Responsible Accounting For St. Joachim’s
Stephen G. Kerr, Bradley University, USA

ABSTRACT

St. Joachim’s is a private school district. The case explores some of the challenges organizations face when implementing appropriate responsibility accounting structures. St. Joachim’s is a not for profit organization struggling with change. The existing accounting reports and procedures are not consistent with the strategic change the organization is implementing. The reader must apply knowledge of responsibility accounting, budget processes, cost allocation, relevant costing, and performance evaluation to create recommendations for accounting policies that will support the organization’s new strategic direction.

Keywords: Case, Transfer Pricing, Accounting, Cost Allocation, Responsibility Accounting, Performance Evaluation, Organizational Structure, Relevant Costing

INTRODUCTION

Dr. Benedict Luca is Chair of the Board of Trustee’s of the Joachim School District. In that role he has been spearheading an effort to raise $35,000,000 for a new building for the District. As an experienced and respected CPA Dr. Luca is making steady progress on that goal. In recent weeks he has heard concerns from some potential donors that also have children in a District school. Those parents are aware of infighting that is reducing their confidence in the District’s plans. If this impression becomes well known Dr. Luca knows he will face an impossible task. Day to day operations are under the control of the Superintendent, Joan Agnes.

Dr. Luca recently confirmed the parents concerns. Dr. Agnes acts as the CEO of the school district. Dr. Agnes invited him to attend the weekly meeting of the senior administrators. During that meeting Dr. Luca learned of a beneficial contract that the superintendent’s office was rejecting. The accounting procedures he had implemented 20 years before were not leading the administrative team towards prudent decisions. He was very concerned by the level of conflict in the decision making process. Since the Superintendent and the Associate Superintendents all lacked business experience he determined that the Trustees would have to intervene. The Trustees are going to need to put in place new control systems so that the crucial work of running the schools is not hampered. Dr. Luca is taking on the task.

BACKGROUND

A pioneering mid-west bishop founded St. Joachim’s School in 1860. The original school provided parochial K-12 education in response to the racist attacks of the know-nothing movement. In the 1930s when good public schools were readily available the school adjusted to a high school only format. The Joachim School District was formed when nearby St. Anne’s, and then St. Mary’s joined together to share resources. All 3 schools experienced declining enrolment during the 1980s as fine new public high schools were built. In the 1990s, the school principals realized that families would not pay private tuition for average education because it included some religious curriculum. After several years of debate the Trustees voted in 2002 to focus on academic excellence and recruit college bound students.

In 2004, the Joachim School District hired a new superintendent, Joan Agnes, implement the new academic focus. She consolidated programs to achieve cost effectiveness and program synergy amongst the schools. By 2006, these big changes were not proving to be enough to restore the schools to their former prestige. The Trustees determined a serious academic image would not be achieved until a new modern facility was constructed. A 100
acre site with good access for the entire existing student population was purchased. To invoke a sense of mission the Trustees named the new school Saint Johns. The Trustee’s hoped to raise $35 million from the local Diocese, Alumni, and friends so construction could be complete for the 2010/11 school year. While the campaign was on, Joan Agnes was directed to prepare the schools for consolidation.

Saint John’s would admit up to 3,000 students. Enrollment would need to increase to use this capacity, even though this was less than the historic enrollment at the three constituent schools. Plans called for St. Joachim’s, St. Anne’s, and St. Mary’s to stop accepting freshmen in 2010/11. All freshmen in 2010/11 would go to Saint John’s and establish fresh academic traditions. The old schools were on valuable real estate and will be sold to raise further investment for Saint John’s after the last class of seniors graduated. Some families that would have siblings in different high schools under this plan were upset with this strategy. Joan Agnes moved quickly to consolidate administration. Her goal for 2008/9, as she described it to the Trustee’s, was to have the District functioning as one school with three semi-autonomous locations. The leaders at the existing schools were struggling to understand their roles through 2014.

ADMINISTRATIVE REORGANIZATION

The schools had a great deal of autonomy until 2008/9. Joan Agnes centralized many administrative functions to ease the transition to Saint John’s. Individual school budgets, programs, and any external revenue activities now required prior approval by Joan Agnes or one of the two new assistant superintendents. The principals and the assistant superintendents are evaluated on the basis of program quality and budget compliance. Joan would start to be more hands on in preparation for becoming the Superintendent/Principal of Saint John’s. The assistant superintendents will also become vice principals in 2011/12 when Saint John’s opens. The existing principles will be given roles as department heads after their schools close in 2014.

