Supplemental Documents for Section 3

Contents

Supplemental Information: Financial Statements

Tools for Performance Oversight

Whenever you receive financial reports from management, at least quarterly, the board will use these to monitor financial results and performance. Some of the tools that you can use as you do this are explained below.

TOOLS FOR PERFORMANCE OVERSIGHT

1. Variance Analysis
2. Financial Ratios
3. Balanced Scorecard
4. Scorecard and Dashboards

Variance Analysis

Variance analysis means assessing the differences (variances) of actual results to those budgeted for the period, as well as to actual results of previous periods (years or quarters).

You will receive the primary financial statements (financial position or balance sheet, and operations or revenues and expenses) with columns showing:

- Actual results for this period (may be quarter and year-to-date columns),
- Budget for this period
- Variance to budget: actual minus budget number (this may be shown both in dollars and as a percentage difference)
- Previous period results
- Variance to previous: actual minus previous number (also in dollars and percentages)

Of course you are hoping to find that actual results are close to budget, that you are "on plan" or "in control". So your variance analysis begins with the largest differences, both over and under budget (don't just focus on over budget, since any large difference means that something happened – a risk – that your plan didn't expect).

You use the same approach to financial performance oversight as you do with non-financial performance oversight (balanced scorecard and performance dashboard in earlier section). You seek first to understand "why", and then "what should be done about it"?

When you see significant gaps, you ask why, using a risk context, i.e.:

1. This is due to a risk that was not anticipated (not in risk inventory)?
2. This is due to a risk that was not accurately assessed or measured (its likelihood or impact was probably underestimated)? or
3. This is due to a risk that was not optimally mitigated?

Your management team, the Director of Education and CFO, should provide you with their written and verbal explanations of why, and what they propose to do about it. This is called Management's Discussion and Analysis (or MD&A).

As with performance oversight, there are a limited number of remedies or choices to deal with variances:

- ✓ Change the strategy – how problems are solved and things are done,
- ✓ Change the resourcing – move money or staff from one item to a higher priority,
- ✓ Change the objective, tolerance or policy – accept that there was something flawed or not fully forecasted in the plan or budget, and tolerate the variance up to a new agreed level,

- ✓ Do nothing in the expectation (forecast or projection) that this is a "spike" not a "trend", and it will self-correct over time.

Your role on the board is to reach a level of confidence that management's explanations and proposals are reasonable or plausible. A governing board doesn't substitute its judgement for management's – a governing board asks questions to be confident that management is using sound judgement.

Before you agree with a change, consider its implications beyond the direct item you are dealing with. Often changes have unintended or perverse consequences, and to the extent these can be foreseen by healthy dialogue ahead of time, these may be prevented.

Variances usually have two components, and you may find it helpful to have management show them separately. These are called volume variances and price variances. Volume variances are due to changes in volume, for example a higher number of students in a Division will lead directly to higher expenses and revenues in several areas. Price variances are due to changes in the price or cost of something, like an increase in salaries or benefits. A tool that you can use is to have staff adjust the budget column to show what the planned amounts would be based on the new (actual) volumes.

You will repeat the same variance analysis steps with each of the variances between this year's actual results and the previous period's.

Don't just look at variances on individual line items. Look for cross implications and inter-relationships – what patterns are emerging? For example, absenteeism, long term disability and overtime may all be higher than planned – what are these indicators of, what is causing these? Effective financial analysis can reveal hidden concerns, issues that are not directly seen in line item variances, but emerge with pattern recognition and questions.

Before you're finished with variance analysis, take a look at the numbers where the actual results are the same as budget, where there is no variance. Sometimes there are things to learn from these, whether it is why this was budgeted so well, or even offsetting differences, or missed opportunities.

EXAMPLES OF FINANCIAL RATIOS

1. Horizontal
2. Vertical
3. Efficiency
4. Profitability
5. Resource Utilization
6. Liquidity

As you dig into variances, it is a little like peeling an onion, one layer at a time. It's very easy to get stuck in the details (micro managing) with financial topics, so make sure to ask enough questions to understand the issues, but then quickly return to the board level to assess things from the strategic level.[1]

7. Stability

Financial Ratios

Another financial oversight tool is financial ratios.

A financial ratio is any number from your financial statements divided by any other, so there is a virtually unlimited number of them. However, there are a few financial ratios that are commonly used as indicators of performance success or potential lapses.

