

AUDITING INTERNAL CONTROLS IN FINANCING PRESCHOOL PUBLIC INSTITUTION: EVIDENCE FROM SLOVENIA

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Abstract:

Public preschool educational institutions in Slovenia are mostly financed by public money, it means by state and municipalities. They are also financed by parents. So, it is important that preschool institutions are using public money transparent and responsible, for this reason public preschool institution should have internal controls in financing. The internal auditor as independent professional should verify if internal controls works. The purpose of this paper is to investigate how internal controls in financing public educational institution works it means which internal controls are important in financing the preschool institution - on the selected institution to show and check how internal controls work. For this reason we divide internal controls in the financing in two phases: (1) internal controls in the preparation of the annual financial plan and financial planning of financial resources for institution's programs and activities, (2) internal controls in obtaining financial resources. We used methods of internal auditing and research approaches as sampling, unstructured interviews and analysis of documents. The results showed that selected preschool institution should work on rules of recovery and monitoring of claims. The findings provide useful academic insight to setting internal controls as well as practical guidance for preschool institutions.

Key words: financing, internal control, educational institution, auditing.

JEL classification: M42, I21.

1. INTRODUCTION

The purpose of this paper is to research, how internal controls in financing of public education institution, in our case preschool education, should be working and how they really work. The programs and activities of preliminary education in Slovenia are mostly financed from municipality's and state's public money and also parent's money, so it is important that financing is transparent and in accordance with the laws. Important part of financing preliminary education is planning of financial resources and cash acquisition (funding). Funding is made from three sources: municipality, ministry of education and parents, that is why we consider preschool public institutions as budget users. Public institution should have internal controls of the funding, in order to reduce the risk of fraud. Research in this area has traditionally focused on private-sector corporations, and surprisingly little is known about the practice in municipalities (Paananen, 2016, 149), who are the founders of institutions in preschool education in Slovenia. Education is a strategic area of development (Nastase and Hodoroaba, 2011, 53). Slovenia is using from state's budget around 350 million euros. The task of internal auditors is to be independent and to check if internal controls in financing exist and if they work. Since 2002, there has been a significant and rapid growth in regulation related to the audit profession (Knechel, 2016, 215).

2. PRESCHOOL EDUCATION

The public preschool educational institution is a public institution that is an indirect budget user of state or municipal budgets, which is financed indirectly through direct users, namely line ministries or municipal administrations. Typically, a special agreement (contract) is required for such financing. The appearance of the unpredictable environment caused by the constant social, political and economic changes, it puts inevitably the management in the position of decisive search of new managerial ways for improving their professional performance (Turi, 2016). That is why the

management (headteacher) of the public preschool educational institution is responsible also for establishing internal controls in financing the institution.

Legal funding of the public preschool educational institution ensures that financial resources are provided and used only to the extent and for the purposes intended by the ministry of education at the state level and the municipal council at the municipal level. The financing of activities is determined by various regulations, including basic legislation (for example, the Law on Financing of Education, Public Finance Act and the Accounting Law), related legislation regulating the individual field of financing, various internal regulations, guidelines and conclusions of the founder. Parents are financing the preschool institution by paying part of the price of programs, defined by the preschool institution and municipality.

The Slovenian Law on preschool educational institutions (Official Gazette of the Republic of Slovenia, No. 100/05) and the Curriculum for preschool educational institution are the basic documents of the legislation that refer to the activity of preschool institution. On these two documents, the planning of programs and activities of preschool institution are based. The public preschool educational institution as a user of public funds must produce two planning documents each year, which must be harmonized. These are the annual working plan, which is the substantive, and the financial plan, in which is the annual working plan financially evaluated.

At the beginning of the school year, the headteacher with other workers prepare an annual working plan of the preschool institution, which is prepared for the school year. This is the basis for the financial plan which are prepared for the calendar year. The financial plan must be in accordance with Article 21 of the Law on preschool educational institutions, with the expected revenues from budget funds and the related price of the institution programs. The financial plan is an act of a budget user, which is gaining more importance. The base for planning of the expected budget for financing the activities of the preschool institution are the municipal budget for the coming year and the confirmed price of institution's programs, defined with the help of municipality.

