financial and nonfinancial perspective.

**2.4 Control activities by Segregation of duties**

The other category of control activity is segregation of duties where, Hayes, Dassen, Schilder and Wallage (2005) points out that in the principle of the auditor, segregation of duties seeks to prevent persons with access to readily realizable assets from being able to adjust the records that record and thereby control those assets. Duties are divided, or segregated, among different people to reduce the risks of error or inappropriate actions (Hayes, Dassen, Schilder and Wallage, 2005). A key measure in segregation of duties is to ensure that no single transaction or chains of transactions are in the hands of a single person (Hayes, Dassen, Schilder and Wallage, 2005).

A transaction or chain of transactions may often involve many different tasks. By assigning these tasks to different people, recipients will reduce the risk of individuals being in a position to commit fraud or conceal errors in the normal course of their duties (European Commission, 2008).

Hayes, Dassen, Schilder and Wallage (2005) mentions that segregation of duties entails three fundamental functions that must be separated and adequately supervised:

1) Authorization is the delegation of initiation of transactions and obligations on the company’s behalf.
2) Custody is physical control over assets or records.
3) Recording is the creation of documentary evidence of a transaction and its entry into the accounting records.
**Motivation of using this theory**

In order to finalize the SLEC’s finance employees’ duties, the company should assign and delegate responsibilities for related activities to different individuals. Therefore, a clear segregation of duties could be identified and the responsibility for record keeping for assets should be separated from the physical custody of assets.

**2.5 Answer the theoretical question**

The theoretical questions will be answered first; the theory application to chapter 4 and 5 will be following.

1. **What is the framework of internal control system?**
   There are five components in internal control system, which are control environment, risk assessment, control activities, information and communication motoring (COSO, 2013). The purpose of internal control system is obtained the target company’s the objectives: effectiveness and efficiency of operations; reliability of financial reporting, relating to preparation of reliable published financial statements; and safeguarding of assets against unauthorized acquisition, use or disposition

**Application of this theory**
Internal control systems are the basis of the thesis and sponsor company, SLEC. The objective are effectiveness and efficiency of operations; reliability of financial reporting; compliance with laws and regulations. SLEC internal control goal is to obtain the reliable information, which will guide to the company decision-making and measure performance. Meanwhile SLEC need the relative policy and regulation to standardize the employee’s duties.

2. **What is the key point when designing the internal control environment?**
   Control environment focus on the overall attitude, awareness, and actions of directors and management regarding the internal control system and its importance in the entity. It is the foundation for all other components of internal control, providing discipline and structure (COSO, 1992).

   The main factors in designing the internal control environment are organization structure and leadership style. Leadership's approach can have an influence on the productivity of her staff and the rest of the organization (Conger, 1992).

**Application of this theory**
The clear organizational structure helps the researcher understand company environment totally and deeply. Meanwhile make a contribution to better evaluate the company’s control environment.
The style of SLEC’s leadership is reflected in both the nature of that organization and its relationships with the community. The leadership will effect on SLEC’s control environment and the people working in SLEC.

3. **What are the categories of internal control activities?**
Control activities ensure that necessary actions are taken to address risks to the achievement of the entity’s objectives for operations, financial reporting, or compliance. The two categories of internal control activities are performance reviews and segregation of duties.

**Application of this theory**
Performance reviews ensure the control activities can be preventive and detective. With understand the content and the method of SLEC’s budgeting, and the means of financial indicator and non-financial indicator, the performance review of SLEC would be more effective and functioned well. Segregation of duties can make sure that SLEC’s assets safety, information and data prepared timely and correct.

4. **What are the functions of the internal control activities’ categories?**
Performance reviews provides an understanding of company’s status of performance, which reflected from the basic financial statements and assess performance improvement or deterioration (Merchant & Van der Stede, 2007).

Segregation of duties seeks to prevent persons with access to readily realizable assets from being able to adjust the records that record and thereby control those assets. The authorization of access the assets, custody the realized assets and the recording must be separated (Hayes, Dassen, Schilder & Wallage, 2005).

**Application of this theory**
Cleary segregation of duties is the main factor that ensures the company’s real assets are safe and makes the accurate information and data timely. Meanwhile, the adequate segregation of duties could be one aspect on improve SLEC’s internal control system.

5. **What are the tools in using in company performance reviews?**
Two main tools are using in company performance reviews. One is making budget, the other is introduce financial indicator and non-financial indicator to evaluate the performance.

**Application of this theory**
The current budgeting method should be identified for SLEC, the means of both financial and non-financial indicator should be understand, and the advantage and disadvantage of the method could be understood in order to figure out the weakness and insufficient parts in company’s performance measurement.
2.6 Summary

The purpose of this chapter provides the theoretical explanation about the company internal control system.

This chapter illustrates the theories and concept, which relate to the thesis. First, COSO framework is the basic concept of this thesis and to ensure effective and efficient internal control system is the main objective of the framework. The organization structure and leadership are the two factors involved in the control environment since these are the background of the target company.

Followed by is the control activity, performance management is the main issue in this section. Performance management contributes to the company evaluation and reviews of performance from various perspectives. In depth, budget and indicators are two tools served in company performance management. The content and method of budgeting and the means of both financial and non-financial indicator, are discussed under the performance review. Suitable budget method and the systemic review indicators are a way to guarantee the effectiveness and efficiency of the internal control system.

Third, the segregation of duties discussed as another factor in control activities. To ensure the employees’ duties are clear is a way to improve company performance and enhance internal controls.

The theoretical questions were answered in the last part. All the theories and concepts introduced in this chapter will be used to conduct the analysis, discussion, conclusion and recommendations in chapter 4, 5 and 6.
Chapter 3 Methodology

This chapter aims to clearly illustrate the research methods that will be applied for achievement the final objective.

The overall research strategy is introduced in (section 3.1) showing the case study; research methods are documentary research and field research. The four phases involved in research design (section 3.2) that will are the roadmap of this research will be explained and shown.

An overview of key research methods will look at the documentary review and structured interview methods that are the two research methods (section 3.3) in this thesis. The research material (section 3.4) will detail the primary data and secondary data collection and how it will be collected though interview and documentary review.

3.1 Research strategy

The case study is a kind of research strategy, which refers to the researcher, could obtain the full view of a single or several objects or processes in the limited time and space (Piet, Hans, Poper, & Mellion, 2010). The object could be a group, a company or an organization. The process could be business working process, a decision making process or a choice of location (Piet, Hans, Poper, & Mellion, 2010).

Case study is widely accepted methodology used to understand the function and situation of internal accounting control in some small-medium size company.

This study is based on the combination of theory analysis and sample research based on a single case study, through understanding the type and scale of the company, environment and background, analysis the company current accounting situation, cash management policy, to achieve research objectives and to answer the research questions.

3.2 Research design

The research design is illustrated in both graphical figures and in text in this section. The illustration presents the research steps to show how the general idea of the thesis’s whole research process will proceed. The text explains each phase clearly.
Phase 1: The first stage refers to chapter 2, the theoretical framework; this research is uses literature of internal control system to establish the understanding for both the researcher and reader. The COSO framework aims to finalize the current internal control system of SLEC, the Control environment and control activities aim to illustrate the suitable theory which can be used in the company internal control system and to understand flawed control environments. Key points of control environment will be illustrating in order to analyze the current environment in SLEC. Factors of control activities will be used to figure out the SLEC’s current control activities. And the financial indicator is used to analyze the growth rate of the expense.

Phase 2: This phase refers to chapter 3 and chapter 4, the research method. It is about collecting data and information. In this research, SLEC’s status of control environment was conducted through interviews and control activities about performance management and segregation of duties were collected by interview and documentary research.
Phase 3: Refers to Chapter 4 and Chapter 5, though the analysis the information and data collected by interview and documentary. The deficiency of SLEC control environment and control activities will be illustrated in the phase 3.

Phase 4: This is the last phase of this research, Chapter 6. Based on the deficiency found in phase 3, the recommendation will be given. The recommendations will help SLEC improve the insufficiency of control environment and control activities, and further enhance the internal control system.

3.3 Research methods

This paper will mainly use the documentary research and interview as research methods.

Documentary review
Documentary review is the use of outside sources, documents, to support the viewpoint or argument of an academic work (Piet, Hans, Poper, & Mellion, 2010).

The process of documentary research often involves some or all of conceptualizing, using and assessing documents. The analysis of the documents in documentary research would be either quantitative and/or qualitative analysis. The key issues surrounding are types of documents and our ability to use them as reliable sources of evidence on the social world, which must be considered by all who use documents in their research.

In this research paper, documentary research will focus on two parts; one is the literature review, COSO framework, the method for making a budget, relevant performance indicators for company performance reviews, the other is reviewing the sponsor company’s financial statement.

Meanwhile, the useful information needs to be collected from books and magazines. Some secondary data could be collected from the Internet; RBS school database, and official websites.

Structured interview
Structured Interviews involves formally recruiting a researcher to conducting an interview (Piet, Hans, Poper, & Mellion, 2010).

Before the interview, a list of predetermined questions is written, also known as an interview guide, which is devised so that each interviewee will respond to a similar series of questions. Structured interview can capture data and information, though the interviewee systematically

In this research paper, interviewees and their positions are listed as follows:
- One company financial manager, (Mrs. Yurong He),
- Three accountants (Mrs. Lijuan Zhang and Ms. Xiaowei Zhang and Ms. Fengxia Li),
- Three cashiers (Ms. Xiaonan Chen, Ms. Zonghua Zhang and Ms. Li Wang).
Company internal control, accounting information will be obtained through interviewing accountant, cashier and financial manager. Information and data included their comments about SLEC’s internal control, staff duties, and method of company performance review.

3.4 Research material

This research will use the primary data and secondary data as the main research material.

Primary data is the raw information before the processing is done. It mainly consists of numerical collections of raw information to be analyzed and evaluated (Piet, Hans, Poper, & Mellion, 2010). In this paper, researcher gets the primary data through observation. Like what is cash amount the company will receive at the beginning of the month.

Secondary data is another form of data compared with the primary data. Secondary data is collecting and possibly processing data by people other than the researcher in question (Piet, Hans, Poper, & Mellion, 2010). It is a kind of data which is collected by others but not researcher. For instance, company background, company financial statement. Those data will be the secondary data in this paper.

3.5 Chapter summary

For the purpose the answering the empirical questions, this research would introduce the case study as a research strategy. Research methods would be documentary research and field research.