Joachim District Schools have three sources of funding. Families pay tuition and are given discounts on the tuition for a 2nd and 3rd child. Each of the 25 local catholic parishes are assessed a fee by the diocese based on the number of children registered from a parish in the system. The state government also gives the District a building grant that partially recognizes the public system savings created by students not attending a public school. Each school is encouraged to enhance their programs by finding additional revenues. In the past, this has included offering continuing education courses, renting out facilities for special events, and fundraising. The first three revenue streams go into the Joachim School Districts account. Each school gets a share of the revenue in proportion to registration. School principals can increase their funding by successful student recruitment.

Both assistant superintendents are new to the Joachim School District. Mark Miller joined the district as the Assistant Superintendent of Administration in the spring. Matthew Kessler joined the District in the summer as Assistant Superintendent of Curriculum. A budget was established for these departments and those that reported to these assistant superintendents. The assistant superintendents are expected to live within their budgets. The budgets will change substantially as Saint John’s comes online and the 3 older schools phase out. An organizational chart of the district for 2008/9 is shown in Exhibit 1.

In previous years, the work now assigned to the assistant superintendent offices occurred at the schools. Centralization was producing savings and helping the District discover best practices to transfer over to Saint John’s. The District was charging the schools for the centralized support services. Each school is charged a per student rate to cover the cost of these departments. Joan wanted the principals to be aware of the cost of the services they were consuming. Since the amount was substantial, the school principals had started to complain about the unfairness of the charges. The complaints became so strong Joan Agnes called a special meeting to review the situation.

MEETING OF PRINCIPALS AND ASSISTANT SUPERINTENDENTS

Joan Agnes called the meeting so that the assistant superintendents and school principals could clear the air through better understanding. She started by presenting a summary of the budgets for the central service departments which reported to Mark Miller and Matthew Kessler. The budget summaries are shown in Exhibit 2.
Mark explained the purposes behind each part of his departments program. Matthew then presented the budget summary for the Curriculum Department. The budget summary is shown in Exhibit 3. He then explained his goals and the work he was doing to establish a unified curriculum plan for Saint John’s by identifying the best resources for each subject at St. Joachim’s, St. Anne’s, and St. Mary’s.

James McGinnis, the Principal of St. Joachim’s, objected to the size of the administration charge to his school. His budget is shown in Exhibit 3. Mr. McGinnis said that $1,627,500 was excessive for a school like St. Joachim’s. He argued that he was subsidizing the other schools. A large number of his students drive to school. The other schools have a high portion of students that require busing. He also commented that his school offers few electives. Their focus is on the required diploma and advanced placement courses. As a result, Mr. McGinnis thought he required less curriculum support per student.

Victor Parachin is the Principal of St. Anne’s. He had objections to the way maintenance costs were included in the budget. St. Anne’s had been extensively renovated about 10 years ago. The upgrades had greatly reduced the schools energy use. Newer equipment meant they had lower maintenance needs and the building was energy efficient. Victor was also concerned about the lack of free space and meeting rooms at his school. According to him, that made it difficult to raise the extra revenue needed to support extra curricular activities.

Marlena Doucette, Principal of St. Mary’s, surprised everyone by not complaining about the budget amounts. Instead, she wanted to know why Matthew was not responsive her school’s special requests. Ms. Doucette had apparently requested approval of a new grade 12 math book in the spring to update her school’s curriculum. Approval was given too late to implement the change in the current year. She complained that the system made it difficult for her to fund enough teaching positions. Even though her teacher-student ratio is already at a low 22.5:1, she indicated some classes were huge because of regulations forcing her to provide close teacher supervision to three students with severe physical handicaps.

The principals were surprised when the assistant superintendents had their own concerns with the system. Matthew Kessler indicated he felt extreme stress due to a projected budget overrun. He explained that his mandate was more complex than anticipated. The only way he would get back on track was to extend the schedule for curriculum assessment. He did note however, that the lack of team spirit was contributing to his difficulty. His comment was directed at Mark Miller’s department.