Based on financial plan, which must be approved and accepted by the ministry and municipal council, the preschool institution receives financial resources. The headteacher, with good management of funds and planning, contributes to the rational use of budget funds.

The financial plan of the public preschool educational institution is prepared on the basis of:

- the annual working plan; according to Article 21 of the Law on preschool educational institutions; this is in line with the expected revenues from budgetary funds and the confirmed price of programs;
- recommendations from the Ministry of Finance to lower material costs;
- Rules and methodology for calculating the price of programs in kindergartens;
- the annual report for the calendar year;
- agreement with the municipality on funds for investment maintenance and funds for the purchase of equipment;
- decisions by the municipal council regarding the reservation of cities during the summer months.

Pre-primary (preschool) education programs have a certain price financed by the municipal and state budget, parents of children in institution and others. The prices of the programs are determined by the preschool institution and given as proposal to the founder of the institution (municipality). The methodology for the calculation of price of programs in preschool institution, which is performing the public service, is determined by the minister responsible for pre-school education (Article 31 of the Law on preschool educational institutions).

Parents pay the price of the program of preschool institution, in which the child is sign up. The cost of the program includes the costs of childcare in the institution which does not include funds for investment and investment maintenance. What part of the price of the program is paid by the parents is determined by the local community (municipality). Parents are classified in classes, taking into account the income per family member compared with the average salary per employee in the Republic of Slovenia and the assets of the family (Article 32 of the Law on preschool educational institutions).

The Law on preschool educational institutions and the Rules on Parental Payments for preschool educational Programs (Official Gazette of the Republic of Slovenia, No. 129/06) have established also the manner and conditions for lowering the price of pre-primary education programs, payed from parents. Parents of children who have registered permanent residence in the Republic of Slovenia or if one of parents has a temporary residence and liable for personal income tax, are entitled to a price reduction. In accordance with the procedure laid down in the Rules, parents can claim a reduction in the payment of the kindergarten at the competent municipal authority. The municipality issues a decision of final payment for parents.

3. INTERNAL AUDITING

»Internal auditing provides an independent verification of financial management systems (management) and controls and consultancy for management to improve their effectiveness,« (Article 100 of the Public Finance Act and Horvat and Martinčič, 2016).

Siriwardane, Hoi Hu and Low says that experienced auditors rate professional integrity, assessing audit evidence, and having a questioning mind (indicative of professionalism competency) as the three most important skills, knowledge, and attitudes (2014, 193)

Internal audit in preschool public institutions is provided by community founder, if this is not possible, however, the institution hire outsourced internal audit. Budget users whose annual budget exceeds 2,086,463.03 euros, are required to provide internal auditing at least once a year, while other budget users at least once within a period of three years (Horvat and Martinčič, 2016).

»Internal control and internal auditing are the least developed sections in school financial management. One of the internal control weakness is that it is usually performed by the accountant, who also prepares statements of account and budget, and in the case of Slovenia the biggest problem in internal auditing is that the state does not provide financial resources, and therefore only those schools that obtain more financial resources from performing activities on the market can afford to conduct this activity. Notwithstanding, the rules for performing internal control can be set in the internal rules such as for example accounting rules and rules on inventory check. The internal rules should define at least the sections of internal control, time-frames and accountabilities,« (Horvat, 2007).

Internal auditors verify the planning and execution of budgets and financial plans, whether the funds are being used properly and expediently, and above all, they ensure that internal controls are in place and that they operate successfully, to reduce the risk of irregular and improper operation. The internal auditor may not perform an operational task and may not carry out audits in procedures in which he previously participated. It is the realization of the principle of impartiality (Vidovič, 2012,14).

Internal auditor should respect the so-called National guidelines, when doing auditing.

National guidelines for internal auditing determine the internal audit as a tool by which the head or the management of the budget user from an independent source gets the assurance that internal controls meet their objectives and that the risks are controlled at an acceptable level. Subjects of internal auditing are all systems, processes, events and activities of budget user,« (Guidelines for State Internal Auditing, 2003 and Horvat and Martinčič, 2016).