Though documentary review, company background, historical data and information, company performance were obtained

By field research, employees’ comments about internal control system, SLEC’s organization structure, leadership style and current control activities were found

Research materials are primary data and secondary data. General information and data of description in SLEC will be the first and foremost a task in chapter 4 which is the following chapter.
Chapter 4 Research findings

This chapter is the research findings section.

First, section 4.1 illustrates the company's background information, the main business and the company's goal.

In section 4.2, the research methods are introduced which include interviews and documentary. Seven interviews are conducted in the research paper to aid in the collection of information and data based on two aspects, namely the control environment and control activities. The documentary review is the focus of SLEC’s financial statement.

The section 4.3 outlines the outcomes of interviews research. It is a summary about the seven interviews under these headlines: (1) background of interviewees, (2) attitude of SLEC’s internal control system, (3) SLEC’s organizational structure, (4) SLEC’s leadership style, (5) SLEC’s budget, (6) SLEC’s performance indicators and (7) SLEC’s segregation of duties.

Section 4.4 demonstrated the control environment in SLEC, which included organizational structure, section 4.4.1 and leadership style 4.4.2.

Then in section 4.5, performance management and measurement, illustrates the current budgeting method and the performance indicators in SLEC, while section 4.6 explain employees’ segregation of duties. The problems will be illustrated at the end of each section.

Section 4.7 will summarize Chapter 4 research findings.

4.1. Company background

Shuguang Lantian Education Company (SLEC) is a famous private company, which is located in Handan, Hebei province, China. It was founded in 2002. After 12 years of development, it has built up its own infrastructure from scratch. Currently, the company has more than 200 employees and approximately 2000 students. The core business of this private company is provision of preschool education.

Company general environment is that a GM is in charge of controlling the company's internal environment. She is also responsible for the direction that the company takes in terms of development and establishing of a holistic development of the strategic plan. The finance department is responsible for the company's financial management and custody assets.

The company's mission is to provide education services which including Chinese, English, mathematics, arts, dancing and computer teaching to parents and children. In order to
research the mission better and provide more convenience to parents and children, SLEC has expanded its capital to update the teaching model, teaching equipment and the supporting facilities like the multimedia instruction, create parenting class, cooperate with the Red-Yellow-Blue (RYB) education institution and provide shuttle bus to customers.

Meanwhile, the company would like to improve its internal control system in order to reach the business goal, which is to maximize the company's profit and minimize costs, and to make sure that effective, and efficient internal control systems are put into place.

SLEC has become one of the largest scale, highest level and the most considerate service private kindergarten. It has also captured a decent market share in the preschool education market in Handan city.

4.2 Methods

In order to obtain relevant information about this company, documentary review and interviews were conducted in this research. Documentary research involves the review of SLEC’s financial statements, while the interviews were conducted with seven employees who work in three divisions of SLEC’s financial department.

4.2.1 Documentary review

In this case study, several company documents were reviewed with the aim of understanding the company's history and financial situation.

The reviewed documents include Profit and Loss Statement, Articles of Association and public company profiles.

4.2.2 Structured interviews

Structured interviews were conducted with the manager and staffs from financial departments in SLEC and the interviewee’s information is listed in Table 1.

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Education</th>
<th>Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yurong He</td>
<td>Financial manager of SLEC</td>
<td>Bachelor</td>
<td>53</td>
</tr>
<tr>
<td>Xiaowei Zhang</td>
<td>Division A Accountant</td>
<td>Bachelor</td>
<td>28</td>
</tr>
<tr>
<td>Li Wang</td>
<td>Division A Cashier</td>
<td>Bachelor</td>
<td>26</td>
</tr>
<tr>
<td>Fengxia Li</td>
<td>Division B Accountant</td>
<td>College diploma</td>
<td>33</td>
</tr>
<tr>
<td>Zonghua Zhang</td>
<td>Division B Cashier</td>
<td>College diploma</td>
<td>36</td>
</tr>
<tr>
<td>Lijuan Zhang</td>
<td>Division C Accountant</td>
<td>College diploma</td>
<td>43</td>
</tr>
<tr>
<td>Xiaonan Chen</td>
<td>Division C Cashier</td>
<td>College diploma</td>
<td>26</td>
</tr>
</tbody>
</table>
The selected interviewees came from three levels in the financial departments in order to ensure that the opinions and comments are independent. The interviewees’ had at least two years of working experience related to accounting.

The structured interviews with the finance staffs at SLEC aimed to fulfill four requirements.

First aspect is collecting the background information of the interviewee, since the interviewee’s background and ability would influence the quality of the interview result, thus the background information must be collected first.

Second, the interviewees’ attitude to the current internal control at SLEC, the effectiveness and appreciation were asked in this part since the thesis focuses on enhancing SLEC’s internal control. Whether the internal control in SLEC is effective and efficient would be judged in this part.

Third aspect is based on interviewees’ attitude and comments in SLEC’s control environment, including company structure and leadership style, explored the weakness of control environment.

Last part designed to get the information about control activities in SLEC. Company’s performance measurement is the main point in this part. All the interview questions are listed in the appendix.

4.3 Outcome of interview research

This section introduces the outcome of interview research. It is a summary of the seven interviews. All the interview questions and transcript will be included in the appendix.

4.3.1 Background of interviewees

In this research, the interview is the main approach to obtaining background information of the interviewees. The background information of interviewee includes job position, education level, work experience and age.

In total, seven interviewees took part in the study. Three of them have a Bachelor degree while the other four have junior college diploma. Financial manager and three accountants hold the Certification of Accounting Professional. The education level of SLEC’s interviewees means they are fully qualified academic staff.

The age of the interviewees ranges from 26 to 50 years. Three of them are in the age bracket between 26-30 years old; followed by the ages of 31-40 (2 persons); 41-50 years old (1 person); and above 50 years old (1 person).
All the seven interviewees have been working at SLEC for more than three years. The financial manager has eight years of working experience at SLEC, while the three accountants joined SLEC five years ago.

4.3.2 Attitude in SLEC’s internal control system

The interviewees mentioned that the current internal control system is not well designed. They are not satisfied with the current internal control.

Firstly, because of the authority of managing company belongs to General Manager, some interviewees think the current company management is not good. It has not only led to employee complaints, but also brings some trouble to teacher in the teaching activities.

Secondly, some interviewees reflected that the company’s expense should be managed and controlled since the General Manager control the company and do not hear from the bottom frequently, that lead to the waste of company’s resource.

In concluded, interviewees do not think the current internal control in SLEC is good.

4.3.3 SLEC’s Organizational Structure

SLEC’s do not have a visible organization chart, and employees are lack of the awareness of their exact position in the organization structure. The top management sets the company’s goal and policies.

Basically, three divisions make up the SLEC, and financial department and the administration office as the bridge for divisions and top management to change and communicate the opinions and suggestions. Also, each division has one chief administrator to hold the daily teaching activities and customer service. The company’s goal and policies set by top management.

4.3.4 SLEC’s Leadership style

Most of the company’s purchasing activities are centralized, which lead to General Manager without considering the practical situation of sub-department and employees’ opinions. General Manager selects the new teaching equipment and materials for each division at the beginning of the each semester, then ask financial department do the payment. After the new equipment delivery and set up by staffs, the teachers in each division are the final users.

However, when it comes to the end of the semester, parts of the materials are no longer relevant to the teaching. As a result, that lead to large portions of the purchased teaching equipment is rendered useless. Thus, the interviewees reflected some negative comments about SLEC’s leadership style.
4.3.5 SLEC’s Performance measurement and Budgeting

Since the GM controls the company’s expense activities, the interviewees thought the control activities in SLEC’s expense process are not effective enough and performance measurement at SLEC is not well designed.

Although, the company's annual target set by the General Manager, and annual budgeting is completed by the financial manager under the requirement of General Manager. During the budget making process, the division’s staffs do not participate in budgeting work. Thus the budgeting execution may not work well, and the annual budgeting in each division did not play the crucial role in divisions’ operating work.

4.3.6 SLEC’s Performance indicators

The performance reviews are completed by the financial manager at the end of each year and as performance indicators act as a tool for the financial manager to help evaluate the company’s performance. However, interviewees thought the current performance indicators are not enough to reflect the company’s performance; the budgeting review has few performance indicators and cannot therefore fully mirror the company's performance and provide valid comments and suggestion for improving performance.

Also, interviewees expect to introduce some indicators to evaluate the profitability and customer satisfaction in order to substantially improve the performance and enhance the internal control.

4.3.7 SLEC’s Segregation of duties

Interviewees introduced their duties in the daily work. As a cashier in SLEC, the job duties include handing the company cash transaction, payment of expense, receive cash payment from customer, make relevant receipt about cash receiving, custody the assets, handling the assets transaction and customer service. While the accountant's job judies is collating accounting documents and report division’s accounting information to financial manager daily or weekly.

And the financial manager in SLEC responsible for making the annual budget for company, managing financial staffs' work, receiving information and problem from divisions and make a solution and suggestion for the problem. Also transact to general manager.

In short, the current internal control system at SLEC is not effective. SLEC’s organization structure is clear and written policies and internal operating procedures that have been approved by the top management. The organization’s operations centralized. The
management uses indicators to review the company’s performance but this is not effective. The periodic reports on the status of actual to budget performance are not prepared and reviewed by top management.

In other words, the interviewees reflect some problems currently at SLEC:

- Currently the company’s management has brought on negative changes to its internal controls, which have lead employees’ to complain and influence company morale.
- Company’s performance reviews are not favorable because the GM has set a target setting process and without regard to employees opinions and suggestions.
- The current indicators used at SLEC are not comprehensive measurements that contribute to the company’s performance. Meanwhile, the interviewees have suggested that new and additional financial indicators should be added to help enhance the company’s internal control system.

**4.4 Control environment**

This section aims to present the current control environment in SLEC. There are two factors will present in this section which are organizational structure and the leadership style. The organization structure will be the first part while the leadership style is the second part.

**4.4.1 Organizational structure**

The SLEC’s organizational structure provides the overall framework for planning, directing, and controlling operations. However, at this time, based on the review the company profile, SLEC does not have a transparent organizational chart that the organization shares.

Therefore, after the interviews, SLEC’s organizational structure is described as follows.

SLEC has three divisions, which is located in a different area in Handan city. The three divisions represented by Division A, B and C in this thesis. General Manager typically oversees and directs the SLEC’s operations. Followed by administration office and finance department, then the Division A, B and C are parallels in the bottom level.