Matthew Kessler presented the group with the schedule of faculty retreats. He was using District buses to send teachers, by subject area, on District-wide weekend retreats to build consensus about curriculum. He noted the excessive internal cost of the District buses he was expected to use. He presented a quote from Brown-Horse Bus Lines for a recent trip for the Science teachers. The external cost of a luxury coach was less than half of the internal cost of a school bus. Matthew then showed the meeting the trip budget which is included in Exhibit 4. He proposed that outside suppliers be allowed to keep Mark honest.

Mark Miller had been very glum during the entire meeting. He took the bus discussion personally. He complained that it would be better for everyone to learn to work within the financial system the Board of Trustees had established. Mark reiterated how much the buses cost. He had to transfer the cost of the trip to Matthew to avoid creating his own deficit. Mr. Miller pointed out that any costs not covered by Matthew would increase the administration charge to the schools. None of the principals were in favor of that alternative. It was simply not fair to compare internal services to an outside bid according to Mr. Miller.

Emotions had built up during the meeting and left everyone feeling anxious. Sharing information had not made the situation any better. The meeting ended with a promise by Joan Agnes to consider all the concerns and respond with improvements to the system. She did not know what the answer would be, but Joan was glad they could work this out before they had 3,000 students filing into a school that was not properly organized!
SUPERINTENDENTS MEETING

Dr. Luca joined the superintendents at their next meeting. They referred to their (Mark, Matthew, and Joan) weekly meeting as the leadership forum. They were very glad to have Dr. Luca present following the difficult session with the principals. Dr. Luca asked a great many questions and there was agreement that the current organization of the Joachim School District was not producing desirable outcomes. They all agreed that the organizational structure and accounting procedures of the District needed to change in light of the current problems.

Before the meeting ended Mark asked if the changes Dr. Luca would propose would help with a new problem he had. James McGinnis had submitted a proposal for approval. James had found an athletic club that wished to rent surplus space from St. Joachim’s. Mark showed the group his analysis which can be found in Exhibit 5. The school was excited about finding $90,000 of needed revenue. Mark was surprised they did not realize this was below costs. He feared that rejection by the central office would escalate the frustration parents were hearing from the principals. Dr. Luca promised to meet with them next week with recommendations to get the successful launch of Saint John’s High School back on track.

EXHIBIT 1: ORGANIZATION CHART

Joachim School District
Organizational Chart
EXHIBIT 2: ADMINISTRATIVE SERVICES

ACADEMIC CURRICULUM and ADMINISTRATION BUDGETS
2008/9 SCHOOL YEAR

Curriculum:
- Salaries and benefits: $960,000
- Materials and supplies: $390,000
- Teacher recruitment and training: $273,000
  Total: $1,623,000

Administration:
- Salaries and benefits: $675,000
- Superintendent and Board: $309,000
- Office supplies and computer operations: $419,250
- Busing: $2,015,625
- Facility maintenance and utilities: $631,125
  Total: $4,050,000

Total: $5,763,000

Budget notes:

1. The Curriculum Department and Budget is administered by Matthew Kessler. He is responsible for the overall academic program and related standards of the District. This includes curriculum development, teacher personnel, teacher evaluation, school planning, and teacher training. The department has 13 full-time staff.

2. The Administration Budget is administered by Mark Miller. He is responsible for all operations outside of the classroom. This includes facility maintenance, accounting, busing, and the superintendent’s office.

3. Everyone who works in the Academic Curriculum and Administration Departments records and codes their daily time allocation through the District's shared outlook calendar. The Superintendents conduct a review the past years time allocations to identify problems and set the next years goals. The time goal for 2008/9 is:

<table>
<thead>
<tr>
<th>Department Providing Service</th>
<th>Total Hours Providing Service</th>
<th>Service hours directed at:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Curriculum</td>
<td>Administration</td>
</tr>
<tr>
<td>Curriculum</td>
<td>21,840</td>
<td>-</td>
</tr>
<tr>
<td>Administration</td>
<td>43,800</td>
<td>2,600</td>
</tr>
<tr>
<td>Total</td>
<td>65,640</td>
<td>2,600</td>
</tr>
</tbody>
</table>
EXHIBIT 3: St. JOSEPH'S HIGH SCHOOL CONDENSED BUDGET