The purpose of internal auditing can be (Regulations on the Internal Audit in Direct Spending Budget RS, 2011 and Horvat and Martinčič, 2016):

- »investigate and evaluate the adequacy, effectiveness and quality of the internal control system,
- providing a reliable and creditable information,
- ensuring compliance with policies, plans, laws and regulations,
- protection of property,
- ensuring the efficient and effective use of resources,
- achievement of stated goals and objectives relating to operations or programs, and continuous improvement of the implementation of the basic business functions of direct budget user. «

The person who is internal auditor should fulfil the conditions determined by the Slovenian Public Finance Act in Article 100a. He or she must acquire the title of state internal auditor or certified state internal auditor. This title can be obtained by a person who has university degree, appropriate work experience and has passed the exam for obtaining the mentioned titles. Other conditions were determined by the Minister of Finance. This has adopted by the Rules on the certification of title of state internal auditor and certified state internal auditor and an educational program for the acquisition of these titles. Internal auditors, who are employees of state agencies, local administrations or other public entities (whether direct or indirect budget users) whose business is audited, have the status of civil servants - officials. They work in internal audit services (Vidovič, 2012, 14).

On the basis of theoretical and law background we assume, when the internal auditor reviews the functioning of internal controls in the financing of the preschool educational institution, he must review the internal controls in two phases of financing: (1) internal controls in the preparation of the annual financial plan and financial planning of financial resources for institution's programs and activities, (2) internal controls in obtaining financial resources. On the basis of the aforementioned legislation, theoretical and empirical experiences, we presented in next chapter the methods of internal auditing, the research methodology in case study and internal controls that the internal auditor needs to examine in two phases of financing the preschool educational institution.

4. RESEARCH METHODOLOGY

We will focus on a singular study of an internal audit case of financing a social entity, and this is the public preschool educational institution in Slovenia. According to the research methodology, the results should help the management of the public educational institutions and the internal auditors in getting to know and understanding the functioning of the social entity in the context of its internal controls in financing.

We set the following research question:

How internal controls in acquiring (funding) financial resources in the public preschool educational institution work?

The research will be of a qualitative nature. The case study is combined with some of empirical methods. It will be performed by using the audit methods of internal controls, inside of this audit methods we will use analysis of secondary written documents, unstructured interviews and the selections of a non-statistical sample of documents or data or employees in the selected preschool institution in 2016. These are methods how we will find out how internal controls of financing in the public preschool educational institution work. According to our best knowledge from theory and practice, such case study in Slovenia was not yet.

Below we are showing which internal controls, based on law and experience should we in position of internal auditor check in planning financial resources and which methods of research and internal auditing we will use to examine the planning of financial resources:

1. First, as the internal auditor we must first check whether the preschool institution has the relevant planning documents. Therefore, we must make an unstructured interview with the head teacher (management), check the existence and content of documents in the area of planning the activities of the institution and check whether the contracts between the municipality and the preschool institution on the financing of the institution are signed and valid. The mentioned documents are internal controls in the planning of financial resources.
2. Second, as the internal auditor we should check that the preschool institution has a properly prepared financial plan. Therefore, we have to check the consistency of the content of the financial plan with the legislation, the consistency of the content of the financial plan with

- instructions from the ministry and the municipality on the financing of the preschool institution. The financial plan is the internal control in the planning of financial resources.
3. Third, as the internal auditor we should check does the preschool institution have an adequately calculated price for the preschool program and are the decisions on lowering that price for parents correct? We must make an unstructured interview with accountant and bookkeeper. Also examining whether the preschool institution follows the rules in the calculation of the price of the program of the preschool institution and whether it has appropriate documents. The internal controls are documents for calculating the price of the program, the documents for lowering the price of the preschool program and laws for calculations.
 4. As the internal auditor we should also verify, are the act of systematisation of jobs (the number of employees is defined by the number children), the annual work plan and the financial plan adopted (confirmed)? We make an unstructured interview with head teacher and verification of the existence of documents of meetings, correspondence between the preschool institution and the ministry of education and other evidence where the reception of these documents is evident. The mentioned documents are internal controls.
 5. And finally we should as internal auditor verify, does the preschool institution have appropriate internal rules relating to the financing of the activities? We should make verification of the Rules on Accounting, the Rules on the Movement of Bookkeeping Documents, the Act on Establishment, the Act on the Systematisation of Jobs, whether they exist, whether they are signed and valid, or refer to the financing of the preschool activities. The mentioned documents and laws are internal controls in the planning of financial resources.