The finance department is charged with the responsibility of collecting the company’s business activities, revenue and expenditure data and analysis, reporting to the GM on a regular basis and managing the company’s existing assets. Also, the finance department is involved in the process of budgeting making based on the company’s goal set by the GM.

In SLEC, the three divisions (A, B, and C) under the GM’s control provide services to customers that include teaching activities, serving foods and necessary medical services.
Meanwhile, interviewees responded that SLEC has an organization structure and is defined in terms of lines of authority and responsibility, and established consider to its nature of its activities. The GM owns the authority to control the company and making decisions. Orders are passed from the top to bottom.

Thus, SLEC establishes appropriate lines of reporting relationship. The bottom level management receives orders and decisions from the top management. The finance department is a bridge that connects the bottom and top management. In addition, the interviewees mentioned that the GM sets the internal control policy at SLEC and they are familiar with the policies.

In other word, the employees in SLEC have the knowledge of internal controls and are familiar with the internal control policies set by company managements. The management authority is centralized in the General Manager.

4.4.2 Leadership style

SLEC’s Leadership style has a significant influence on the control environment. The management style in SLEC creates an atmosphere that is conductive for the effective operation of internal control (COSO Framework, 2003).

Through the interview with financial manager Mrs. He and other financial employees, SLEC’s leadership style can be explained as follows.

In SLEC, management decisions are ultimately controlled by a dominant individual or group of individuals, which is typically upper management, or in SLEC’s case, the General Manager (Conger, 1992). The GM decides the company’s operational direction and the rest of the departments in SLEC will also receive the decisions from upper management. In the end, the GM always makes the final decision about company investments, human resource policies, employee’s job responsibilities and purchasing orders, while the rest of the individuals and/or departments do not have any authority to participate in the decision making process.

The interviewees responded that they are not satisfied with the current management style. First, most parts of the company’s activities are centralized and the GM does not consider the practical situation of each division. Second, there is no doubt that the GM owns the authority of operating company, but the GM always makes quick decisions and without considering the current service demands such as teaching activities.

After receiving the response and feedbacks from SLEC’s employees, the researcher has provided a sample illustration of the company’s leadership style to include the tasks of completing and of purchasing teaching equipment and facilities. See Figure 4.
From Figure 4, the current decision-making is as follows: GM will make a final decision and the departments of SLEC departments are rarely trusted with decisions or important tasks.

All the departments from the top-down management execute the tasks. The figure shows that the main tasks are given to the Finance department and Division A, B and C will receive the final distribution (i.e. equipment).

The GM has the authority to make the decision about selecting and purchasing teaching equipment. The GM is in charge of the process of selecting items and contacting suppliers independently without consulting the other department members and without taking into consideration the status of using the equipment by the teachers.

Then the finance department executes the task of purchasing equipment and then completing the payment. After the equipments have been delivered to Division A, B and C, the employees are responsible for setting up, and finally used by teachers.

Based on illustration of the leadership style at SLEC, the following problems are explored:

First, the interviewees complained about this equipment because it caused problems both with teachers' morale and productivity in the long term. Some teachers reflect that the new teaching equipment does not meet the teaching demand and standards. Other teachers do not receive the benefit from the new equipment due to lack of related skills, which have led to the lower equipment utilization rate and the waste of resources.

Second, the example shows that the GM sets procedures unilaterally and in the process;
takes no account of considerations from other group members' suggestions and opinions. The General Manager makes a personal and quick decision which is evidence of an autocratic leadership style (Keuning, Bossink, & Tjemkes, 2010).

4.5 Performance management and measurement

This section aims to finalize the current SLEC’s performance management, which includes the budgeting and performance indicators. Based on the interview with employees, the performance measurement in SLEC includes three steps.

First is performance planning and setting the targets, which are the basic steps of the company’s performance measurement and to making the company budget. Here the General Manager sets the targets.

Second is making the budget, which is done by the financial manager, based on the company’s historical data and reviewing the performance, which is the comparison work in performance measurement.

Third is performance evaluation, which refers to evaluating the actual results in the year. The evaluation aims to find a variety of results compared to the previous year and it focuses on the accounting data such as the company’s costs and profits.

After explaining the general steps of performance measurement in SLEC, the details about budgeting and performance indicators will be the following sections.

4.5.1 Budgeting

SLEC’s budgeting is a part of performance management and measure and is influenced by the company’s organizational structure and the leadership style. The following will introduce the current SLEC’s budgeting process based on the document reviews and interviews.

Based on the interview with SLEC’s staff, Mrs. He pointed out that the purpose of budgeting at SLEC is to forecast the company’s revenue and expenses in the next year. The company’s owner and the financial manager need to be able to predict whether the business will make a profit or not. Budgeting at SLEC is also a financial framework for making decisions in the next year. Meanwhile, SLEC make use of both financial indicator and non-financial indicator as a performance review tool to enable the actual business performance to be measured against the forecasted business performance. Thus the budgeting is a way to provide how the company performs in a given period of time.
In detail, SLEC makes a budget once a year in August because of the new academic year starting in September of each year. Hence, the budgeting work must be completed before the term begins.

First, the GM sets the next academic year targets since she owns the authority to control the company. Normally targets are aimed by SLEC as a whole and then the GM makes the targets for the whole company.

Then the targets are passed to the financial department. SLEC’s financial manager receives the target from General Manager and makes the annual budget. Also the financial manager does not make the budget based on each division, but on the company as a whole.

After the annual budgeting is completed, the financial manager allocates the resource based on the proportion of each division occupied by the whole company.

At the end of each academic year, the financial manager evaluates the result variance between current year and the previous year.

**Budgeting content**
Budgeting at SLEC summarizes the activities in the company’s operations. According to the documents reviews, there are two parts involved in SLEC’s budgeting: revenue budget and expenditure budget.

Firstly, the revenue budget aims to predict the revenue in the next semester. Because all of the company’s revenue comes from customers, the number of students is a part of revenue budgeting. SLEC’s revenue is set as gross revenue, which is the amount customers actually pay to SLEC when they make their purchase in one year. The company’s revenue consists of three parts: tuition fee, accommodation fee and meal fee. All the revenue comes from customers and they pay them once a year.

Then the expense budget, which represents the expense parts of company operation, includes the employee’s salary, teaching equipment, food material, office stuff, repairing and rental.

Last is the gross profit, which is the difference between revenue budget and expense budget. It is an approximate amount about the company’s profit in the next year.

Based on the operating budget concept, Penner (2004) mentions that SLEC’s current budget is the operating budget for the whole company. It includes the revenue budget and expense budget. The revenue budget involves all of SLEC’s revenue and expense in consideration of the direct cost and indirect cost.

**Budgeting method**
The following table 2 illustrates the method of SLEC making budget.
The method of making the revenue budget at SLEC involves first setting the goal of the number of students in the next semester. Normally, the General Manager sets the total number of students in the next year as a target. The target is based on the current data and a specific percentage is then added. The added percentage is the three-year average growth.

Thus, the forecasted number of students at SLEC in the next year is the sum of students in the three divisions.

Tuition fee, accommodation fee and meal fee are maintained the same as last year. Thus, the forecasted total revenue is equal to the total number of student times the tuition fee, accommodation fee, and meal fee per student.

The method of preparing the expenditure budget at SLEC is similar as revenue budget, based on the historical data to make the forecast. First, set a goal of the total cost in the next year. Using the actual total cost in the current year, adds a percentage, which is the three-year average growth, and then calculates the forecasted total cost. After that, with the proportion of each expense occupied the total cost in the current year, decide on the forecasted amount in the next year.

### 4.5.2 Performance indicators

The performance indicators used in SLEC’s performance management as a tool to mirror the company’s performance during the fiscal year. Two types of indicators involved in this section, which are financial indicator and non-financial indicator. Financial indicator presents the information from the SLEC’s financial statement while the non-financial indicator presents reflect the health of the organization from non-financial aspect.
The following Figure 5 shows the current performance indicators in SLEC’s performance measurement.

**Figure 5. Current Performance indicators at SLEC**
Sourced by author

**Financial indicators**
In order to measure the SLEC’s performance regularly, the financial manager uses some financial indicators to evaluate the company’s performance.

First is the growth rate, which includes the annual growth rate and the annual growth rate for the company’s expense. The financial manager uses the growth rate to calculate the growth of company’s expense annually. It compares the current expense result to the same item in the previous year and is shown in percentage. The growth rate includes the salary growth rate, office stuff growth rate, repair growth rate, and teaching equipment growth rate.

Second is the rate of expenses to the total cost. SLEC calculates the percentage of using the each expense item divided by total cost. The rate is as a reference for the financial manager to decide on the next year’s budget.

Third, the gross profit margin is another financial indicator, which used in current SLEC’s performance measurement. Put simply, the gross the profit margin in SLCE is calculated by subtracting the company expense from total revenue and dividing the number of total revenue.

The above are the current financial indicators involved in the current SLEC’s performance measurement. These indicators can provide the difference and increase or decrease tendency for SLEC’s expense and profit. First, the growth rate represents the growth speed
for the company’s expenses. Then the proportion shows the structure of the company’s expense, which may help SLEC figure out the largest items in expense. And in the next year’s budget, the rate considered as a standard to set the amount of expense. Lastly, those indicators present the company’s development ability, which means the higher growth rate, the stronger development ability.

**Non-financial indicators**
The non-financial indicator is also a part in SLEC’s performance measurement. Since the SLEC is a private education company, the number of students is definitely measured annually.

The growth rate for the number of student enrollment is a non-financial indicator measured in SLEC’s performance review. The financial manager Mrs. He, mentioned that SLEC’s customer is the student, and the company’s revenue comes from the customer, which means that the more customers, the more revenue. Thus SLEC pays attention to the increasing number of student enrollment.

Based on the interviews, staff in SLEC expected through some nonfinancial indicator to evaluate the health of the organization. For instance, the employee turnover is one of the non-financial indicators. Interviewees thought that if the employee turnover is high, it could be some management problems or control problems exist in the company, which lead to the employee resign.

Also, since some interviewees responsible for the customer service, they can receive the feedback from customer both strength and weakness about SLEC’s teaching activities, food quality and the teaching material using in the lesson. From the interviewees' point of view, they expect that the customer satisfaction could evaluate regularly in order to obtain customer’s feedback and finalized the weak points and problems on teaching activities. Further make a solution to solve the problems and improving the company's performance.

