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Making the most of audit committees in primary and secondary education institutions

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A matter of primary importance

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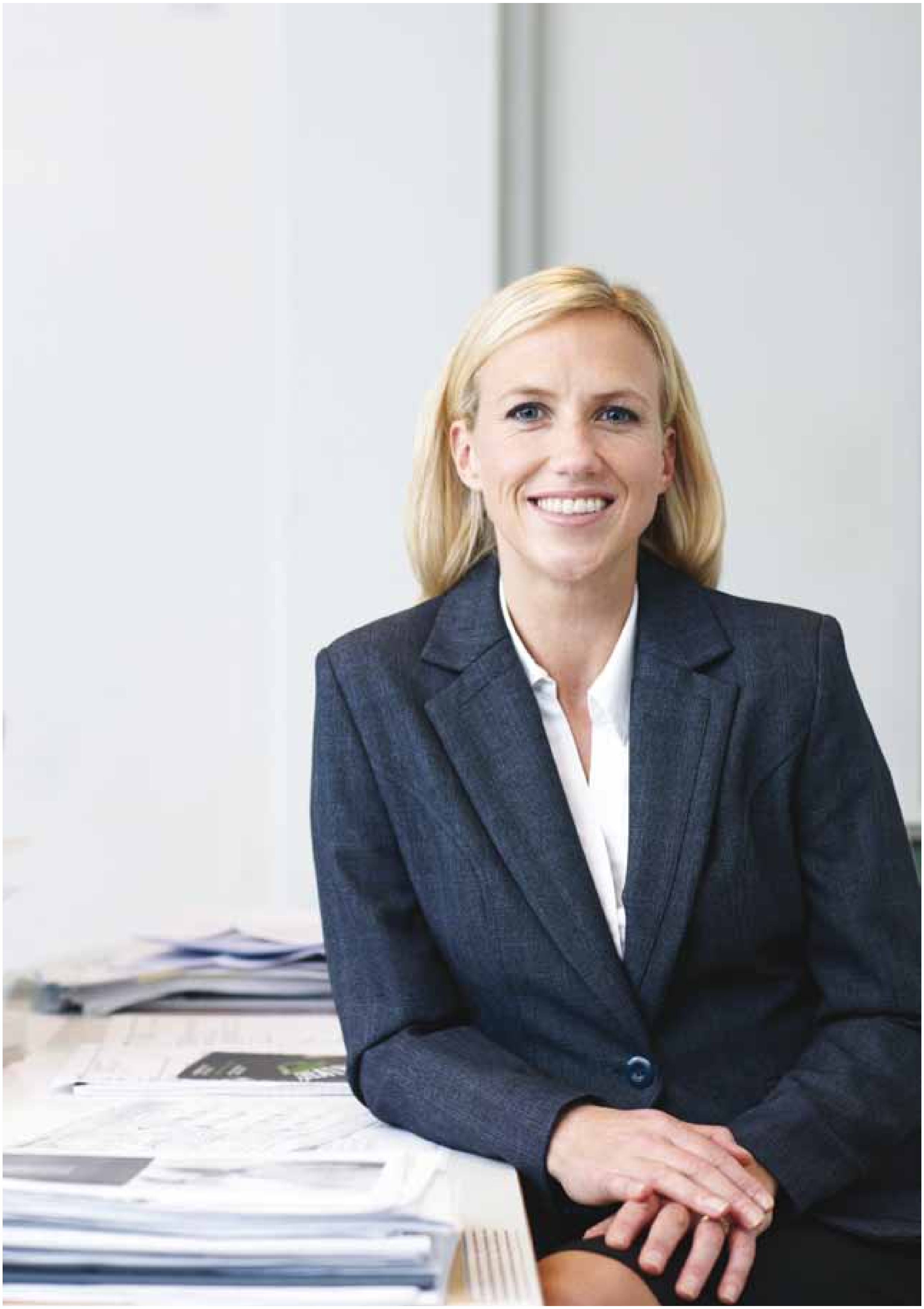
Biography
Maurice Chang

Maurice leads PwC Canada's K-12 Education Sector Consulting team. He has nearly 15 years of experience in consulting roles and has worked closely with over 40 district school boards, government ministries and agencies in the education sector. His main clients include chief superintendents, directors of education and superintendents responsible for business administration, finance, human resources (HR), information technology (IT), facilities and operations.

Maurice's expertise includes operational reviews, performance improvement, deficit management and service restructuring. He takes a pragmatic and results-oriented approach to help organizations tackle the education sector's issues in the areas of governance, HR, finance, facilities and IT.