<table>
<thead>
<tr>
<th>Revenue:</th>
<th>Regular Program (1)</th>
<th>$4,935,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Continuing Education (2)</td>
<td>$787,500</td>
</tr>
<tr>
<td>Expenses:</td>
<td>Central Office Charge</td>
<td>$1,627,500</td>
</tr>
<tr>
<td></td>
<td>School Overhead (3)</td>
<td>$375,000</td>
</tr>
<tr>
<td></td>
<td>Academic Program (4)</td>
<td>$3,354,000</td>
</tr>
<tr>
<td></td>
<td>Continuing Education (5)</td>
<td>$540,000</td>
</tr>
<tr>
<td>Deficit</td>
<td>$5,896,500</td>
<td>$(174,000)</td>
</tr>
</tbody>
</table>

(1) State regulations require each student to receive 1,200 hours of instruction. St. Joachim’s break their students into homeroom cohorts. They have 26 cohorts for this school year.

(2) Continuing education classes run throughout the year. 60 classes are scheduled and the budgeting assumption is that registrations will average 25 per class. The standard offering involves 80 hours of instruction. Regardless of status the cost is $525 per class.

(3) This is primarily the salary and benefits of the superintendent and related school based support that is not centrally processed.

(4) The budget rate per cohort is $129,000 per class. This covers faculty salary and benefits and related classroom resources.

(5) The regular faculty staffs the continuing education program. A budget of $9,000 per class covers the teacher contract and all the course related supplies. This helps the district keep staff that could make more in the public school system.

EXHIBIT 4: TEACHERS RETREAT

Matthew Kessler took the Science teachers to Mega-City for a Saturday planning retreat. The round trip was about 300 miles. The school bus left at 8 am and returned to St. Joachim’s by 10 pm. Mark billed the Curriculum Department for the trip using his budgeted costs for the bus program. Mark’s calculation follow:

| Bus Costs: | Garage and yard (1) | $249,000 |
|           | Fuel (2) | $324,000 |
|           | Tires (3) | $82,500 |
|           | Annual insurance | $145,125 |
|           | Drivers (4) | $405,000 |
|           | Bus leases (5) | $810,000 |
|           | Total Cost | $2,015,625 |

| Total route miles | 312,500 |
| Cost per mile | $6.45 |

(1) The bus yard costs $60,000 per year. In addition to the base cost the minor repairs, cleaning, and safety checks add up to $21 per day per bus. The Joachim School District operates 45 buses and has 200 regular school days.

(2) An average route requires 3 hours per day. Each bus consumes $12 of fuel per operating hour.

(3) Government regulations require most of the tires to be changed annually, regardless of wear.

(4) Drivers earn a total wage of $15 per hour for driving and mandatory waiting periods.

(5) Buses are becoming more expensive to finance every year. The District leases all its buses for $18,000 per bus per year. Major maintenance is provided by the leasing company.

The transfer price for the bus was $1,925. (180 miles * $6.35/mile). When Matthew Kessler asked for a quote from a local bus company they offered the trip for $967.50 ($2.325 per mile plus $270 per day for the driver).
EXHIBIT 5: RENTAL PROPOSAL

St. Joachim’s School borders on a state park containing a very popular bike path. The Heritage Trail Bike Association (HTBA) is a volunteer group of 400 local residents that do volunteer maintenance of the trail and promote weekend use of the trail. They want to rent 2 surplus classrooms from the school for equipment storage and offices. These classrooms have outside access to the park side of the school and are ideal for the purposes of the Association. HTBA has offered to pay $7,500 per month and will provide its own minor maintenance and upkeep of the rooms so MSD will not incur any incremental cost increases. Mark is concerned the proposed revenue will not cover the schools cost for those classroom. Using the costing method required for filing education costs with the state Mark produced the following analysis:

<table>
<thead>
<tr>
<th>Classroom hours</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular and CE use</td>
<td>36,000</td>
</tr>
<tr>
<td>HTBA hours</td>
<td>5,077</td>
</tr>
<tr>
<td>Total Classroom hours</td>
<td>41,077</td>
</tr>
</tbody>
</table>

The cost of the classrooms under this methodology is $2,002,500 ($1,627,500 + $375,000) according to the budget found in exhibit 3. This gives a cost of $48.75 per classroom hour ($2,002,500/41,077).