**4.6 Segregation of duties**

This section aims to finalize the SLEC’s finance staff’s job duties, which could be helped SLEC explore the insufficient part of segregation of duties in control activities.

**Duties of Financial manager**
SLEC has one financial manager who is in-charge of the company's overall financial activities and internal accounting control.

The financial manager is in-charge of the daily route, organizes and monitors division’s work. The financial manager also receives information and problems from divisions and makes solutions and suggestions for the problems after consultation with the general manager. Making the annual budget for SLEC is based on the historical data and information.
**Duties of Accountant**  
SLEC has three accountants who are responsible for the division’s finance work.

Accountant in each division is in charge of customer service, collecting data, collating accounting documents, make internal financial statement and report department financial information to financial manager daily or weekly.

**Duties of Cashier**  
Each division has one cashier, who is responsible for handling the real money in the company. Their works include handing the company’s cash transaction, payment of expenses, and receiving of cash payment from customers.

Meanwhile, according to the interviews with the cashiers at SLEC, cashiers also have another authority in custody. The duties in custody is to manage office suppliers and teaching materials, authorizing transactions, handling the related assets, allocating materials to teachers and making documentary files.

However, at SLEC, there is no specialized staff that is responsible for the custody of assets like office supplies and teaching materials. The management of physical assets belongs to the cashier in each finance department.

**4.7 Summary**

This chapter illustrated and analyses the findings of the research paper. The sponsor company's background was explored first. The company's goal is to obtain profit and control company expenditure through effective and efficient internal control. Thus the insufficient parts of internal control could be finalized.

The seven interviews were conducted to obtain the information and comments of SLEC's internal control in control environment and control activities while the documentary review focuses on the financial statement.

Based on the findings of interviews and documentary review, SLEC's current situation of internal control, specifically in the control environment and control activities are as follows:

First, based on the interviews with the financial staff, it is clear that the current internal control system in SLEC is ineffective and inefficient. The insufficient parts are mainly concentrated in the following aspects: leadership style, performance measurement and segregation of duties.

SLEC’s operations are centralized, which could explain the low equipment utilization rate and the waste of resources. The autocratic leadership style that is evident at the company could lead to its decision making and not meeting the division’s real demand.
SLEC’s finance staffs’ segregation of duties is not definite and the authority of custody and recording are not separate.

The SLEC’s current budgeting method is not effective and the content is not complete. Also the current budgeting does not contribute to internal control activities

Second, the documentary reviews indicate that SLEC’s current financial indicators are uncompleted, one-sided and do not relate to company profitability. This suggests that SLEC uses relevant performance indicators to identify the weakness in performance measurement.
Chapter 5 Discussion

Chapter 5 provides a critical review and analysis of the issues and problems identified in SLEC’s control environment and control activities. As Hayes, et al (2007) describes that the internal control systems are an integration of activities, plans, policies, and efforts from the employees and business, it was important for the researcher to determine and understand the different components that make up SLEC’s internal control system.

Specifically, the five factors that will be discussed in this chapter are: organization structure, autocratic leadership, budgeting methods, indicators in performance review and segregation of duties. These factors will help identify solutions and recommendation, which will be discussed in further details in Chapter 6, regarding the methods and procedures that management can implement in order to secure the company’s assets and manage its recourses.

5.1 Organizational structure

Based on the interviews and documentary review, SLEC’s employees understand the organizational structure but there is no visible organizational chart, in the company profile and website.

According to Myers (1996), a visible organizational chart is a tool for a company to ensure the organizational structure. Also, an organization chart helps employees clear the relationship and help other departments to understand and enhance the coordination of the organization. The interviewees mentioned that SLEC’s employees have an understanding of how the organization structure works, but employees are unaware of their exact position in the organization, which leads the staff members confused about their duties that can result in the low efficiency and effective work.

Based on a combination of the organizational structure theory, the concept of the division structure (Kinicki and Williams 2003) and the status of the company’s structure, SLEC is a divisional structure. Each division has specialized departments to service customers. It is designed for a group of people with different professional expertise and who work together in a formal group. The purpose is to provide the service to similar customers.

Meanwhile SLEC is also a hierarchical organization whereby the top-level management has absolute power to manage the company. This means that few people have some authority to make the orders and those orders are then passed from top to bottom. The decisions made by the top of the pyramid (the General Manager) are passed to the middle level managers, administration office and finance department, and last the orders are sent to the chief administration in each division.
5.2 Leadership style

As mentioned previously, based on the analysis of SLEC’s leadership style, the interviewees’ opinions, and according to the theory by Keuning, Bossink, and Tjemkes (2010), the autocratic leader makes quick decisions and ignores how and why the things happen. Also Nayab (2011) claims that an autocratic leader is the one who believes in taking all the important decisions for him/herself. SLEC’s GM makes the decision of selecting and purchasing equipment by herself and there is no room for any change. The subordinates simply carry on with the work assigned to them. However, the final users of the equipment are the teachers who are in charge of the teaching activities in SLEC. If the GM made a decision without consulting anyone else in the departments and nor did she seek the users’ opinions and suggestions, this could result in the equipment that was purchased, would not be fully utilized by the teachers, thereby the company will have a waste of valuable company resources.

Therefore, the autocratic leadership style in the company is to ensure that the decision making process is quick and will help the team reach a solution quickly, which can often lead to issues and problems. Under the authoritarian leader, the employee gets more work as opposed to a group that gets bogged down in detailed discussions (Hamilton, 2007).

SLEC’s current leadership style is autocratic leadership and this is likely to have some negative effect on the company’s internal control system.

As this research has presented, there are some negative effects on SLEC’s internal control system. First, the current leadership at SLEC affects the employees’ work negatively. Since the GM makes the purchasing decisions arbitrary, the new equipment and facilities often confuses the users and disrupts the teaching plan. Employees have also complained about the current leadership style.

Second, the centralized leadership style at SLEC means that the decision-making is unilateral without little, if any, regard for the subordinates. As a result, the decisions made at SLEC reflect the direct opinion and personality of the manager, which will definitely influence the overall decision-making process and operations of the company.

Third, the one-way communication without feedback and suggestions from staff already leads to waste of company’s resources and investments. The current leadership style has resulted in increased employees’ complaints and has created problems with low employee morale within the organization.

Respectively, the autocratic leadership style in SLEC’s current internal control system is not conclusive and brings negative developments within the organization.
5.3 Budgeting

As mentioned in Chapter 4, performance measurement in SLEC has three steps, which includes targets set by General Manager, making budgeting by the financial manager under the General Manager’s requirements and budget distribution in each division.

According to Cardy and Leonard (2011) performance management can be a very broad domain and encompasses many functions and levels in an organization. It shows that the more employees involved in performance management in target setting, the more opinions and suggestions will be obtained from the participants (Keuning, Bossink, & Tjemkes, 2010). Therefore, in the case of SLEC, only the top management is responsible for setting targets but this is neither sufficient nor comprehensive.

Meanwhile, based on the status of SLEC, and by combining the performance management theory by Cardy and Leonard (2011), there is lack of feedback and improvements in the performance at SLEC. After the financial manager evaluates the performance, the company does not make any follow-up action to revise the planning in order to improve the performance. Therefore, the current budget explained in Chapter 4, is unreliable and unacceptable.

According to the current performance measurement, there are some weaknesses of the current budgeting system at SLEC as discussed below:

First, according to the budgeting method by Gruen (2005), SLEC’s current budgeting method is incremental budgeting, which is a budget, prepared using a previous period’s actual performance as a basis with incremental amounts or percentages added for the new budget period. The incremental budgeting is a sample method used in public and private companies (Gruen, 2005). SLEC’s GM and financial manager could simply understand the incremental budgeting method and calculates the results. This method can also be used when a company income increases at a marginal rate (Gruen, 2005).

Second, SLEC’s current budgeting method does not make the relationship with company revenue and expenditure. The revenue and expenditure budget in SLEC are independent, which may lead to the insufficient control activities and revenue not covering the expenditures (Pandey, 2009).

Third, according to the top-down budgeting theory (Florin, 2011), SLEC’s budgeting work is a form of top-down budgeting, which is made by the top management without the input of the sub-departments and divisions. The budgeting work is done by one person, which in this case is the financial manager, Mrs. He, and without participation and opinions from other divisions. This could lead to results in underfunding or overfunding of allocated resources to the various divisions, causing an ineffective control process. According to Florin (2011) and Kinney and Raiborn (2012), a top-down budgeting method is where the company’s budget is...
completed at the top management level and the data and information are passed from top to bottom while, the resources are allocated made by top management.

However, upper management normally has little or no input towards the practical operating activities at SLEC. Theoretically, departmental heads have a better understanding of the financial needs of their division than the upper management. A company’s budget that is created by a person without input from the top management can result in underfunding or overfunding of a department as stated by Kinney and Raiborn (2012).

SLEC’s GM is typically not familiar with the divisions teaching activities, the student enrollment situation, and the usage of teaching resources. Thus, the goal set during the annual budget is only based on the GM’s decision and opinions and could likely lead to budget overspending or underestimation Florin (2011). This is where employees in the sub divisions may feel resentful that their input is not valued in the budgeting process. In addition, the chief administrator of a division is at odds with upper management over the financial issues, which can cause tension and performance issues in the workplace (Keuning, Bossink, & Tjemkes, 2010).

As mentioned, if SLEC uses incremental budgeting, whereas taking a previous period’s actual performance as the basic with incremental amounts to prepare next year's budget (Gruen, 2005), the incremental method may not be accurate and suitable for the company's operations the next year. If SLEC assumes that the company activities and methods of business will continue in the same way while failing to take into account the changing circumstances, the incremental budgeting process could provide unreliable financial results which could lead to problems and issue with company’s goal which is maximum profit and minimum costs with an effective internal control system.

Since SLEC has introduced the incremental budget as its budgeting method, there is no doubt that the divisions' expenses will increase because the incremental amount is already included in the annual budget (Gruen, 2005). This method of budgeting can also give employees the impression that the company is growing and expanding, however, this does not mean that the company's financial or business goals are always doing well.

Finally, since upper management makes the budget and the sub division staffs do not participate in the budgeting process, the distribution of the budget does not always meet upper managements’ expectations. The staff reflects that the budgeting in the daily work does not function well and that the chief administrator does not take into account the annual budget while making the division's plan. Therefore, under the company’s current situation, it seems that the budget at SLEC does not play an important role in the company's internal control system, which can lead to the budget and actual results having a large variance in the financial statements at the end of the fiscal year.