Maurice obtained his MBA from the University of Western Ontario and his Bachelor of Applied Science from the University of Toronto. He is a licensed professional engineer in Ontario.



"Considering the big sector financial expenditures and the intense public scrutiny placed on school boards, the status quo is not going to cut it anymore."

Publicly-funded and privately-managed education institutions across Canada are facing rising levels of scrutiny over their large financial expenditures. At the same time, accounting regulations have become more complex and continue to evolve at a rapid rate. The need for effective audit committees, with appropriate expertise in financial and accounting matters, has never been more pronounced in the primary and secondary education sector.

Governments and school boards across Canada are responding to this need with new mandates. British Columbia's Ministry of Finance recommended in June 2010 that the Vancouver School Board set up an audit committee to provide oversight and make recommendations on the school board's fiduciary responsibilities. In September 2010, Ontario's Ministry of Education released regulations that require all 72 Ontario district school boards to establish mandatory audit committees by January 31, 2011, following the fall trustee elections. Nova Scotia is the only other province that mandates audit committees in the education sector

While this is a step in the right direction, adoption is far from ideal in practice for many school boards. Field work from PwC's K-12 Consulting Team observes that many school boards have yet to set up audit committees with independent advisors, even those in jurisdictions that have regulatory requirements to do so.

Considering the big sector financial expenditures and the intense public scrutiny placed on school boards, the status quo is not going to cut it anymore: school boards must act now to establish effective and transparent audit committees. School boards in provinces that are not currently mandated to have audit committees must also prepare themselves for this type of regulation.

This paper sets out a series of leading and emerging practices to assist school boards and other education institutions establish and implement effective audit committees.

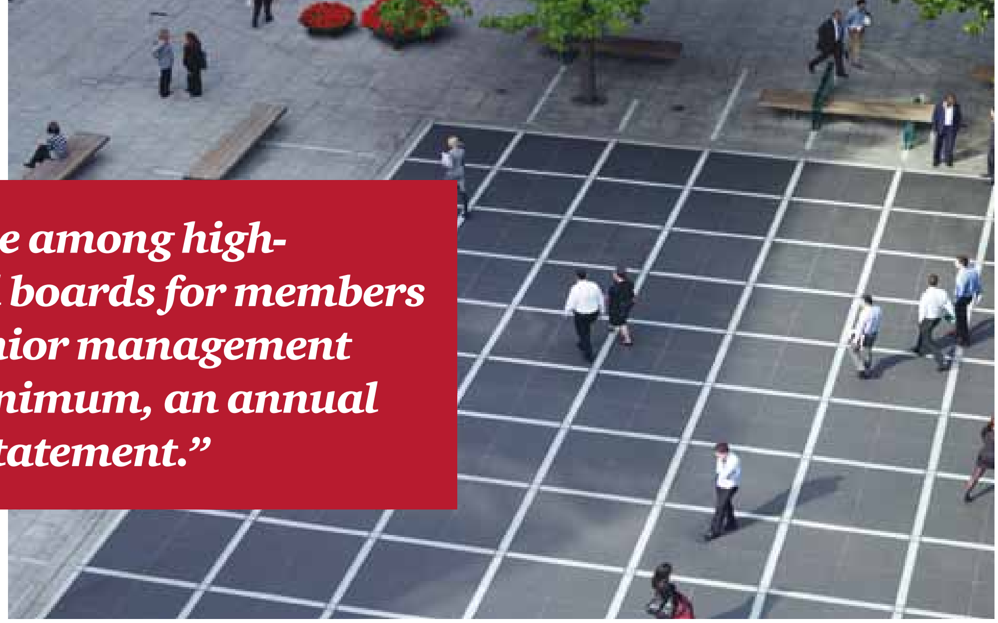
Emerging issues and practices

New audit committee practices are emerging in response to the issues faced by the primary and secondary education sector. Audit committees should consider adopting these emerging practices as they refine their responsibilities to effectively navigate the changing landscape faced by school boards.

Whistleblower/Hotline

Many education institutions and other not-for-profit organizations have hotlines in place as part of their whistleblower policies and procedures. This is a growing trend that we encourage audit committees to jump on to help meet the growing need for transparency from external stakeholders.

The audit committee is generally charged with oversight of the hotline, particularly for items of financial interest, including financial irregularities or fraud. Leading practices provide clear policy guidance on what should be reported to the audit committee, including the timing of issues and type of activity. It is recommended that audit committees be informed of what is reported



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through the hotline at least annually. In addition some school boards have chosen to have the chair of the audit committee receive immediate notification of particular activities or activities involving certain individuals within the organization.

