

Langley School District 35:
Governance and Internal Controls
Examination

July 2010



OFFICE OF THE
Auditor General
of British Columbia

Table of Contents

Auditor General's Comments	1
Executive Summary	2
District Response	5
Detailed Report	6
Background	6
Key Findings and Recommendations	9
A. Board Governance.....	10
B. Internal Controls.....	15
C. Long-term Planning.....	18

Appendices

1 – Sources of Examination Criteria	20
2 – Good Governance	21
3 – Good Practices in Internal Controls.....	26
4 – Summary of the Guidelines for Board Use of Information	28

Auditor General's Comments



John Doyle, MBA, CA
Auditor General

School Districts in British Columbia are responsible for the education of the children of the province – a significant responsibility. A key factor to the success of each District is the elected board that governs it. It is critical that these boards function well, with effective working relationships between members and with senior management. Equally important is the board's governance role: ensuring that the right things are indeed being done.

Following some budget challenges and a request by the board and senior management of Langley School District 35, I decided to conduct an examination of their board governance, internal controls over key financial processes, and long-term planning. My staff identified some significant issues and this report speaks very directly to these.

We have made a number of recommendations to the board, the most important one being that trustees must find ways to work together effectively. We met with the board to discuss our findings and recommendations, and were very encouraged by their response to the report. The board has accepted all our recommendations and has made a united commitment to address the issues raised.

The next step is for the board to finalize its action plan. However, the real challenge will be working together, with senior management and the wider education community, to successfully implement that action plan.

I look forward to a continuing relationship with the Langley School District as it implements the report's recommendations and I also encourage all other Districts to read and learn from this report as well.

I would like to thank the board, management and staff at the Langley School District for their frankness and openness during our examination, and for the excellent cooperation and assistance they provided to my Office.

A handwritten signature in cursive script that reads "John Doyle". The signature is written in dark ink on a white background.

John Doyle, MBA, CA
July 2010

Executive Summary

We conducted this examination under section 13 of the *Auditor General Act*, and as required by subsection 13(4), a summary of the results of our examination will also be reported to the Legislative Assembly. The Auditor General decided to conduct an examination following a request by the Board and senior management of Langley School District 35 (Langley SD or the District).

In Spring 2009, errors with the District's budget figures became evident. The resulting cumulative deficit total is currently projected by the District to be approximately \$13.5M, comprised of the \$8.2M reported deficit from the 2008/09 audited financial statements and the deficit currently projected by the District of \$5.3M for 2009/10. The District has prepared and submitted to the Ministry of Education a deficit elimination plan starting 2011/12 and ending 2014/15. The complexity of the financial accounting and reporting for school districts in general makes it more difficult to interpret the current financial position of the Langley School District. We will examine these issues further in Langley SD 35 as part of our financial statement audit work.

We examined the District's Board governance, internal control activities over key financial processes, and long-term planning. For each of these areas, we have provided both the key findings of our examination, and recommendations for addressing these issues.

Governance

Although the Board is performing some of its governance responsibilities and meeting weekly, we found that the Board is not functioning well, nor modelling a positive "tone at the top". The lack of good working relationships amongst Board Trustees poses a significant risk to the overall success and future financial health of the District. There is also a lack of sufficient, appropriate and regular information, particularly financial information, required by and provided to the Board to fully assess organizational performance and support Board level decision making. Trustees also need to work effectively with senior management.

The common goal of all Board trustees and senior management is the education of the children of Langley, and this focus must be remembered at all times with other agendas set aside. Respectful behavior needs to be modeled between Board members and between the Board and senior management. Board members need to find ways to work effectively together. There needs to be a proper balance between the Board holding management accountable in a respectful and professional manner, and supporting senior management in moving forward.

Internal Controls

Regarding internal controls, we found that while some key internal controls are in place with improvements made or being made, some do not yet exist or are not adequately designed. There is at least one significant internal control weakness in each of the four key financial processes examined that management has not yet addressed. We will also provide a management letter containing greater detail in these areas, together with related recommendations.

Long-term Planning

Longer-term planning for financial viability and capital management purposes can also be further improved. The District prepares and updates enrolment and facilities information annually, including its ministry required five year capital plan. However, longer-term planning is not performed, including preparation of a 10-year School District Facilities Plan. The District's strategic plan does not have a longer-term focus and its education-related goals are not linked to financial resource planning. Longer-term planning in Langley SD would enable more robust strategic planning and proactive decision making, particularly around sensitive topics such as potential school closures or reconfigurations.

Summary of Recommendations

To address our main findings we made the following recommendations.

Governance

1. We recommend that Board trustees develop ways to work together to effectively discharge their responsibilities.
2. We recommend that Board trustees ensure that they understand, accept, and are addressing their governance roles and responsibilities.
3. We recommend that the Board require senior management to provide it with sufficient, appropriate and regular information.
4. We recommend that the Board engages in a healthy level of questioning and holding senior management accountable, in a respectful, professional and appropriate manner.

Internal Controls

5. We recommend that senior management prepare and action a plan including responsibilities and timelines to address identified control weaknesses, including those outlined in our detailed management letter, and provide regular updates on progress to the Board.