In other words, the improper budgeting method may lead to overspending or underestimate of the company's budget. Overall SLEC’s budgeting process begins with the GM setting
targets annually and then having the financial manager make the annual budget according to the GM's requirements. However, the General Manager normally has little or no input on the practical operating activities in SLEC. In fact, the divisional heads have a better understanding of the demands of the divisions than the upper management. Therefore, if only one person creates the company’s budget without having any input from the other departments, the results of the financials can lead to underfunding or overfunding a department.

Additionally, if SLEC's GM is sets the financial goal or budget based only on her experiences, this is not enough to have a reliable budget because she is not familiar with the overall functions of the business such as the divisions’ teaching activities, the student enrollment situation, and the usage of teaching resources. Such a situation not only causes waste of the company’s resources and investment, but this also brings about complaints and low employee morale among the staffs of SLEC. Furthermore, employees in the subdivisions may be resentful that their input is not valued in the budgeting process and the chief administrator of a division will always be at odds with upper management over the financial issues, which can cause tension, and performance issues in the workplace.

5.4 Performance indicators

Based on the findings in chapter 4, there are two categories of performance indicators involved in the current SLEC’s performance measurement, which are financial indicator and non-financial indicator.

Financial indicator aims to evaluate the company’s financial performance from three aspects, activities, profitability and liquidity. Gitman (2012) claims that financial indicator analysis involves methods of calculating and interpretation financial ratios to control, and review the firm’s performance. Meanwhile, the non-financial indicator reflects the long-term viability and health of the organization (Kaplan, 2000) and is used to measure company’s performance through internal operating, employee-oriented and customer-oriented factors. Milost (2000) concluded that financial indicators compares firm’s value-expressed amount and the non-financial ratios are descriptive.

However, in the case of SLEC’s current performance indicators, both the financial and non-financial indicator could not illustrate the current performance fully and sufficiently. The financial indicators only showed the increased tendency for a company’s performance. The increased percentage will lead to the management incurring additional costs since the increased percentage actually encourages the manager to adopt a “use it” attitude and such an attitude will definitely lead to waste of a company’s resources (Gruen, 2005). On the other hand, the non-financial indicator at SLEC is the number of student enrollments, however, this single non-financial indicator cannot represent the whole picture of SLEC’s performance. The growth rate for student enrollments can only show the variations in the number of students enrolling in the school, but this does not show the reason behind the changes in the number of increase or decrease of students each year.
The financial indicator at SLEC aims to measure the increase or decrease of the company’s expense and the gross profit margin measures the company’s profitability (Gitman, 2012). However, this could not be measured sufficiently using SLEC’s financial performance, and thus, making no contributions to the internal control system. While the non-financial indicator only measures the student enrollments, this example is not a sufficient form of measurement in SLEC’s performance as it doesn’t measure other factors like the employees and customers’ service satisfaction. In addition, there are several different forms of performance indicators that could be used, such as evaluating and analyzing SLEC’s performance in 2011. See Table 3.

Financial Indicators

Expenses within the Revenue
As for an example of a financial indicator, first is to find out what the proportion of the revenue occupies expenses and there could be a way to discover which expense occupies the revenue in an unreasonable range (Pandey, 2009). Therefore the formula is: Rate of expense to revenue = each expense item/Revenue*100%

Variance between budgeting and the actual result
Second are the variance between budgeting and the actual results. Based on the financial manager’s opinion, even though SLEC makes a budget annually, the company did not check the variances between budgeting and the actual results. Thus, it is important to check whether SLEC’s budgeting process works well (Bodnar & Hopwood, 2012). Therefore the formula is: Actual result - Budgeting amount

Net profit margin
Third is net profit margin. Gitman (2012) defined net profit margin as a term which measures the percentage of each sales dollar remaining; after all costs and expenses, including interest, taxes, and preferred stock dividends, have been deducted. This can help SLEC measure how much out of every RMB of sales a company actually keeps in earnings.

It should be noted that profit is important for any company’s management and employees. Thus, from the financial manager’s point of view, the net profit is a factor that measures the company’s performance and to make sure how much money does the company earns after interest, tax and other payments (Gitman, 2012). According to Gitman (2012), net profit margin is a commonly cited measure of a firm’s success with respect to earnings on sales or service.

Non-Financial Indicators

Turnover Rate
Meanwhile, about the non-financial indicator part, first is teacher turnover rate. Since SLEC is a private school, sales service to customers, thus the stability of a teacher is a key point that
top management should concentrate on. The low teacher turnover may reduce the risk and cost for top management control and training teacher, which can mean SLEC’s teachers are fixed. Also the teacher turnover rate can show the employee loyalty.

The following part takes SLEC’s financial data in 2011 as an example for analyzing the performance. See Table 3.

Table 3 (1). SLEC’s financial data in 2011

<table>
<thead>
<tr>
<th>Items</th>
<th>2011</th>
<th>Expense to revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>15275.80</td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td>4448.31</td>
<td>29.12%</td>
</tr>
<tr>
<td>Food material</td>
<td>1486.34</td>
<td>9.73%</td>
</tr>
<tr>
<td>Insurance</td>
<td>1849.90</td>
<td>12.11%</td>
</tr>
<tr>
<td>Repair</td>
<td>163.45</td>
<td>1.07%</td>
</tr>
<tr>
<td>Teaching equipment and facilities</td>
<td>2749.64</td>
<td>18.00%</td>
</tr>
</tbody>
</table>

Net profit margin

Net profit | 1387.04 | 9.08% |

Employee turnover

Employee | 248.00 | 3.00% |

According to the Table 3 (1) and (2), here are some results that contribute to SLEC’s finances:

First, the payroll accounts for 29% of revenues and teaching equipment and supplies accounts for 18% of revenues. These two items are the largest expense at SLEC, which could be a major risk in the company's internal control.

Second, the teaching equipment and facilities shows the second largest variance between
budgeting and actual results, which resulted in over budgeting by 359.21RMB.

Third, the net profit margin at SLEC is 9%, which means in 2011, 9% of the total revenue is the net profit for SLEC subtracting expenses, interest and tax.

While the teaching equipment and facilities are a major piece of the company’s expense, a large part of the revenue will be used to cover this expense. However, if the utilization rate is low on the equipment and facilities, this actually contributes to a waste of company funds and resources, which is one of the major contributions to SLEC’s low employee morale.

The employee turnover is at 3%, which is not high, and it can mean that the employees at SLEC are loyal and willing to stay in the company.

In summary, the financial indicators variance of budgeting versus actual results; the expense proportion to revenue may reflect some the problems that the company budget is out of control. Nonetheless, the non-financial indicator shows that employees at SLEC are stable and settled at the company.

5.5 Segregation of duties

Based on the research findings in chapter 4, segregation of duties in the financial department have lead the employees to complain and feel unhappy about their job responsibilities. Even if the three levels of financial employees in SLEC have a clear overview and understanding of their job responsibilities, some parts of their duties are still confused and illogical.

According to the fundamental functions of segregation of duties (Hayes et al., 2005), authorization, custody and recording must be separated and adequately supervised. This means that there should be two different staff members:

1) one staff member who is responsible for managing and allocating the realizable assets;
2) the other employee would record the information in order to control those assets.

By dividing the job and tasks, this will help to ensure that they meet the functions of segregation of duties.

Segregating accounting duties are not going to eliminate errors and fraud, but they can help reduce them (European Commission, 2008). A clear segregation of duties can ensure the safety of assets, ensure the records matches the real assets, and make the employee’s job easy and logical. Secondly, adequate segregation of duties could avoid the mistakes created by personnel, thereby reducing information error (European Commission, 2008). For example, allocating equipment to sub departments without recording will lead to not paying the bills on time and misplacing invoices and receipts. In addition, adequate segregation of duties could avoid asset misappropriation.
However, SLEC’s cashiers are in-charge of preventing fraud, recording and allocating the equipment and factories. As Hayes et al. (2005) would claim that this goes against the principle of segregation of duties. These duties should be segregated, among different people to reduce the risks, errors, or inappropriate actions. Furthermore, the cashiers own the responsibilities of authorizing, recording and allocating equipment, and this could also lead to the misappropriation of a company’s assets, which could lead to inconsistencies in the recording of physical assets (Hayes et al., 2005). Consequently, the mixed duties can make a cashier’s job complicated.

There are a number of problems that have been unearthed after analysis of the financial staff’s job duties. First, a single person has the authority to assess, allocate and record the assets and this could lead to accounting information error (Hayes et al., 2005). Second, when one person is in charge of multiple tasks, this may lead to low quality of results in financial documentation (European Commission, 2008). For example, real assets cannot match the recording of what assets were purchased or sold. Generally speaking, the uncertain segregation of duties increases the risk of inappropriate use of assets and the accounting information misstatement.

SLEC’s cashiers are responsible for custody assets, record and allocate the equipment and factories. The right of custody, recording and allocating when owned by one person goes against the principle of segregation of duties. In order to reduce the risks, errors and inappropriate actions, these duties should be allocated to different individuals.

Meanwhile, the cashiers own the right to recording and allocating the equipment and this could lead to the company’s assets misappropriate and inconsistence of recording and physical assets.

In order to prevent asset misappropriation and intentional financial misstatement, there is need to ensure clear staff’s duties (European Commission, 2008). Some guidelines on assets custody, recording and allocation should build in the internal control system. In addition, the authorities of assets custody, recording and allocate should be separate.

5.6 Summary

This chapter discusses the five aspects of the research findings presented in Chapter 4 namely, organization structure, leadership style, budgeting, performance indicators and segregation of duties. Each of the aspects has been evaluated and has proved to show or contribute weaknesses or flaws in SLEC’s internal control system.

Firstly, SLEC’s does not have a transparent organizational chart. However, after receiving the opinions and feedbacks of the employees interviews, this research can determine that SLEC’s organizational structure is a divisional structure, which means that each division has a group of people responsible for a particular service or task according to the work flow and customer demand (Kinicki and Williams, 2003). Nevertheless, SLEC is also a hierarchical
organization where the GM sits as the top of the hierarchy and each department sits below the GM in descending order of subordination (Keuning, Bossink and Tjemkes, 2010). Second, the company’s autocratic leadership style has resulted in increased employee complaints and low employee morale and an increase in wasted resources (Hamilton, 2007).