Conflict of Interest

Conflict of interest continues to generate more public discussion and prominence. As a result, some school boards have developed very detailed, written conflict of interest policies. Some organizations are making certifications from key employees or educators publicly available. It is leading practice among high-performing school boards for members of the board and senior management to complete, at a minimum, an annual conflict of interest statement. In addition, central administration should review all trustee and senior management conflict of interest statements to ensure transactions are evaluated consistently.

In many cases a separate internal conflict of interest committee is set up to monitor that management and employees comply with and enforce the policy. In most cases, the audit committee receives a report from the conflict of interest committee on existing conflicts and which individuals have not completed their annual form.

Risk management

Enterprise Risk Management (ERM) is a process designed to identify potential events that may affect the board, manage risk to meet risk appetite and provide reasonable assurance over board objective achievement.

While ERM is not a new concept, the economic impact on not-for profit organizations has given it greater attention and focus, along with the public perception that high-profile business failures are related to risk taking without appropriate safeguards to manage those risks and related consequences. Although many types of risk mitigation exist today (legal, insurance, compliance programs, etc.) there is often insufficient collaboration across the programs, and little comprehensive reporting to help boards fully understand their risk exposure and the risk management processes in place. More importantly, there is often little formal or consistent evaluation of the board's risk appetite, which typically drives strategic decisions and responses to key risks.

A formal evaluation process will help school boards become more knowledgeable of the risks they face; identify gaps that can be addressed; and make more informed, strategic decisions in the future. Leading organizations are taking steps now to strengthen their processes in this area. We recommend that school boards consider establishing formal budget risk mitigation strategies, including proper documentation on the following:

At the beginning of the board's budget cycle:

- Identify significant expenditures not clearly detailed in the budget, but may occur due to sudden circumstances;
- Assess the chance of occurrence for each budget risk, as well as quantify the impact to the budget should the risk happen;
- Assess the effectiveness of controls currently in place; and
- Propose mitigation strategies or enhance current controls to minimize the chance of occurrence for each risk, as well as contingency actions that management will take should the risk happen.

Throughout the budget cycle:

- Report from time-to-time the material budget variances that may negatively impact the financial outcome of the board – this may be communicated through the interim financial reports;
- Update the chance of occurrence, amount and impact of each of budget risk formally identified at the beginning of the budget cycle; and
- Address any new budget risks not previously identified.

The level of detail in the budget risk mitigation plan will depend on management's and the school board's preferences; but, at a minimum, it should include a summary on the elements described above. Regular updates will give reviewers a better understanding of the board's budget risks.

Standard practices

In addition to adopting emerging practices, it is equally important that audit committees review their current practices to see how they match up with those of high-performing education sector audit committees. Below are some of the key common practices that have become "standard" in recent years among effective audit committees, as well as several inconsistent practices.

To increase audit committee value, we recommend that school boards look to the standard practices as they set and refine audit committee roles, responsibilities, and practices.

Standard practice	Inconsistent practices
Separate audit committee is established	Annual self-assessment on audit committee performance is conducted
Audit committee members are independent from the school board administration	Director of Education, Chief Superintendent, and/or Chair of the Board periodically attend meetings
Audit committee charter is drafted, reviewed regularly and updated as necessary	Financial expert is required to sit on audit committee. Charter outlines the requirement and clear role definition
Frequency and length of meetings has increased	Formal educational program is established for new and existing audit committee members
Responsibilities for external audit relationship are clearly defined	Annual assessment is conducted by the audit committee on internal and external audit performance

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Committee membership

Size: Many education sector institutions' audit committees are comprised of five or seven members. In Ontario, regulation calls for audit committees ranging from five to seven members depending on the total number of board trustees.

Experience: Committees should include at least one financial expert to provide insight on the significant accounting changes in recent years (and anticipated in the coming years) and navigate the increasing complexity of annual financial statements. In our view, including external members with financial expertise is a must to ensure the appropriate financial oversight. The professional backgrounds of external members could include accounting, law or other professions, depending on the needs of the committee and its mandate. The audit committee charter should clearly describe the requirements to be deemed a "financial expert."

Succession planning: When considering succession planning, an emerging practice is to have an independent nominating committee of the board appoint the chair and other members of the audit committee. The Chief Superintendant, Director of Education, and/or the Chair of the Board of Trustees should also attend audit committee meetings every once in awhile to ensure that they are kept in the loop.