6. We recommend that the Board ensures that it receives regular updates from senior management and ensures that a strong system of controls is in place and working effectively and mitigating risk to an acceptable level.

Long-term Planning

7. We recommend that senior management and the Board move to a longer term period of at least five years for strategic planning, and that the District's strategic plan include a link between its educational goals and financial resource planning.
8. We recommend that management provide more regular information to the Board on longer term strategic and facilities planning and progress, including annual evaluation of its facilities planning and financial management.
9. We also recommend that the District prepare a 10 year School District Facilities Plan.

Audit Team

Malcolm Gaston, Assistant Auditor General
Jim Neily, Director
Tara Anderson, Manager
Jenny Wang, IT Audit Manager
Phil Hancyk, Auditor

District Response

Dear Mr. Doyle,

The Langley Board of Education would like to thank you and your team – Malcolm Gaston, Jim Neily, and Tara Anderson - for meeting with us on Tuesday, June 22nd.

We all appreciated receiving and are humbled by the draft "Langley School District Governance and Internal Controls Examination Report". We are grateful for the time you took to answer our many questions. Each of us has reviewed the report. We are committed to working with our senior management team to develop a plan to address all of the recommendations you have made.

We particularly appreciate your commitment to continuing to work with the district, because we know that successfully implementing all the recommendations will not be easy. Our experience is confined to Langley. The broader experience of best practices that you and your staff provide will therefore be of great assistance.

All Langley trustees agree - as they have confirmed by individually signing this letter - that the common goal of school district trustees and management is the education of children and that this goal must never be forgotten. We do not expect to always agree on how to best achieve that goal, nor were we elected to always agree. We will, however, make a conscious and determined effort to improve "the tone at the top" by working on the issues that are before us, without revisiting the issues and conflicts that are behind us.

You have given us much to think about, and to act on. We each have ideas percolating on how to implement your recommendations. We will be working on and sharing those ideas over the summer in order to develop a plan of action. We appreciate your continued input and guidance as we undertake this work.

Sincerely,

Joan Bech, Chair, Langley Board of Education
Wendy Johnson, Vice-Chair, Langley Board of Education
Steve Burton, Trustee, Langley Board of Education
Stacey Cody, Trustee, Langley Board of Education
Robert MacFarlane, Trustee, Langley Board of Education
Alison McVeigh, Trustee, Langley Board of Education
Rod Ross, Trustee, Langley Board of Education

Detailed Report

Background

Purpose of Examination

We conducted this examination under section 13 of the *Auditor General Act*, and as required by subsection 13(4), a summary of the results of our examination will also be reported to the Legislative Assembly.

The Auditor General decided to conduct an examination following a request by the Board and senior management of Langley School District 35 (Langley SD or the District).

We examined the District's Board governance, internal controls over key financial processes, and long-term planning.

Context

Located approximately 45 kilometers southeast of Vancouver, Langley SD provides services to both the City and Township of Langley, and is neighbour to the communities of Surrey to the west and Abbotsford to the east. The District serves over 18, 500 students; employs over 2, 200 teachers, support staff and administrators; and its 09/10 amended budget is approximately \$158 million.

Langley SD is governed by a Board of Trustees of seven members, elected every three years as required by the School Act. The current Board composition has been in place since the election of November 2008 when some members were re-elected. Prior to this election, the Board approved some reconfigurations to schools to address declining populations in some District areas and to manage finances. Some parents and members of the public were not happy about the reconfiguration of the South Central region, and these views are now represented on the Board.

There has been significant turnover in the senior financial management of Langley SD in the past two years. The Assistant Secretary-Treasurer resigned in the spring of 2009 and the Secretary-Treasurer retired in June of the same year. A new Assistant Secretary-Treasurer was hired in June 2009, with a new Secretary-Treasurer hired in August 2009. Together they assisted Langley SD in dealing with the budget errors found (as described below), addressing the recommendations from the Deloitte report and improving the District's internal controls. However, the new Secretary-Treasurer resigned in December 2009 and an Interim Secretary-Treasurer started in January 2010. A search for a new permanent Secretary-Treasurer has been ongoing during 2010, but it has been difficult to attract a qualified candidate. The current Interim Secretary-Treasurer's term ends in June 2010.

Langley SD is one of several school districts that operate using a decentralized system. A decentralized system is one where school principals are cost centre holders, accountable for their school budget and for how allocated provincial funding is expended for their school, within relevant legislative requirements such as Bill 33 class size limits and collective agreements.

In spring 2009, errors with the District's budget figures became evident. The amended 2008/09 budget surplus of \$264,000 submitted to the Ministry in February 2009 was revised to a budget deficit of \$4.8M.