After evaluating the company’s structure and leadership style, and with the help of the employee interviews, we can determine that the issues and problems of SLEC’s internal control system is also due to a poor budgeting system and performance reviews. The current budget method (incremental budgeting) has resulted in the risk of overspending or underestimating the company’s performance. For these reasons, the current budgeting method at SLEC may not be appropriate or not suitable for the company and is affecting SLEC’s internal accounting system.

In addition, SLEC’s performance management and measurements also needs to be reevaluated against the business goals and objectives. Cardy and Leonard (2011) defined that performance management can be a very broad domain and encompasses many functions and levels in an organization. Last, the current segregation of duties has caused some problems within the internal control system and due to unclear defined tasks; there has been a large risk of improper use and allocation of assets.

In the end, the weaknesses indicate that the current internal control system at SLEC needs to be improved.
Chapter 6 Conclusion

Chapter 6 will answer the main research questions, being:

“What improvements can be done in regards to the control environment and control activities of the Shuguang Lantian Education Company?”

Before answering the main questions, the empirical questions will be answered first.

1. **What are the weaknesses of SLEC’s current control environment as regards to organizational structure?**

According to the response from the interviews (section 4.3), SLEC’s written policies and internal operating procedures have been approved by upper management. Employees have an understanding of how the organization structure works, but employees are unaware of their exact positions in the organization, which leads the staff members mislead and confused about their job duties that result in low efficient and effective work.

2. **What are the weaknesses of SLEC’s current control environment as regards to leadership style?**

The current autocratic leadership style (section 4.4.2) in the company could lead to the company's decision-making process not meeting the division's real requirements and demands of the business. The interviewees also complained that the current management style does not control adequately and thoroughly the company's work. Currently, if the company has one individual (the general manager) making all the company's decisions, this has proven to have challenges in the current decision-making process and that this has not been the best and/or effective way to operate the company (Hamilton, C, 2007).

3. **Does the current budgeting method work well in SLEC’s performance measurement?**

Based on the status of SLEC and by combining the performance management theory by Cardy and Leonard (2011), there are lack of feedbacks and improvements in performance at SLEC. After the financial manager evaluates the performance, the company does not make any follow-up actions to revise the planning in order to improve the performance. Therefore, the current budget explained in Chapter 4, is unreliable and unacceptable.

In addition, with little or no input on the practical operating activities in SLEC, the upper management makes the annual budget, which may lead to overspending or underestimating of the company’s actual performance.

4. **Are the current performance indicators sufficient and effective in SLEC?**

Based on the findings in Chapter 4, SLEC’s current performance indicators, both the financial and non-financial indicators, could not illustrate the current performance entirely and
sufficiently. The financial indicators only shows the increased tendency for a company’s performance, which will leads to the management incurring additional costs since the increased percentage actually encourages the manager to adopt a “use it” attitude and such an attitude will definitely lead to waste of a company’s resources (Gruen, 2005).

On the other hand, the non-financial indicator at SLEC is the number of student enrollments. However, this single non-financial indicator cannot represent the whole picture of SLEC’s performance. The growth rate for student enrollments can only show the variations in the number of students enrolling in the school, but this does not show the reason behind the changes in the number of increase or decrease of student enrollments each year.

5. Are the finance employees’ duties separate and clear to meet the company internal control activities?
Based on the analysis of SLEC’s financial employees’ segregation of duties, it is unclear and chaotic. A single person has the authority to assess, allocate and record the assets, which could lead to accounting information errors. Furthermore, one person in charge of multiple tasks may lead to the low quality of results where real assets cannot match the actual records of assets.

In order to answer this main research question the researcher proposes the following improvements.

6.1 Organizational chart
Although SLEC’s employees have a general understanding of the company’s structure, the employees have a lack of awareness regarding their position within the organization. Therefore, an organizational chart helps a company build and design the organization structure to meet the company’s objectives, and help to guide the employees to know their rights and responsibilities (Meyers, 1996). Accordingly, the organizational chart adds transparency providing as much information to an employee’s needs to act in the best interest of, the company, their team and the company’s mission.

The following figure below is the SLEC’s organizational chart.
The organizational chart is suitable for the size and complexity of SLEC's business, which also illustrates the relationships between departments and shows where each employee falls under the different functions of the company. In addition, SLEC could apply a simple list of responsibilities so each employee can take ownership of a specific set of tasks so that employees on each team will be aware of what everyone is working on. Additionally, this list could provide information about who or where employees need to talk or ask for guidance, deliverables, and approvals (Meyers, 1996).

The organizational chart will then raise the managers and employees’ awareness about where each employee stands and how they contribute within the organization. This will help make SLEC’s control environment and control activities to be more efficient and effective.

Unfortunately, since SLEC GM’s current leadership style is autocratic, it is unlikely that the organization or its employees have any influence or have the ability to make changes to the leadership style of the company. However, with an organizational chart, employees and managers can visually see the framework within which an organization’s activities for achieving its objectives are planned, executed, and controlled. Additionally, the organizational chart illustrates and reflects the power structure of the company (in this case where the GM sits above all managers and employees).

The recommendation here is for the company as a whole to understand and recognized that the leadership, who is overseeing the entire organization, and the way an organization is structured, will determine the organization’s culture, success and satisfaction (Conger, 1992).
6.2 Meetings

The autocratic leadership does not work well in the SLEC’s internal control environment and confuses certain control activities. Therefore, it is recommended that SLEC should hold meetings where employees have the opportunity to share and show their opinions about the company’s internal control system to the upper management (Keuning, Bossink & Tjemkes 2010).

In order to improve the current SLEC’s leadership style and reduce its negative effect on the internal control system, it would be nice to organize a company meeting or division meeting and invite some of the teachers and staff so that they can voice their opinions about the current year and then present their suggestions about the following year. Thereafter, the upper management should take into account the employees' opinion and suggestions to help make the decisions about how to build or improve on the company’s internal controls and policies (Keuning, Bossink & Tjemkes 2010).

Company meetings can be organized in several ways. For example, managers should organize regularly scheduled meetings with their employees within each division. SLEC could also implement a “Managers only” meeting and last, a large company meeting at the end of each semester where all employees attend the meeting. The participation of staff members and managers is important not only in the decision-making process, but also in shaping the organization's vision (Keuning, Bossink & Tjemkes 2010).

At every meeting, the division managers could report and summarize previous semester's goals and objectives based on the information that they have learned from the previous year and they can make new target goals and objectives for the following semester. In order to ensure the target is achieved effectively and efficiency, the financial department and administration department should be responsible for monitoring the work. The division heads and the manager of the teaching department should be in charge of collecting feedbacks and suggestions from employees, which can then be summarized and reported to upper management.

6.3 Budgeting method

The improper practices of budgeting methods can lead to a significant loss of customers, in which case the parents and students of SLEC, and revenue (Gustafson and Parson 2010). Therefore, in order to make up for the deficiency and improve the internal control system at SLEC, it is better for upper management at the company to ensure that the divisions’ chief administrators and the financial employees are involved in the budgeting process. The involvement of the financial employees in the budgeting process can improve the accuracy of the budget and its practicability (Penner, 2004).
Furthermore, Figure 7 can help to explain the process of improving the budgeting method at SLEC.

![Diagram of budgeting method](image)

**Figure 7. Budgeting method at SLEC**  
Sourced by author

Since SLEC has three divisions, it is recommended that first the divisions will make a budget. This entails including the number of new student enrollments and the added revenue and expenses caused by new student enrollments. The assumption is that the tuition fee, accommodation fee and the meal fee are maintained at the same usual level.

Then, a report of the division budget should be presented to the SLEC’s financial manager. The financial manager would then review each division budget and combine the three divisions budget and then calculate the company's annual budget. The annual budget would then include the sum of three divisions number of student enrollments, total revenue, total costs and the expenses allocated in each item like payroll, insurance, purchasing equipment and facilities.

After the financial manager has combined the three divisions' budget, the financial manager will report the final numbers to the GM. The General Manager could then revise the budget based on her experience and her evaluation, thereafter, finalizing the budget and distributing the new budget to each division of the company.

With the allowance from the General Manager, this method of budgeting allows for the application of practical work and feedback to the divisions (Redburn, Shea and Buss 2007). Therefore, with an improvement in the budgeting method, the budget will be more effective and reliable since the divisions’ employees have participated in the budgeting process. This method may reduce overspending or underestimation, thereby making the budget more accurate to meet future company goals and objectives.
6.4 Systematic indicators in performance measurement

By using the current performance indicators to review company performances, SLEC performance measurements are not sufficient and contribute negatively to the internal control system. In order to measure SLEC’s performance adequately, it would be better to introduce more indicators from both the financial and non-financial aspects of SLEC’s performance measurement. Financial indicators describe the particular figure, difference, or mean value, such as price, operating results, variance, and the average amount of profits (Wua, Lin, & Chang, 2011); while the non-financial indicators expresses as absolute and relative figures, and may explain the relationships or occurrences which cannot be present from the financial statements. For example, the employee satisfaction and customer satisfaction cannot be presented from the accounting information (Wua, Lin, & Chang, 2011).

According to Gitman (2012), financial indicators provides an easily understood assessment of a firm’s financial performance that can be tracked over time based on the accounting information. It entails evaluating the company’s financial performance from three aspects: activities, profitability and liquidity. Through this, one is able to calculate and interpret the financial ratios to control and review the firm’s performance. The non-financial indicator measures a firm's performance from the non-financial aspect, which cannot be presented by the accounting information.

The following table presents the indicators proposal for SLEC’s performance measurement.

Table 4. Performance indicators at SLEC
Sourced by author

<table>
<thead>
<tr>
<th>Financial Indicators</th>
<th>Non-financial indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expense</td>
<td></td>
</tr>
<tr>
<td>Expense growth rate</td>
<td>Number of student enrollment</td>
</tr>
<tr>
<td>Rate of each expense to total cost</td>
<td>Customer satisfaction</td>
</tr>
<tr>
<td>Rate of each expense to total revenue</td>
<td>Employee turnover</td>
</tr>
<tr>
<td>Profitability</td>
<td></td>
</tr>
<tr>
<td>Gross profit margin</td>
<td></td>
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<tr>
<td>Net profit margin</td>
<td></td>
</tr>
<tr>
<td>Budgeting</td>
<td></td>
</tr>
<tr>
<td>Variance</td>
<td></td>
</tr>
</tbody>
</table>

The table above shows that based on SLEC’s current indicator, there are some new indicators that can be added both in the financial and non-financial perspectives.