Meetings

The changing regulatory and economic environment and heightened role of the audit committee call for more frequent meetings to audit financial statements and review internal and external audit plans. In the past, meeting once a year was considered the bare minimum. Nowadays, typical audit committees meet between three to five times per year. Ontario school board audit committees are required by the new regulation to meet a minimum of three times per year, with additional meetings if required. Members should participate in person as often as possible.

Audit committees should take into account the following to ensure they make the most of their time:

- Set up time in each meeting agenda for separate *in camera* sessions with the external auditors, internal audit (should it exist), and the treasurer/senior business official. This provides an opportunity to speak openly with each group.
- Consider having committee members meet alone once in awhile. Take the time to discuss issues independently of other stakeholders.
- Distribute materials in advance of each meeting.
- Ensure the chair of the audit committee reviews the agenda and other key information with the external and internal auditors and management in advance of each meeting to ensure the appropriate items are being covered and the chosen time is enough for discussion.

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Responsibilities

Effective audit committees define their responsibilities within a charter that is reviewed and updated regularly, preferably on an annual basis. Most audit committees oversee the school board's general compliance with laws and regulations and some have responsibilities for oversight of the institution's risk management program. Primary responsibilities should include: ensuring quality financial reporting and related internal controls, maintaining relationships with external auditors and internal audit, and oversight of the school board's ethics program.

Over the past few years, regulatory oversight and monitoring of education sector institutions has increased.

- Numerous new accounting standards have been issued that impact higher education and other not-for-profit organizations.
- Regulations related to Public Sector Accounting Board (PSAB) have continued to drive implementation considerations around fixed asset accounting, school board reserves reporting and other issues.
- Employee benefit plans have come under increased scrutiny from constituents.

All of this activity falls under the responsibilities of the audit committee, and it is important that committee members understand the various financial and compliance risks that exist within the institution and the management structure, and their specific responsibilities for mitigating such risks. It is common to establish a formal education and training program on these matters for new and existing audit committee members.

Most boards also have formal orientation programs for new members, as audit committees have oversight across all school board areas, including financial, operational, tax, information technology and compliance risks. Holding a separate orientation/education session at least annually for audit committee members would provide additional knowledge and information to carry out fiduciary responsibilities efficiently and effectively. Potential education topics include:

- New accounting or regulatory standards that require implementation;
- Updates on changes in management's controls or processes in a particular area;
- General industry risks;
- Management risk assessments; and
- Other areas of interest and responsibility to the committee.

Charter

Many leading education sector institutions regularly assess both the adequacy of their charter as well as the committee's performance against the charter. A strong self-assessment conducted in an open and constructive manner should enhance the performance of the committee and benefit the school board by ensuring the committee is meeting their fiduciary responsibilities.

Self-assessments should be performed annually, either by comparing performance against the charter or against leading practices; the most effective assessment would incorporate both. Consider different methods including: using a facilitator, either within the school board or an outside advisor; or obtaining feedback from members through a group discussion, individual surveys, or by interview. School boards should evaluate the pros and cons of each method, including time, cost, and quality of responses, to determine the most appropriate one to use.

Trustees and directors should determine who should be solicited for feedback, including other board members, management and external advisors that interact with the audit committee. Finally, there should be a review of the feedback and a consensus built around appropriate response, if any, to the results.

Other considerations

In assessing the effectiveness of audit committee responsibilities, keep in mind the implications that can arise in the relationships between audit committees and other board committees.

Increased coordination across board committees

Compensation is an emerging issue for multiple board committees. Many provinces across Canada have established "sunshine" disclosure rules that require public disclosure of public sector employee salaries; school board staff are frequently profiled. As a result, each school board should establish a compensation committee to provide oversight over compensation-related matters; although, in our observation, the majority of school boards lack a dedicated committee. Audit committees should work with the compensation committee to ensure that they are informed of how their decisions affect the organization's finances, as the majority of school board expenses are generally compensation based. These discussions should outline responsibility and accountability for various compensation decisions.