- Revenue from HTBA: $90,000
- Cost of the proposal (5,077 @ $48.75): $247,504
- Loss on rental proposal: $157,504

TEACHING NOTE

The concept behind this case is to examine the futility of introducing a new strategy without creating accounting structures to support that strategy. Saint John’s High School is the physical manifestation of the Joachim School District’s decision to focus on college bound students. The process of closing 3 schools and opening a new school is a huge management task. Joachim School District is implementing a new strategic direction and so the case places the reader in a more constrained situation. The challenge is to create accounting systems in this not for profit organization that will contribute to success of the implementation process. There is no “CFO” character in the case to stress accounting policy over the quality of the personality in that role.

Responsible Accounting for St. Joachim’s directs the reader to consider specific issues arising in the process of implementing new strategy. It requires an application of cost and management accounting curriculum to a situation that is within the comprehension of a typical undergraduate. The major topics are: budgeting, revenue and cost allocation, transfer pricing, organizational structure, and performance measurement. The reader assumed the role of a board member advising the chief executive officer of the school. Careful communication is necessary. The analysis will focus the CEO on which management accounting policies are obstacles to the implementation of the strategic plan. An easy, but inappropriate, escape from the problems is to recommend a new strategic plan. The reader will need to prioritize the problems in the context of the Joachim School Districts Strategic direction towards a consolidated, high academic, high school facility.

TRANSITION

The Joachim School District is going through an intense transition. In the current year of 2008/9 the school principals have lost autonomy through the creation of two assistant superintendent offices. In addition the Trustees are focused on a capital campaign. By 2013/14 the principals will then wind down their schools and Saint John’s High School will be the only school. Given the lengthy history and tradition in these schools the closing process will be painful. The current accounting policies still reflect the independent history of St. Joachim’s, St. Anne’s, and St. Mary’s. Changes in the system are required to support the transition. It is not reasonable to have the assistant superintendents and principals held responsible for actions that are not priorities during the transition. In other words the whole governance system of the school needs to be aligned with the situation.
Change has to start with the Trustees. They cannot abandon their supervisory role due to the capital campaign. The evidence in the case suggests the Trustees are very passive. Evaluation of the day to day operating officers of the District is infrequent and limited. Dr. Luca will gain important information about the day to day school operations from this assignment. That information can contribute to better governance from the Trustee’s. As evidenced by the complaints from parent’s the success of the capital campaign cannot be assured if the operations are not well attended to. The awkward transitional plan provides a basis for concern about the Trustees skill set.

All the administrators within the Joachim School District are facing a huge professional challenge. Substantial changes in responsibility will occur over the 5 year transition period. Joan Agnes’s role has to change. She is moving into a one school situation requiring progressively more involvement in daily school business. The assistant superintendents and principals have to deal with uncertainty surrounding the start of Saint John’s. Ultimately the management will become centralized in one place. The change will perhaps be hardest for the previously independent school principals who are shifting to lower level administrative roles. Implementation of clear goals and incentives for the principals will reduce the confusion. The accounting system be used to reduce the confusion.

RESPONSIBILITY ACCOUNTING

Responsibility Accounting is the process of organizing reports and procedures to measure financial items under a manager’s control. There is no point in holding a manager responsible for amounts over which they have no authority to change. The current system treats the principals of St. Joachim’s, St. Anne’s, and St. Mary’s like profit centers. Unfortunately many of the school costs are now controlled by the assistant superintendents. Most of the revenues are also determined by sources outside of the school principal’s control. Responsibilities of these administrators are greater than the real authority they have. Good responsibility accounting would limit the each principal’s responsibility to costs they can influence.

Without clear responsibilities the rational choice of the Principals will be to ride out the closure process. It is too soon for the Joachim School District to administratively sideline the role of the three school principals. The schools need to provide a quality program and actively recruit students for at least 2 more school years. At the same time the central departments have to support them while preparing to take control of new school operations. At the moment, there is a role conflict between the principals and the assistant superintendents due to their different focus of their mandates. The assistant superintendents should not have authority over the school principals. All five of them should report to Joan Agnes, as she is ultimately responsible for the successful transition to a single school. So good responsibility accounting would reflect only those costs five administrators influence.