Further we are showing which internal controls should we in position of internal auditor check in acquiring financial resources and which methods of research and internal auditing we will use to examine the obtaining of financial resources:

1. First, as the internal auditor we should check is the acquiring of financial resources (calculation of financial requests to ministry and municipality and price of programs to parents) carried out in accordance with the financial plan? For checking internal controls we should make comparison of gross balance (comparison of the group of accounts of the 760-dotation of the ministry, municipal dotation, parents payments) with the financial plan.
2. Next, as the internal auditor we should check is the claim substantively and formally appropriate. We check internal controls with selecting a non-static sample and checking on the sample whether the financial requests are substantively and formally relevant (non-static sampling), which means checking the formal correctness (or containing the relevant information, the release date, ...), the content regularity (eg. amount, compliance with the law and calculation program prices, ...) and the timeliness of the financial requests given.
3. Then we should verify are the payment orders formally and substantively appropriate? We verify internal controls with choosing a non-statistic pattern of payments and verifying formal and substantive relevance, which means checking the following: date of issue, date of service rendered, correct calculation of financial requests to ministry, municipality and parents.
4. Next, as the internal auditor we should check is monitoring money transfer established? We check internal controls with selecting a sample of weekly printouts of inflows and outflows, and checking the amounts on the sub-account of the The Public Payments Administration of the Republic of Slovenia (PPA).
5. Then we verify is recovery of claims arising from the payment deadline? We check internal controls with a sample of matured receivables up to 30 days, up to 60 days and up to 90 days, and verification of the payment of financial requests. We check internal controls with a sample selection and examination of warnings and enforcement orders and making interview with accountant and headteacher.

In next chapter we will make the case study on the selected preschool educational institution, which will be based on the methods of audit and research that we have described in this chapter.

5. RESULTS AND DISCUSSION

The case study was conducted from the point of view of the internal auditor. In this case study, we give concrete results from the internal audit of the functioning of internal controls in the public preschool educational institution for financial planning of financial resources. In the continuation of this chapter we provide some of the more important results from the internal audit, whereby the financing of the activities of the public preschool educational institution is revised in order to obtain the appropriate ground for providing assurance about properly established and functioning internal controls. We will show the results of the verification of control activities. The objective of assessing the operation of internal controls is to determine the degree of completeness and reliability of the financing programs and activities in preschool institution.

5.1. FINANCIAL PLANNING OF FINANCIAL RESOURCES

First, we show the results of checking internal controls in the preparation of the annual financial plan and financial planning of financial resources for institution's programs and activities. We have verified the existence and validity of planning documents from the area of funding and base activities of preschool institution. We found that the preschool institution regularly prepares the development plan, the annual work plan, the financial plan, with the ministry responsible for education and the founder municipality. They have all signed valid contracts (agreements) about the financing of activities. The plans have been prepared in accordance with the Law on Financing of upbringing and education, the law on public finances, the accounting law and regulatory regulations.

Particularly close we checked the price calculation of the kindergarten program in more steps, for the purpose of verification of the coherence of the process of financing activities related to payments of parents with legislation. The goal of the price for the program from preschool institution side is to ensure the smooth financial management of the preschool institution, whose founder is the municipality, ensuring public service in accordance with the needs of parents and at the same time prescribed norms and standards. In the first step of checking the calculation of the price of the preschool institution program we collect the basis (regulations) that determine the price of the preschool program. The bases for calculating the price of the preschool institution program are the Law on preschool educational institutions; Rulebook on the methodology for pricing programs in kindergartens performing public service (Official Gazette of the Republic of Slovenia, No. 97/2003, 77/2005, 120/2005); Rulebook on norms and personnel conditions for performing activities pre-school education (Official Gazette of the Republic of Slovenia, No.75/05, 82/05, 76/08, 77/09, 102/09, 105/10).