School boards should identify individuals that are likely to receive public scrutiny over their compensation packages, particularly if these individuals have duties over potentially sensitive topics, such as budget development, labour relations, human resources, school closures or

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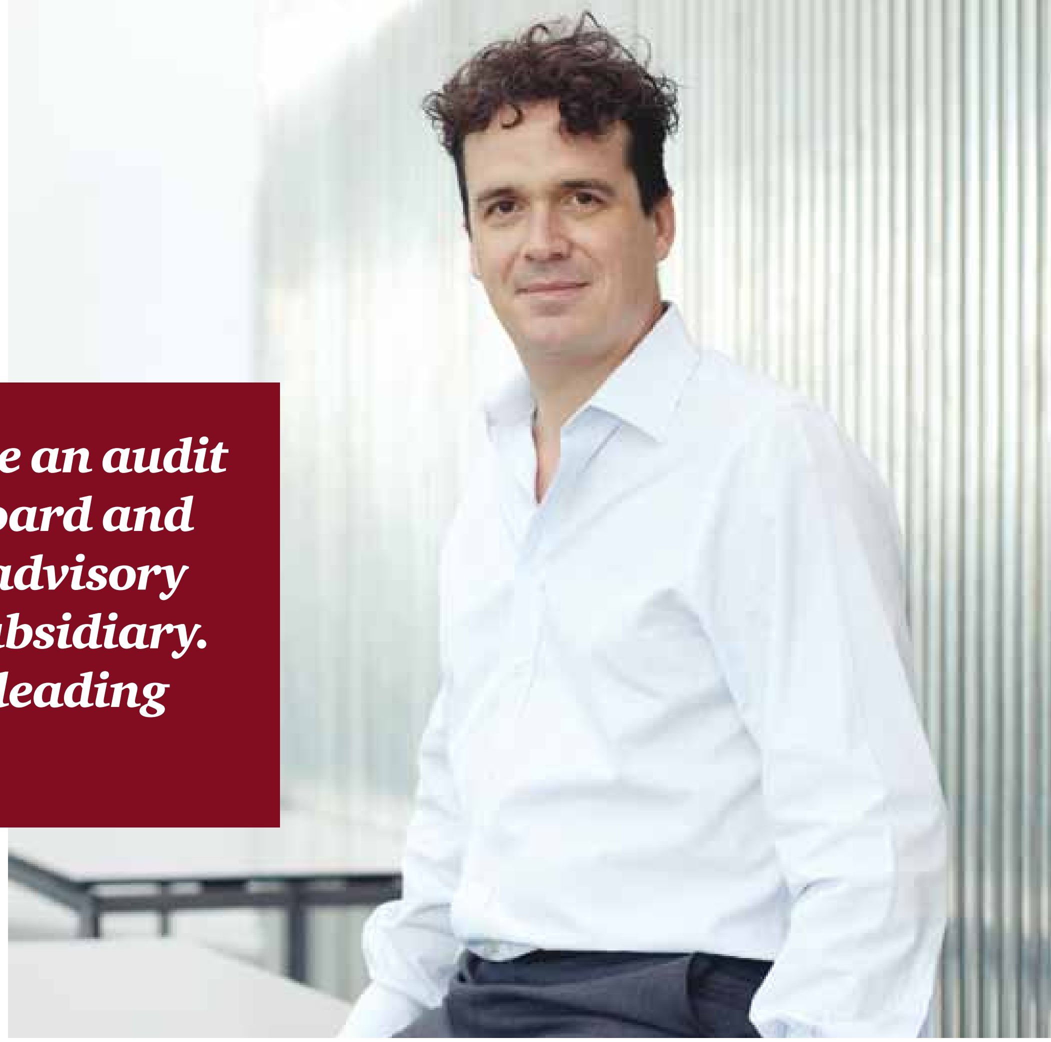

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accommodation reviews. From there, the committee should consider the following questions and keep the audit committee informed:

- Are the compensation levels within a reasonable range as expected by the general public?
- How do the salaries compare to school boards of similar size and complexity?
- Are there other individuals within the organization with unique salary characteristics; and what are the metrics used for those individuals to determine compensation?
- Which board committee is responsible for overseeing compensation approval for these individuals?

Board-owned subsidiaries

Several school boards--particularly large, urban boards--have established board-owned subsidiaries to oversee various assets that belong to the board. For instance, the Toronto District School Board established the Toronto Lands Corporation as a wholly-owned subsidiary to manage the sizeable real estate portfolio of the school board. Audit committees of boards with subsidiaries should maintain a high level of diligence and scrutiny over the activities of the board's subsidiaries to ensure proper risk management.

For those subsidiaries under the control of the board, it is common to have an audit committee for the board and a separate audit or advisory committee for the subsidiary. This is considered a leading practice as the universe of risks can be substantially different in the specific environment that the subsidiary operates in. It is important for the charters of each committee to clearly communicate the areas of responsibility. It is equally important to determine the method and frequency of communication between the two committees. It is leading practice for the chair of the subsidiary's audit committee or advisory committee to attend the board's audit committee meetings and present on behalf of the subsidiary to keep both committees equally informed.