The school principals should not, therefore, have items in their budgets for which the Joachim School District does not want them to be held responsible for. The conflict with the assistant superintendents is partly the result of the principals trying to manage a large cost. An unfair situation exists when the very personnel they need to criticize to reduce costs, also have some authority over them. There is a mixed message when budget responsibility is not aligned with the organizational structure. The case contains enough information to facilitate specific analysis and recommendations for more decentralization or centralization. It is the author’s opinion that centralization is a better strategy in light of the Joachim School Districts strategic plan. To restore alignment in this direction, the following budget changes are necessary:

1) School Revenue: The school principals do not control revenue from the parents, state, and diocese. Evaluation of student recruitment can occur without placing this amount in their budget report. Joan can implement individual rewards for successful recruitment which reflect the unique challenges each principal faces. Revenue from special events and extended education should remain under the schools control. Each principal and their faculty can then make decisions that best reflect the income they want to raise and provide opportunities for them to allocate these funds to areas of school need.
2) **Regular Faculty Budget**: This budget should shift to the Superintendent. Teacher/student ratios and the presence of special needs cases are not under the principal’s control. Each principal should be evaluated on the basis of the leadership they provide to the staff placed under their control.

3) **Curriculum Budget**: This budget is to establish the program for Saint John’s. Overseeing the current schools in their final years is a limited priority. The principals have no control over these costs. The curriculum department is a cost center. Joan Agnes should implement performance measures to adequately monitor development of the Saint John’s program.

4) **Administration Budget**: This budget enables a diverse set of services. There is no revenue function here. Passing costs to the schools will facilitate inefficiencies within the Department. Another problem is the unique situation at each school. Maintenance and busing needs are unique at each school, so allocation is not appropriate. A better method is to regard the Department as an unallocated cost center. Joan Agnes can implement performance measures better suited to the department’s role, than scrutiny and complaint from the school principal.

In light of these changes that result in alignment financial reports with responsibilities more effective performance evaluation can be considered.

**PERFORMANCE EVALUATION**

Change cannot be an excuse that justifies waiting until some future date to look at performance measurement. The responsibility accounting reports and budgets will promote discussion of specific expectations during every step of the transitional process. These schools now have a five year planning horizon. The district has new additional priorities to raise $35,000,000 and start construction of the Saint John’s facility. It is unwise for the Trustee’s to let the existing schools drift due to a lack of purpose. The resulting lack of motivation could threaten the success of the capital campaign and increase recruitment challenges for the new school. Clear performance expectations will reduce tension by coordinating each person’s role.

The prior discussion indicated that quality of decision making within the Joachim Schools District is dependent upon clear expectations and basing performance evaluation on items that officials can control. The primary performance standard is that of meeting the budget. There is little evidence in the case that the accounting and other management systems of the District link to specific performance criteria. The current system does not provide specific rewards for achievement of specific goals. It is unrealistic to expect a high level of motivation toward District goals. The Trustee needs to provide the superintendent and principals with a clear set of goals that link to the Trustee’s Strategic plan. This communication is missing in the current situation.

There are a few concepts that the Trustees need to emphasize. The performance criteria used to evaluate the principals and superintendents needs to be specific and the expectations quantified. Performance will improve if the criteria are understood through extensive discussion. Benchmarking the performance of the officials with other similar districts increases the forthrightness of performance discussions. Rewards must be evident for good performance. The place to start is with Joan Agnes. Dr. Luca should establish specific criteria and goals for her that the Trustees can then use as a basis for monitoring progress. The goals should clarify her supervision of principals and assistant superintendents, recruitment goals, student achievement, and budget constraints. In order to support her work the Trustee’s should also regularly review the assigned responsibilities or the leadership team and require Joan to regularly report on her evaluation of those positions.

Defining performance evaluation criteria is not easy. In the case of the school, many aspects of the implicit goals inherent in the case will conflict. A desire to provide a high degree of student-teacher contact time is at odds with the need to keep per student costs down. Looking at the specific measures will clarify the strategic plan the Trustees are using and will perhaps lead to enhancements of the plan as everyone learns how to link things together. Aligning the measures with good responsibility accounting reports will enable the Trustees to detect problems earlier than Dr. Luca was able to do in the current case.
SERVICE DEPARTMENT COST ALLOCATION

The Curriculum and Central Administration budgets are a significant percentage of the Joachim School Districts total budget. In a decentralized approach, the principals need to be aware of these costs so they can participate in the decisions about the centralized services. School principals will then evaluate the large allocation using criteria such as fairness, understandability and accuracy. They will comment on the services received when they do not live up to an expected standard. No amount of central “efficiencies” will counteract the complaints in a decentralized model.