"Horizontal" ratios are variances described above. In addition to variances, you will want to look at trend analysis, over a longer period of time. Management should be reporting key financial indicators using line graphs or bar charts showing several quarters or years of results.

"Vertical" ratios show each line item as a percentage of the top line – in the case of expenses, of total revenues, or in the case of assets or liabilities, of total assets or liabilities. These too are helpful viewed through the lenses of variances (how much have these changed) and trends (over multiple periods).

"Efficiency" ratios include the vertical ratios for each expense item, as well as aging of payables and receivables (number of days.) Efficiency ratios are the most popular ratios used in the public and not-for-profit sectors, since they help you to understand, "Are we productive enough?"

Some examples of efficiency ratios in School Boards are:

- ✓ Operating or administrative cost per student
- ✓ Teacher – student ratios
- ✓ Administrative costs as a % of total costs
- ✓ IT expense as a % of Total Costs
- ✓ Any line item or group of expenses as a % of Total Costs, or per student
- ✓ Maintenance / Utility Costs per square meter

As with all ratios, these only make sense if we compare them with benchmarks, otherwise they have little context. The main comparator benchmarks are:

- Budget: variance analysis compares financial ratios with budget or plan,
- Time: trend analysis compares financial ratios with your own previous performance,
- Standards: compares actual to a standard, or minimum acceptable level. These may be an external standard, such as a provincial education standard, lending covenant or collective agreement standard, or they may be internal, a standard agreed on within the School Board.
- Industry peer comparator: compares actual to an industry peer group of comparative School Boards or other organizations. This is the best benchmark to use, since it is both external and stretch – if you choose the right comparators, they will cause you to stretch and improve your performance. These may need to be adjusted for your School Division's special circumstances or situation. For example, comparing the financial ratios of an urban school division to a rural or

[1] Keith Rissling, Professional Director faculty, also referred to in other places throughout this section.

remote school division sometimes feels like comparing "apples to oranges". So select your peer comparators carefully, don't be afraid to make adjustments, and understand that both variance analysis and financial ratios are just diagnostic tools – they are meant to help you ask questions, not to be answers themselves.

Somewhere in the context of benchmarks, you should be able to identify an "optimal" level of performance.

All of these can and should be graphed visually, so that you can tell at a glance how the School Board is doing compared to budget, previous, standards and peers. Just like with performance dashboards, these financial charts or graphs can be colour-coded red, yellow and green to indicate actual performance compared to tolerance ranges (plan/budget).

"Profitability" ratios help you answer the question, "Are we making enough money?" Of course, in the context of a School Board, you are interested in planning and receiving appropriate and sufficient revenues, in balanced budgets and in reasonable growth, but not so much in generating large surpluses (unless these are earmarked for future capital projects.) Large surpluses on a continuing basis in the public sector usually mean that students (customers) are being under-served today.

"Liquidity" ratios help you answer the question, "Do we have enough cash?" You can use working capital and current ratios, but often these are not the best way to be confident that your School Board has enough cash. Instead, review cash flow projections, and have management differentiate between accrual accounting revenues and expenses, and cash flows. Some organizations keep a cushion of cash or working capital, although again, being a funded organization, it may be useful to monitor cash flow projections with tolerances or scenarios built into these, and to rely on a bank or credit union operating line of credit to fund timing differences.

"Stability" ratios help you answer the question, "Do we have enough surplus?" Here, you are looking at levels of debt and the cash required to service principal and interest payments. Again, being a publicly funded organization, your borrowings and payments are generally reviewed and approved by the Ministry as new major capital projects are undertaken. The School Board does need to make sure that you have enough cash to make payments (liquidity, above), and that capital projects are planned out far enough in advance before facilities, equipment or other tangible capital assets wear out. This is where you on the board can be asking questions of management:

Capital Projects Planning

Management should be conducting an analysis of the useful life and average age of tangible capital assets, to identify future required capital, and to begin to plan how these will be paid for.

The school board is responsible for ensuring a long-term facilities plan:

The school board is responsible for staff maintaining the school division facilities. Facilities include all the schools, office buildings, bus garages and other buildings owned by the School Division. Facilities also include the contents of these buildings and the land around them.

A long-term facilities plan can include maintaining existing facilities, building or buying new facilities, and decommissioning old facilities. A School Board's facilities plan depends on the demographics of the school division and the priorities of the school board.

Construction of new schools and major renovations to existing schools are considered capital projects and are supported through capital funding. Generally, both the School Division and the province provide capital funding for major projects. The capital funding provided by the provincial government is separate from the Operating Grant.