In the second step of checking the calculation for the price of the preschool program, we checked the calculation methodology on the number of departments. The cost of the preschool institution program is calculated based on the number of children which is defined as the highest norm for the forming of each separate type of department, no matter how many children are actually included in the department. If the number of children in the department is less than the number specified as the highest norm for forming a particular kind of department, the municipality as the founder of the preschool institution is bound to ensure the preschool institution funds in the amount of the program price for the number of children, which represents the difference between the actual number of children in the department and the highest norm. We took into account the rule that the preschool institution created two program pricings for children in departments: the price of the program of the first age period from one year old to three years old and the price of a program of another age period from three years old to the time of entry into school.

We compared the number of subscribed children in the first and second age brackets with the number of children determined by norms for both age periods (for the first age period, the norm is 7 to 10 children in a department, for the second age period is the norm of 14 to 19 children in a department). On this basis we compared the number of children enrolled and the number of classes. We did not find any irregularities. The financing difference to reach the norm was actually covered by the founder municipality.

In the third step of testing the calculation of the price of the preschool program we checked the basics or elements for calculating the price of the programs. As it is clear from the regulations, the basis were labour costs, material and service expenses and expenses of the food for the children. The expenses, which were not elements for calculation according to the rule book, were covered by the preschool institution's founder according to the law, the act about establishing an institution or in accordance with the contract for financing of the institution.

First we checked the accuracy of the calculation of labour costs. The basis for calculating labour costs is systematization of working posts, determined by the number of departments and children, while using norms, defined by the rules on norms and personnel conditions for performing activities of preschool education. The correctness of computing the number of sections was checked in the previous step. Therefore in continuation we checked the calculation of the number of employees. The systemization of posts was determined by the headteacher in cooperation with the assistant headteacher, the systematization was confirmed by the founder or mayor of the municipality. We took into account the rule, that labour costs were represented only by employed pedagogical workers and others professional preschool institution workers. We checked the correctness of the type calculation (headteacher, assistant teacher, assistant headteacher, counsellor, janitor, cook and her assistant, organizer of nutrition, cleaner, laundress, accountant, bookkeeper, administrative worker) and the number of employees. Below we checked the calculation of labour costs. We took into account the cost of salaries in the calculation as derives from the state's Collective Agreement for the Salaries. In the accounting of the preschool institution we acquired the full amount of the labour costs for the school year 2015/2016 and we randomly checked the salary of the headteacher and assistant headteacher (we took salary information for the selected month, about 16.1% of contributions on salaries, and other labour costs such as reimbursement of the meal, the amount of collective insurance, eventual jubilee reward, recourse and transportation to work). We did not find an irregularity in internal controls.

Then we checked the accuracy of the calculation of the expenses for materials and services for a specific month. In the accounting department we acquired the costs for a certain month, the costs that were necessary for the operation of the preschool institution: heating, electricity, water, gas, public utilities, compensation for the use of building land, insurance premiums, office supplies, payment transaction costs, telephone services. We payed attention whether at this calculation any other costs may be accounted for, that did not fall within the elements of the program price of the preschool institution, these costs were for example, costs for investment maintenance and investments, which were in accordance with the law provided for preschool institution by the local community and all other costs not directly related to the implementation of a public service program (for example: redundancies for redundant workers, providing funds for the work of trade unionists, the employment of workers with whom they go beyond prescribed norms, funds for restoration of worn-out equipment, furniture). We did not find any irregularities in internal controls.

We also checked the calculation for the cost of food for children: We got the type and quantity of food for preparing meals and lunches for a certain month from the diet organizer; we acquired the prices of these foods and calculate the monthly expenses for break time snacks and lunches for a 9-hour program. We compared this cost to the average monthly diet price calculated by preschool institution and we found a low, 2% deviation. On a sample of 5 children, who were absent in a given month, we checked whether in the absence of the children from the kindergarten the corresponding amount of food worth is deducted from the parents. We cannot find an irregularity in internal controls.