Joachim School District currently has a poor cost allocation system. The system allocates costs on a per student basis. Since the principals cannot manage the base, they have no way of making decisions that will automatically affect the costs charged to their schools. Some of the cost bases which will make the system more effective are, in addition to the number of students, curriculum needs, student needs, and the age of the facilities. The system does not reflect the use of services by the schools in terms of distinguishing features. The principals’ complaints are well founded. Allocation can only be effective when there is a reasonable cause and effect relationship with the cost driver and the managers have control over the amount of the cost driver they use or incur.

There are several traditional methods of allocation to support department costs. The direct method is the easiest and for that reason is extensively used. The indirect methods of step-down and reciprocal are more complex and accurate. The extensive use of service hours provided by the District in the case indicates the importance of time. It is therefore possible to allocate some or all of the service department costs using time as a cost driver. Under such a system, the school principals have an incentive to cut back on the services requested. Other bases maybe appropriate for items like utilities and busing. The applicability of Activity Based Costing also merits consideration if a reader chooses a decentralized approach to the case. However, efforts to cut back on the requests could have other negative effects.

All of this leads to a discussion about why an organization would allocate costs in the first place. One reason is gain an understanding of the resources used in differentiated products to support pricing decisions. Another argument is that we need to know the full value of inventory on hand to disclose to stakeholders. Neither argument is applicable in this case. As the District moves toward a single school there is no product or remote locations to cost out. It really does become the equivalent of reorganizing the deck chairs on a sinking ship. The best decision to support the decisions made regarding responsibility accounting is to not allocate the costs to specific schools or programs. The organization is small enough that Joan Agnes will be able to intervene and make budget adjustments more easily than maintaining a cost allocation system.

Dr. Luca will achieve better accountability if he were to dismantle the cost allocation system. He should direct Joan Agnes to treat the central departments as cost centers that report directly to her. There are few decisions that the schools can make to influence the costs in these departments, so allocation is not appropriate. A more effective budget control is careful evaluation by the superintendent. She needs to carefully evaluate the mandate of each assistant superintendent in light of available resources and the service expectations at the school. The budget will communicate her expectations to them and the school principals.

TUITION MANAGEMENT

The private nature of the Joachim School District means revenue management is critical. Information in the case reveals the district is passive about revenue. It collects revenue from tuition, the state, and diocese and passes it on. The schools appear to be the aggressive ones by managing their continuing education revenues. A good report will note the Superintendent’s responsibility for revenue. A process of regular reviews will ensure the District is getting every possible dollar from these sources. Giving the school principal’s control over their local revenues from rentals and continuing education allows them to make rational decisions regarding how much time should be devoted to these activities.
Allocating the primary revenues sources to the school is problematic. The author believes Dr. Luca should advocate against this practice. The District needs to ensure the schools have a fair distribution of faculty and other resources to meet the needs of students accepted into those schools. A number of liabilities arise if the schools do not meet their obligations. These obligations remain regardless of revenues. Revenue allocation is not therefore a good idea. The trustees and superintendent are the appropriate authorities to take action to increase revenues from the central sources. A cost center approach to the schools will decrease the incentive of the school principal to allocate time to revenue initiatives better handled at a higher administrative level.

Joachim School District enrolments are declining according to the case. The only operational step mentioned to increase enrolment is the revenue attributed to the schools. This is hardly significant. Dr. Luca needs to establish more depth in process of enrolment management. The school will not increase enrolment from 2,400 to 3,000 solely on the basis of a new building. Parental satisfaction needs monitoring to assess Joan’s effectiveness. The Trustees can address trouble before they translate into further losses. His report should also recommend specific incentives to encourage Joan Agnes to make school promotion her first priority.