When planning new capital projects, construction or major renovations, you will want to ask, has staff considered the following points?

- **Research the student demographics** of your area. A new school or a major renovation is a big financial commitment. Will it still be needed, five, ten, or fifteen years from now?
- **Consider maintenance costs**. Funds will be needed to maintain the school throughout its life. What will be the cost of routine repairs, cleaning, heat, light, etc. for the life of the school?
- **Review the Ministry of Education requirements and formulas** for school construction. The Ministry of Education has developed detailed requirements for schools to ensure they reflect building codes and other technical requirements. The Ministry of Education also has established formulas for the amount of space to be allocated for different functions within a school.
- **Consider partnering with other agencies**. Increasingly School Divisions are partnering with other community agencies in the construction of new facilities. For example, a building might house the Pre-K-12 school in one wing and the regional college in another wing. Or a building might house the School Division office, town office, local public library and public health clinic.
- **Get lots of input** from students, staff, parents and community when designing the school building. After all, they are the ones who have to live with the building for the next 20 or more years. Students, staff and others can also provide a reality check for architects and ensure that design of the school is appropriate for the functions and activities that take place there.

There are significant risks involved with the construction or renovation of tangible capital assets. The board will want to consider how best to oversee major capital projects. At a minimum, key risks and milestones should be identified by staff and monitored by the board. Without micro-managing, the board will also want to be assured of effective and ethical procurement, contracting, payments and value for money, as well as fraud prevention and detection. For some major projects, you may want to consider an ad hoc board committee (e.g. Facilities), or assigning oversight of a project to an existing board committee (e.g. Audit Finance & Risk).

Other Financial Oversight Tools

Each quarter, your School Board may have a practice of revising projections for the remainder of the year based on your financial oversight through variance analysis and financial ratios. In this way, management can show you whether a variance is expected to be brought into line through remedies, or if it will grow even more. This tool gives you a clearer look at the full year picture, and whether even bigger changes or remedies are called for sooner rather than later.

Balanced Scorecard and performance risk dashboards, described earlier, should each include a financial dimension, including a few key financial indicators and ratios. It is a good idea to review financial and non-financial performance scorecards and reports at the same time and meetings (quarterly performance reporting meetings). This is because the non-financial and financial performance are inter-related, and are best understood as an integrated pattern or system.

Another advantage of integrating non- and financial performance oversight is not getting so bogged down in lagging, quantitative indicators, but using these in the context of leading, qualitative indicators. For example, student and staff performance results almost always precede, and ultimately are more important than, financial indicators.

When you conduct your *year end* financial performance monitoring, you follow a similar process to the quarterly steps, but with particular emphasis on:

- Did we achieve maximum value for our dollars?
- What did we learn about our budgeting process?
- You will review the Notes to the Statements and discuss the entire financial statements with the auditors.
- Take the time to debrief last year's budget and actual results, and use these learnings to make you better at budgeting in the future.
- Impact on Next Year’s Budget?
- Impact on the Strategic Plan?
- Consider longer term (multi-year) trend analysis?
- Perform any required reporting. Year-end financial statements, along with the auditor’s and management (MD&A) reports, are among the most important accountability reports that your School Board provides to the Ministry and other stakeholders.

Internal Audit Charter

Mission and Scope of Work

The mission of the [Name of School Board]'s Internal Audit department is to provide independent, objective assurance and consulting services designed to add value to and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the Internal Audit department is to determine whether the organization's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to gain reasonable assurance that:

- Risks are appropriately identified and managed.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employees' actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control process.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed appropriately.

Opportunities for improving management control, profitability, and the organization's image may be identified during audits. They will be communicated to the appropriate level of management.

Accountability

The Internal Audit department shall be accountable to management:

- Provide annually an assessment on the adequacy and effectiveness of the organization's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.
- Report significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Periodically provide information on the status and results of the annual audit plan and the sufficiency of department resources.
- Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

Independence

To provide for the independence of the Internal Auditing department, its personnel report to the Internal Audit director, who reports to the Director of Education.

Responsibility

The Internal Audit director and staff of the Internal Audit department have responsibility to:

- Develop a flexible annual audit plan using an appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the Audit Committee for review as well as periodic updates.
- Implement the annual audit plan, as approved, including as appropriate any special tasks or projects requested by management.
- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter.
- Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion.
- Issue periodic reports to management summarizing results of audit activities.
- Provide a list of significant measurement goals and results to management.
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify management of the results.
- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organization at a reasonable overall cost.