On the financial indicator section, SLEC could first add the proportion of the expenses to the
total revenue. This could help measure the percentage of each expense in revenue, and find the largest expense at SLEC. In addition, it also provides a guideline for SLEC so that in future works, SLEC could pay more attention to the largest expense and thus, control and monitor the use of these expenses.

Second is the variance between budget and actual results. This indicator measures the difference between budgeting and the actual results. It does not only measure and judge whether the budgeting in SLEC works well, but it also discovers items that cause a big difference between budget and actual results. By using this indicator, SLEC could find the anomalous change in the company’s expense and SLEC could find the related reasons that causes the change.

Third is net profit margin, which measures SLEC’s net profit annually. This indicator measures the percentage of each sales dollar remaining after all costs and expenses, including interest, taxes, and preferred stock dividends (Gitman and Zutter 2012). This indicator helps SLEC measure the company’s profitability and about how much out of every RMB of sales a company actually keeps in earnings (Gitman and Zutter 2012).

Meanwhile, the non-financial indicator should introduce the customer satisfaction, which is based on the company’s requirements (Wua, Lin, and Chang, 2011). Since SLEC is a service company and does not have real products to sell, according to Milost (2000), the customer satisfaction would be a necessary and crucial factor, which measures performance on a non-financial perspective and in improving company’s performance in the future.

The customer satisfaction could be separated in two parts which are the (i) satisfaction to teacher and (ii) the satisfaction with teaching contents.

Last is the employee turnover, the turnover of employees should present the health of the organization to a certain extent (Basu, 2010). Upper management should have an overall idea about the stability of teachers and the low employee turnover reduces the risks and costs incurred by SLEC’s training and managing staff (Basu, 2010). Also, the customers’ feedback and comments about teaching activities and teachers should be collected in order for further improvements.

In summary, by using the systematic performance indicators, the variance of company’s individual expenses, the profitability, and the return on assets could be evaluated from a financial perspective in order to mirror the company’s performance in the fiscal year. Furthermore, the customers’ feedbacks and comments about teaching activities and teachers should be collected in order to further improvement.
6.5 Adequate segregation of duties

The uncertain segregation of employees’ duties increases the risk of inappropriate and irrelevant use of assets and the accounting information provided can be misleading and misguided.

Separating the authorities of assets custody, record keeping and access would be beneficial to SLEC. This can reduce the risk of asset lost, improper use and the misrepresentation of financial and operational information. Therefore, policies should be built in the internal control system to ensure adequate segregation of duties, standard practice in assets custody, and record keeping and access.

It is also recommended that the company’s cashier maintain custody of assets and transfer the recording assets to the accountant. This will ensure that the authority of custody and recording are two separate entities, thereby resulting in the safety of assets and adequate accounting information (Hayes, Dassen, Schilder and Wallage, 2005).

Company’s regulations should be clarified along with the duties of the accountant and cashier. Employees should fully understand their job duties and responsibilities in the workplace. In addition, a third party, such as the administration department, should check the recording of real assets regularly. When information errors or problems are found, it is necessary to report any discrepancies to the financial manager and to upper management at SLEC. Therefore, it is recommended to provide better check and balances in the accounting department in order reduce the loss of assets (Gruen, 2005).

6.6 Summary

The main objective of the current thesis is to explore the improvement of SLEC’s internal control system as regards to the control environment and control activities. This is the last chapter of the thesis.

According to the findings presented in Chapter 4, the discussion of the deficiencies in Chapter 5, and answering the theoretical and empirical questions, the research was successful in order to find the answer to the main research question. Respectively, recommendations were provided in order to help with the deficiency presented in both the control environment and control activities.

An organizational chart and holding staff meetings aspires to improve the control environment while the budgeting method, systemic indicators and the cleared segregation of duties focuses on enhancing the control activities. By adding an organizational chart, this provides SLEC’s guidance to all employees by laying out the official reporting relationships that govern the workflow of the company (Meyers, 1996). The meetings allow an opportunity for SLEC employees to present their opinions, feedbacks and suggestions about the current
internal control system and decision-making process and also on how to improve the internal control system.

The proper budgeting method will help to avoid overspending and/or to underestimate performances, while the indicators could review SLEC’s performance better and to be more effective than ever before. In addition, cleared segregation of duties in SLEC reduces the risk of improper use of assets.

In conclusion, the company’s control systems are made up of procedures and methods created by management to help protect company assets and to manage company resources. The internal control systems make up the control environment and control activities in SLEC, which is centered around how the company will operate which can reflect on the matters of the company’s mission, management style and operating procedures. SLEC’s GM should create and promote an ethical business environment while working closely with all managers and employees.
Chapter 7 Reflections

First, a great gratitude goes out to Dr. Ton Voogt and Mr. K. Van Brakel who have spent a lot of time and effort in providing me professional comments and suggestions to inspire and guide the research and to improve the thesis comprehensively.

During the period of constructing the research paper, the researcher spent a lot of time on collecting relative resources, which includes the general information of SLEC, internal control system theories, budgeting and performance measurement theories and research methodology. Through this, the researcher improved their personal abilities to learn new theories and methods.

Before starting and being able to complete this research, all the relevant internal control knowledge and information were received from the lectures and textbooks, which have never been applied to the real case independently. After doing the research on the internal control system at SLEC, the researcher began to have a deep understanding on how real private companies implement measurements within their organizations. For example, by introducing budget methods and performance indicators into a company, this can help an organization to control its company business activities and provide better internal accounting controls.

Finally, during the period of completing this paper for SLEC, the researcher realized that the knowledge of internal control system can be complicated and ambiguous. Therefore, it is important to continue to learn and expand one’s knowledge of internal control systems in order to achieve a higher level of understanding of control environments and activities. In the future, if the researcher decides to work in finance and/or accounting, it is beneficial for the researcher to keep improving and to try and get a deeper understanding of different internal control system.
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Appendix

Interview Questions

First part the background information, 4 questions, including education status, age, and position and working experience.
  1. What is your position?
  2. What is your age?
  3. What is your highest level of education?
  4. How long have you been work in this company?

Second is the attitude of the SLEC's internal control system
  1. Do you think SLEC's internal control is well designed now?
  2. What area do you think is the most weakness part in SLEC's internal control? And give the reason.

Third are comments about SLEC's control environment.
  1. Does your company have an organization structure? And could you please explain?
  2. Is the structure of SLEC clearly defined in terms of lines of authority and responsibility?
  3. Is the entity establishes appropriate lines of reporting, giving consideration to its nature of its activities?
  4. Is the organizational structure appropriate for the size and complexity of the company?
  5. Does your company set internal control policies? If yes, are internal control policies communicated to all of the organization's employees?
  6. Are management made decisions collectively or controlled by a dominant individual or group?
  7. Who is responsible for company's management and operating?
  8. Are all the operating activities centralized or decentralized?
  9. Do you think the current management style is good? And give the reason.

Last part focuses on comments about SLEC's control activities in two aspects, which are performance review and segregation of duties.
  1. Does your company have performance measurement? How it is?
  2. Does the company have a performance review timely?
  3. Who is making budget in the company?
  4. Why does the company make budget?
  5. How do you make the budget? what methods are using?
  6. Do you think the methods are working well? If no, give the reason.
  7. Does the division review the budget after finished?
  8. Does the budget involve all company income and expenditure items?
9. Does the company compare the budget with actual result timely? If yes, who is in charge for this job?
10. Which items are the key items when company review performance?
11. In your opinion, what would you consider to be the main measures of financial performance in SLEC?
12. Does the employee's duties is clear and valid?
13. Who is responsible for custody assets, transaction assets and recording data? Are those authorities separate?
14. In the company, is it possible for one staff to have access to all valuable information and assets without the consent of senior staff?
Attitude of SLEC’s internal control system

1. Do you think SLEC’s internal control is well designed now?

WL: not bad.
ZZ: I don’t think so.
XC: not good
XZ: I don’t think is good
FL: no
LZ: I am not satisfied with it.
YH: no

2. What area do you think is the most weakness part in SLEC’s internal control? And give the reason.

WL: I think the control about company expense. GM always spends money on buying equipment or others. But sometimes it is not necessary.

ZZ: maybe the company management, I don’t think it the weakness, maybe it is strong point, it is convenient for GM, make all the decision making, but now I didn’t see the positive effect. Yes, it is no doubt that Manager controls the company, also that sometimes make my job confuse.

XC: company management and the operating should be paying more attention. Even the company is belonging to GM, but how it possible that the Manager control company own and did not ask our opinions.

XZ: the company management, decision making maybe the weakness.

FL: company management. If the GM can listen to our opinion, maybe it will be better for the company development.

LZ: the company management should be.

YH: company management.

SLEC’s control environment

1. Does your company have an organization structure? And could you please explain?

WL: I think we have. But not on the website or company profile. We have three campus and all are school.

ZZ: Maybe we have. Three campus, we have administration office which responsible the repair and some other things.
CX: I didn’t see on the website or some company’s documents. I think we have. Our boss is GM, then we have administration office and financial department, then three campus.
XZ: I think we have, but I never saw it. Three campuses, financial department, in each campus, we have canteen, teaching department. If we have some problem, we report to the financial manager.
FL: yes. the boss is GM, and financial department and administration office under the manager’s control, three branch campuses.
LZ: I never see the chart before. But I think we have the organization structure. The top management is GM. The three campuses provide teaching, accommodation, meals for students.
YH: I don’t think the company has public chart about the organization. Not on the company profile, no on the website. GM is boss, then financial department collecting revenue and expense data, making budget based on GM’s required. And three campus organized students having lessons, provide food servicing, health care, and accommodation.

2. Is the structure of SLEC clearly defined in terms of lines of authority and responsibility?
WL: yes, I think so.
ZZ: I agree. SLEC’s structure is clearly for the authority, we know who our leader is.
XC: yes, is clear.
XZ: SLEC’s structure is clear for the authority and responsibility.
FL: yes
LZ: yes, authority in SLEC is clearly.
YH: yes

3. Is the entity establishes appropriate lines of reporting, giving consideration to its nature of its activities?
WL: I think so. Company’s activities relate to customer are clear. The chief administration of each campus has fully authority about the teaching activities and the teacher management.
ZZ: yes. It is. The administration office in charge of repair equipment, management and arrange shuttle bus, we are in charge the customer service and the collecting tuition fee.
XC: yes, we are collecting tuition fee from students, and keep the company’s assets safety and recording data
XZ: yes
FL: I think so.
LZ: I think is clearly and appropriate.
YH: it is clear.