DIRECT SCHOOL REVENUES

The budget for St. Joachim’s reveals how important extra revenues are to the schools. Continuing education encourages a learning environment and prompts the educational mission of the District. Other revenue sources need careful assessment in light of the District’s educational mission. Costing is difficult in the school setting. The facility is “free” because it already exists for other purposes and this creates an awkward joint-costing dilemma. Only increment revenues and costs are relevant factors in determining if a proposal will provide a financial contribution. There is an ongoing vulnerability that the District can be accused of subsidizing non-core activities, which is why the analysis offered by Mark is common response. The cost analysis associated with common facilities produce circular cost calculations. The HTBA proposal will increase school revenues by $7,500 per month with no apparent increased out of pocket expenditures. The gain will have the effect of reducing the overall classroom cost at St. Joachim’s. Mark is using a cost method that is not applicable to this type of decision.

Joachim School District should consider carefully what types of organizations and programs are appropriate for the school. They do not apparently have guidelines for the school to use when considering proposals in light of the strong incentive given to the principals to attack extra income. There are organizations and activities that place the school at unacceptable risk regardless of how much they are prepared to pay. A clear policy would increase certainty for the school principals and promotes offers that are acceptable.

TRANSFER PRICING

The current system encourages the team to source services outside of the Joachim School District family. Mark has to charge his full cost of the bus trip to Matthew’s department. This cost figure is appropriate for handling major budgeting decisions and evaluation of the full bus program. It is not an appropriate cost for a special order. Only the incremental costs are relevant to the decision.

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Garage</td>
<td>$21</td>
</tr>
<tr>
<td>Fuel</td>
<td>$48</td>
</tr>
<tr>
<td>Tires</td>
<td>$0</td>
</tr>
<tr>
<td>Insurance</td>
<td>$0</td>
</tr>
<tr>
<td>Drivers</td>
<td>$210</td>
</tr>
<tr>
<td>Bus lease</td>
<td>$0</td>
</tr>
<tr>
<td>Total</td>
<td>$279</td>
</tr>
</tbody>
</table>

The incremental cost for the trip to the District is well below the $967.50 quote provided by Brown-Horse Bus Lines. The inappropriate costing model will cause Mark to save money if he orders from the outside service but at the expense of the Districts overall cost. The District’s leadership team needs training in cost techniques for decision making.
There are various techniques for establishing prices between units of a business. These techniques include: cost based, negotiation, dual, and market pricing. Each technique provides managers in the organization with different incentives. For example, variable cost pricing may motivate Mark to over use the buses due to the low cost. An appropriate transfer pricing strategy will depend on the type of organizational structure the reader recommends.

To be consistent with the earlier recommendations transfer pricing will be unnecessary. The superintendent will include a cost factor in Mark and Matthew’s respective budgets for the planned number of trips. A budget provision of $279 will cover the extra cost Mark will administer through his bus unit for the science trip. Unless it was evident that commercial bus services can offer service at less than variable cost, Joan Agnes will insist Matthew and the principals use District buses. Proper budget negotiations will reinforce the need for good costing skills. The potential for conflict over the outside pricing is diminished.

There is one concern that the reader will want the Trustee to emphasis concerning bus costs. The bus quote indicates there may be an overall cost issue with the bus service within the Joachim School District. Caution is required because the Brown-Horse Bus Line offer is for a single trip and therefore may not represent a market price for regular service. Also, they not have the number of buses needed by the District for school days. The District will avoid cost inefficiencies if they, from time to time, research the cost of outside provision of non-teaching services.

ACCOUNTING PERSONNEL

Many smaller organizations do not recognize the value of a highly trained accountant. There is room in this case to discuss when an organization needs to make that investment. Dr. Luca has probably inadvertently inhibited the development of a more sophisticated accounting function because of his role and skill set. A professional accountant working with the Superintendent on a day to day basis would have identified the need for adjustments to the accounting process at Joachim much earlier than Dr. Luca in his Trustee role. Once there are multiple administrative units to control the skills of a professional accountant can be useful. In many cases the CEO is an expert in the service or industry and is not aware of what an accountant can provide. The 3 accounting staffers reporting to Mark Miller have missed a great opportunity for advancement. If used in a classroom context this situation provides an opportunity to list the communication and administrative skills these individuals should have been using to grow into the role of District controller.

AUTHOR INFORMATION

Stephen G. Kerr is on the faculty of Bradley University where he teaches cost and management accounting. He earned his PhD from the University of Alberta in 2000. Prior to starting an academic career Stephen worked in industry. In his last industry position he was the CFO of a short-line railroad. His academic research is centered on accountability and accounting information directed at decision making.