Authority

The Internal Audit director and staff of the Internal Audit department are authorized to:

- Have unrestricted access to all functions, records, property, and personnel.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of the organization where they perform audits, as well as other specialized services from within or outside the organization.

The Internal Audit director and staff of the Internal Audit department are **not** authorized to:

- Perform any operational duties for the organization or its affiliates.
- Initiate or approve accounting transactions external to the Internal Auditing department.
- Direct the activities of any organization employee not employed by the Internal Auditing department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the Internal Auditors.
- Interact directly with the audit committee without approval of the CEO.

Standards of Audit Practice

The Internal Audit department will meet or exceed the *Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors.

In-Camera and Executive Sessions Protocol

Principles

[Name of School Board] meetings are generally confidential meetings. They are not held in public. There is an expectation that the discussions held during the meetings are maintained in confidence.

The [Name of School Board] and its committees carry out their functions primarily through meetings. Meetings are most effective when, in addition to School Board Members, those people whose input is required attend and participate in the meeting. Most [Name of School Board] meetings include School Board Members and members of Senior Management as determined by the Board Chair and the Director of Education.

There are times when limitations are required on attendance by Senior Management and other advisors who customarily attend meetings. Such meetings are considered to be *executive sessions.*

In camera sessions strictly speaking means any agenda item or part of an agenda item when minutes are not being taken – these often take place at the same time as executive sessions, but they are two different things – executive sessions deal with who is present; in camera sessions deal with pausing taking minutes.

Protocol

The [Name of School Board] may meet in a closed or executive session if the subject matter deals with:

1. Sensitive matters about an identifiable individual that require board discussion;
2. Performance or remuneration of the Director of Education. In this instance, the results of the *executive* session are to be communicated to the Director of Education as soon as possible thereafter by the Board Chair or his/her designate;
3. Labour relations, collective bargaining or other sensitive human resources issues; and
4. Matters that are, or may become the subject of litigation or are related to confidential legal, civil or criminal proceedings.

Process

A regular *in camera* agenda item at the beginning and/or end of each board and committee meeting affords the opportunity to consider and, when applicable, hold an *in camera session*: the Director of Education would normally stay and participate in all *in camera sessions* unless the Director of Education's employment/performance or a board discipline matter is being discussed.

The Chair should determine and announce who will remain in the meeting and the rationale if requested for excluding any individuals being asked to leave the meeting. The Corporate Secretary will ordinarily remain to take the minutes or will be available for consultation to the Chair, if business is to be conducted in an *executive* session.

The Chair must ensure that School Board Members discuss only those items on the agenda that have been identified as being required to be held *in camera*, and do not hold discussions on new issues that are not properly *in camera* items.

In most cases, formal Board decisions will not be made during *in camera* sessions, but rather, once the regular Board meeting reconvenes immediately following the conclusion of the *in camera* session.

There may be situations when those who regularly attend board or committee meetings should not have access to the pre-meeting materials or post-meeting minutes of an *executive* session. This is most likely to happen with members of management. Therefore, the minutes of the *executive* portion of the meeting, if any, will be recorded separately and forwarded to legal counsel to retain. These minutes are approved at an *executive* session at the next regularly scheduled board or committee meeting.

Directors and staff will treat with the utmost confidentiality all materials and information that is distributed for discussion in executive session.

Examples and Cautions

In camera and *executive* sessions have legitimate purposes but they should be used judiciously and sparingly.

For example, the [Name of School Board] and Director of Education might meet *in camera* to have a candid discussion about the affairs of the school board which can include matters that are in the developmental stage not ready for broader discussion within the school board.

Typically, the Director of Education will be present for all board meetings throughout and would only be excused for *in camera* proceedings when the School Board Members are dealing with Director of Education performance or compensation.

Other typical examples of *in camera sessions (which are also executive sessions)* include when the Audit Committee or board meets with the external or internal auditor without management being present.

Because *executive sessions* restrict normal attendance, their use should be limited to those occasions when they are absolutely necessary. The indiscriminate use of *executive sessions* can result in important input not being provided and those required to carry out the will of the Board not fully appreciating its objectives.

In camera and executive proceedings held during a meeting, whether planned or impromptu, can disrupt the flow of the meeting and the continuity of management input by requiring those to be excluded to leave the room and waiting until they are called back. Therefore, efforts should be made to plan the calling of *in camera and executive sessions* to minimize their disruptive effect.

Review: Annually by Governance Committee