By adding up all items of costs for a particular month, we calculated the monthly cost of the preschool program. Originating from the written checks, we found that the calculation of the preschool program was correct.

For the purpose of checking financial planning, we also obtained and study internal policies, which were the basis for the financing of the activities of the preschool institution. Internal policies were updated and signed, people were assigned to update and received these policies regularly. In documents (as internal controls) we did not find any irregularities.

5.2. ACQUISITION OF FINANCIAL RESOURCES (FUNDING)

By comparing the gross balance (obtaining a yearly amount from the accounts 760-dotatiton of the ministry, municipal dotation, parental payments) and the financial plan we checked, if in the processes of acquiring financial resources by the municipality, by the ministry and by the parents everything was in accordance with the financial plan.

We randomly selected a sample of five financial requests sent to the municipality and the ministry, for the year of 2016, and checked their formal and substantive relevance and whether they were sent on time. We tested their formal (title, date of issue) and content suitability (compliance of the amount and the price of the program, which is covered by the municipality or the ministry, with a financing contract and a calculation of the prices for the kindergarten program; and compliance of the amount of investment maintenance with the financing contract). We found that following the rulebook on circulation of bookkeeping documents, the control was performed by the accountant. We made sure, if the submitted claims were recorded in the records of issued claims. No errors were found in the examined sample of applications and in the observed work process as well as no shortcomings in the functioning of internal controls.

Then we checked the internal controls of the acquiring the funding by parents. We checked the existence and components of the records of caring fee and from the records. We randomly selected a sample of charged care fee and tested formal and substantive the correctness and appropriateness of the calculation of care fee by comparing it to the preschool program price. We randomly selected a sample paid bill and check the punctuality of the delivery. Calculation of care fee was actually carried out by the accountant, while the bookkeeper was responsible for printing and sending bills. Special attention was paid to the recovery of overdue claims on the parents from care, where we start out from amount of outstanding and unpaid receivables on the day 31.12.2015. Based on an interview with the accountant and the headteacher we collected evidence that the preschool institution or more particularly the accountant sent to parents reminders, called the parents on the phone, for the purpose of repayment of the claim, arranged the payment of claims in several instalments, executed e-enforcement, thus performing acts as a good manager. Based on a sample of expired receivables, we checked their monitoring in accounting. The accounting officer performed a write-off of claims on the basis of failed e-enforcement; in the event that the costs of judicial recovery exceed the amount to be claimed and if the time needed for the abatement of the debt has passed, preschool institution decided against judicial recovery and could cancel the receivables preschool institution took into account the general limitation period of 5 years (Article 346 of the Obligatory Code). Recovery and monitoring of claims was carried out, but without written instructions or the rules on the recovery of claims.

In the examined sample of the accounts of care fees and payment orders and in the observed work process, no errors were detected, nor were there any weaknesses in the functioning of internal controls, the only drawback is in the missing instructions for the recovery of claims.

Payments from applications and payment orders were monitored weekly by the accountant and headteacher, so that the accounting officer made a weekly printout of transfers from the sub-account of the PPA, the headteacher of the reviewed and signed the printout.

Results on the above mentioned internal controls in the field of acquiring of funding sources from parents, we consider it appropriate, except in the field of collection and monitoring of claims, where they are rated as partially adequate.

6. CONCLUSION

The results of case study show that selected preschool institution should work on rules of recovery and monitoring of claims. These rules are one of the internal controls in financing the preschool public education. The unpaid claims are mostly the result of unpaid financial requests (bills) from parents. Without the rules of recovery of claims there is no paid money for financing the programs and activities of the institutions. At the same time, the liquidity of the preschool institution can become worse. In order to minimize these losses, a more active involvement of local actors is necessary (Nastase et al, 2011, 54). We suggest that municipalities as the founders of preschool educational institutions should encourage the elaboration of rules of recovery of claims.

We would also like to mention the shortcomings of the research. According to the research methodology, the results of the case study cannot be generalized, but they can help in recognising the main internal controls in financing the preschool school on which it should be transparent because it uses public money.

For future research we recommend the make comparisons of this research with other countries and other preschool schools.

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