4. Is the organizational structure appropriate for the size and complexity of the company?
WL: I think now is good. it is suit for SLEC.
ZZ: from my point of view, I think it looks like good. appropriate for SLEC’s size.
XC: maybe
XZ: I think it is ok
FL: I think so.
LZ: In my opinion, the current company is good.
YH: I think not bad.

5. Does your company set internal control policies? If yes, are internal control policies communicated to all of the organization’s employees?
WL: we have the policies, but I think it did not communicate to all the employees when it is set.
ZZ: yes we have. I think is the top management made and did not take our opinions.
XC: we have and it didn’t talk to us before.
XZ: yes we have. It did not take our opinions when set.
FL: we have. But it didn’t involve our opinion
LZ: we have. It did not take our opinions when set.
YH: yes. It didn’t communicate to all of the organization’s employees. It is set by the top management.

6. Are management made decisions collectively or controlled by a dominant individual or group?
WL: Individual
ZZ: of course individual
XC: SLEC is private company. Of course is individual.
XZ: Individual
FL: Individual
LZ: of course individual
YH: definitely individual.

7. Who is responsible for company’s management and operating?
WL: of course GM
ZZ: it is GM responsible for company’s operating and management.
XC: it is GM
XZ: It is no doubt that GM.
FL: definitely GM
LZ: it is GM
YH: GM

8. Are all the operating activities centralized or decentralized?
WL: Centralized. Private company, of course centralized.
ZZ: centralized. The boss controls everything.
XC: GM control everything
XZ: GM makes company goals, control development direction, and other things
FL: I think it is centralized. The boss is the king.
LZ: I want to say it is centralized.
YH: in my opinion, it is centralized
9. Do you think the current management style is good? And give the reason.
WL: I don’t think is good. GM always making decision quickly and without considering the current employees condition, like the teacher’s requirement. Last year manager spend much money to buy some equipment form a friend, maybe a business partner. But it makes the teacher confused. Manager encourages them to use it in the class, but they did not need it.
ZZ: not good. Yes, I remember that equipment, manager just ask our financial department to pay the bill to the supplier, then delivery to campus and set up, manager think the new equipment maybe give some positive effect to the teaching activities. But actually the teacher did not need it. And some teachers complain that they don’t know how to use it. Some said that the equipment starting and setting waste too much time and make the class delay.
XC: of course not good. Sometimes the manager’s decision is not logical for the company’s operating.
XZ: I don’t think it is good. Sometimes GM make decision from her point of view and she didn’t consider about the real situation about company.
FL: not good.
LZ: I don’t think it is good now. Maybe manager first consider employees’ opinion and then make the decision that will be better for company management.
YH: yes I agree them. The management in our company is not good. The manager’s style actually makes some problem for the company’s resource. The new equipment and facilities indeed waste company’s money. And now the equipment and facilities are leave unused for long time. General management encourage teachers use it, but teacher didn’t need. And I heard that not one teacher complain about that.

SLEC’s control activities
1. Does your company have performance measurement? How it is?
WL: yes we have. Normally is first GM set the next year goal, like the number of new enrollment student, or the revenue, and then financial manager makes the annual budget. Then end of year we do the evaluation about the whole year. I think financial manager is familiar with this job details than us.
ZZ: we have. Financial department based on the GM’s requirement make the annual plan, at the end of academic year, the manager do the evaluation.
XC: yes we have. The company annual budget made by financial manager, and then the campus received the annual budget from financial manager. The end of academic year, financial manager does the evaluation about the performance. I think financial manager can explain the detail to you.
XZ: yes. I also the financial manager can explain better than me.
FL: yes we have.
LZ: yes.
YH: yes we have. Before the new student enrollment in each September, every August I made the annual budget based on the GM’s goal. The budget is made as a whole not in each campus. According the budgeting in company, I made the campus budget. and then send to
2. Does the company have a performance review timely?
WL: yes the end of each academic year.
ZZ: yes
XC: we do the review yearly
XZ: yearly review the performance
FL: yes we do
LZ: we do it yearly
YH: yearly do review.

3. Who is making budget in the company?
WL: Mrs. He
ZZ: our financial manager Mrs.He.
XC: financial manager
XZ: financial manager
FL: Mrs. He our financial manager
LZ: Mrs He
YH: I made it.

4. Why does the company make budget?
WL: I think it is a plan for our next year’s job
ZZ: it is a plan and direction for the company operating.
XC: for company planning and decision making in the further.
XZ: The boss wants to have a plan for the next year.
FL: I think not only the boss, but also the financial manager need the budget to plan next year job and allocate the resource.
LZ: the budget can help company evaluate the result at the end of year.
YH: the plan is a reference for GM makes decision in the next year.
Also it is convenient for me to do the evaluation at the end of year, even these years I did evaluate the budget and actual result. It is a plan or a guideline to allocate the resource to each campus.

5. How do you make the budget? What methods are using?
YH: first is the yearly target. Normally it is the number of students in the next year. Because the numbers of student decide how much money we can get from the customer. GM asks use the three-year average growth rate of customer to forecast the next year target. then out tuition fee, and other fee are maintained in the same level as last year. Thus we have customer quantities, and we have how much money the company can get from one student, then we can calculate the yearly revenue.

The yearly cost uses the same rate, three-year average growth rate to calculate. After that, company expense is decided based on the proportion of occupied total cost in last year. since
the end of each academic year, I evaluate the performance that including the proportion of each expense occupied the total cost. That figure is used to make the next year’s budget.

Then each campus has the proportion in company’s cost based on the previous year. the proportion is reference to decide the campus budget in the next year. I did not use too difficult method to make the budget. Our company is not the manufacturing company, and we did not sell the real products. Thus our budget is simple.

6. Do you think the methods are working well? If no, give the reason.
WL: maybe not. the budget made by financial manager and GM, we did not participant in the budget work. maybe they will miss some expense.
ZZ: it didn’t work well. Even the financial manager make budget, but the campus do not familiar with the budget, and sometimes and budget is not suit for campus.
XC: no. I think the campus should make the budget first, then financial manager combing the three campus’ budget and make the company budget. I think that is the logical way.
XZ: it is not work well. Maybe let campus make budget first then send to financial manager is better.
FL: not good
LZ: no
YH: I don’t think it is a good way. but since the SLEC is control by GM, I just follow her idea and order to do the job. I think the campus make budget first is more logical and useful than I did.

7. Does the campus review the budget after finished?
WL: No. campuses just receive from financial manager and did not give feedback to financial manager or top management.
ZZ: no, no review
XC: no review
XZ: campus didn’t review budget. just received
FL: no
LZ: no
YH: no

8. Does the budget involve all company income and expenditure items?
WL: yes I think so
ZZ: yes
XC: yes
XZ: yes
FL: it involved all income and expense
LZ: yes involved
YH: yes

9. Does the company compare the budget with actual result timely? If yes, who is in charge for this job?
WL: I don’t think we do it. We only compare the actual result in current year and previous year.
ZZ: I think it should be done by financial manager but we don’t do it.
XC: no
XZ: no
FL: no, we don’t do the comparison between actual result and budget.
LZ: we don’t do that
YH: I think is will be better for company performance measurement and improving budget, but I don’t do that yet. We only compare actual result in current year and previous year. Once a year.

10. Which items are the key items when company review performance?
WL: the profitability.
ZZ: the gross profit margin maybe.
XC: profitability, growth of company cost
XZ: growth of company cost. Profitability maybe
FL: I don’t know
LZ: I don’t know
YH: company expense growth rate. The proportion of expense occupied the total cost. But I don’t think it is useful, I plan to make some change, use the total revenue instead of total cost maybe better. Also gross profit margin is to measure the profitability.

11. In your opinion, what would you consider to be the main measures of financial performance in SLEC?
WL: Since we are also do the customer service, we can receive some complain from customer. I think something relate to customer satisfaction should be one.
ZZ: customer satisfaction, net profit. some parents complain about the lesson are not suit for their kids.
XC: customer satisfaction, net profit.
XZ: since the GM investment much money in company, I think the return on investment should be the considered. Customer satisfaction is the one. The employee turnover should also be the one. Employee turnover is also a factor to show the company's management good or bad.
FL: employee turnover, it probably presents the whether the company's management is good or bad
LZ: return on assets, or investment, the net profit.
YH: net profit margin, return on assets should be necessary since GM invest large money into company. Also the proportion of expense occupied revenue.

12. Does the employee’s duties is clear and valid?
WL: yes clear.
ZZ: yes clear. I am a cashier, mainly in charge of cash management of this division. Like every month when parents pay fees in cash, I check and custody the cash. After we finish the
collecting fee, I deposit money to bank account and ensure the money safety. Also I am in charge of managing the teaching equipment and assets. The teaching equipment included notebook, pencil, laptop and etc. Teacher gets those things from mine and I make a record about when and who get those equipment.

XC: clear and valid. I am responsible for assets safety, allocate the equipment and facilities and make recording.
XZ: clear. My job is to help accountant in collecting fees each month, then the company’s supplier comes to settlement monthly, like food supplier, book and teaching equipment supplier. Usually pay them by cash.
FL: clear. Usually I make the payment notice for student monthly, pick up the tuition fee from parents. Sometimes the reception work also belongs to me.
LZ: clear. Beside to do the reception, we consolidate the financial information, division receipt and expenditure, every month, from 5th to 10th, we make the salary statement for division, send to financial manager weekly or monthly.

YH: clear. On the financial personnel management, I was responsible for managing division’s financial staff, organizing finance staffs meeting regularly, recruiting and training new staff. On financial work, I am responsible for the overall financial situation of the company, including the making company’s financial budget; review the company’s business situation, and performance review.

13. Who is responsible for custody assets, transaction assets and recording data? Are those authorities separate?
WL: Me. I did all the things
ZZ: I did, it is no separate.
XC: Me, not separate.
XZ: the three cashier
FL: cashier, I don’t think it is separate.
LZ: cashier. Not separate.
YH: the three cashiers. Those authorities are not separate.

14. In the company, is it possible for one staff to have access to all valuable information and assets without the consent of senior staff?
WL: I think only financial staffs in SLEC and top management have access to all valuable information and assets.
ZZ: it is not possible
XC: maybe, it is possible.
XZ: not possible
FL: I don’t think so.
LZ: maybe
YH: not all valuable information and assets, part of assets could be since the cashier are in charge of assets safety and allocate the resource to teachers.