The District's Board contracted Deloitte in May 2009 to review the discrepancies in the 2008/09 amended budget and the circumstances leading up to the projected deficit, and to provide internal control recommendations to prevent similar issues from reoccurring. In this limited scope engagement, Deloitte did not discover any errors that had not been identified by District staff and concluded that management's calculation of the projected amended budget deficit of \$4.8 M was appropriate. The Deloitte report noted that most of the significant errors (which included processing errors, changes in estimates, and adjustments made by management to mitigate the impact of errors) involved inappropriate spending authorization, or authorization provided without first ensuring sufficient funds. Deloitte noted that the errors resulted from a breakdown in the system of internal controls over the budgeting process and that these errors needed to be corrected for the 2009/10 budget.

The 2008/09 reported deficit in the District's audited financial statements was \$8.2 million, significantly greater than the revised budget deficit of \$4.8M. From September 2009 to February 2010, the District identified further errors in the 2009/10 budget and estimates the deficit for 2009/10 to be \$5.3M. The projected cumulative deficit to be eliminated is now approximately \$13.5M, composed of the \$8.2M reported deficit from the 2008/09 audited financial statements and the deficit currently projected by the District of \$5.3M for the 2009/10 fiscal year. The District has prepared and submitted to the Ministry of Education a deficit elimination plan to eliminate this deficit of \$13.5M starting 2011/12 and ending 2014/15.

The complexity of the financial accounting and reporting for school districts in general makes it more difficult to interpret the current financial position of the Langley School District. We will look at these issues further in Langley SD 35 as part of our financial statement audit work in the near future.

Scope of Examination

In Scope

We examined the District's Board governance, internal control activities over key financial processes, and long-term planning. We focused on areas we assessed as high risk: governance and accountability; budgeting; financial accounting/management/reporting; payroll; purchasing/payables/payments; and long-term planning for financial viability and capital purposes.

We assessed the design and existence (or lack) of expected key controls. (See the Internal Controls section B and Appendix 3 for information and guidance on internal controls.)

Our examination assessed these areas against established criteria (see *Examination Criteria* below) and we are reporting on the gaps that exist between the examination criteria and the District's current practice.

Out of Scope

We did not test the effectiveness of key controls in existence at the District (i.e. whether controls that existed were working as intended). Some testing of controls will be performed as part of our future financial statement audit work.

Our assessment of internal controls was at the District, and not individual school, level.

We did not audit the deficit amounts referred to in the Context section of this report. They are presented only to provide background as to why this examination was undertaken.

This examination does not constitute a forensic investigation and was not intended to identify all material errors or fraud.

Examination Criteria

The criteria used for this examination are outlined below and were based on our review of best practice documentation and guidance. (See Appendix 1 for the list of sources for the examination criteria.)

A. Board Governance

To evaluate whether the District's Board of Trustees is taking necessary steps to fulfill its roles and responsibilities, thereby providing effective governance for the School District.

B. Internal Controls

To evaluate whether internal controls over key financial activities at the business process level are adequately designed and exist for each of the following key financial processes:

1. Budgeting
2. Financial Accounting, Management, and Reporting
3. Payroll
4. Purchasing/Payables/Payments (including capital and operating expenditures)

A forensic investigation is generally only conducted when a person or persons are suspected or accused of committing fraud and there is a likelihood that strong legal evidence exists to support that claim. Fraud is an intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain. All organizations face fraud risk and the risk of fraud is higher when there is an absence of a strong internal control system. However, it was determined at the time of planning that a forensic investigation did not appear warranted, and that an examination would be an appropriate way to assist the Board and senior management in moving forward.

C. Long-term Planning

To evaluate whether the District's long-term planning for financial viability and capital purposes is adequately performed, understood, and used by management and the Board to properly inform decision making.

Timing

Our fieldwork was carried out during March to May 2010. Given that controls have been improved, particularly since the summer of 2009, and more improvements are continuing to be made, this assessment is a snapshot in time and is not a reflection of the full fiscal year ended June 30, 2010. We have noted in this report where new controls were being introduced, particularly if they were beginning in or subsequent to March – May, 2010, and prior to the final report date.

Approach of Examination

Our approach included interviews and examination of relevant Langley SD documentation. Interviews included a sample of Langley SD Board trustees, school principals, District principals of central District departments, as well as relevant Langley SD senior management and staff, and Ministry management.

Walkthroughs of key financial processes were performed to examine the design and existence (or lack) of key controls.

The working papers of the current external auditor were also examined. We met with two other B.C. School Districts to discuss any good practices. Feedback from recent OAG surveys on governance was also considered.

Key Findings and Recommendations

A key risk to the future success of the Langley SD is the working relationships amongst Board trustees. To improve and move forward effectively, trustees need to focus on their common goal of educating the children of Langley and find ways to work together effectively with each other. Trustees also need to work effectively with senior management.

Langley SD is making progress in improving its internal controls, and is working towards improving financial management practices. However, there are still several significant internal control weaknesses that management has not yet addressed. Longer-term planning for financial viability and capital management purposes can also be further improved.

A. Board Governance

The Board is not working together effectively and is not taking all the necessary steps to fulfill its roles and responsibilities.

Further support could also be provided by senior management.

Why is good governance important?

Good governance is essential for ensuring that an organization is allocating resources wisely, and that it is serving the public interest in an open and transparent manner — which in turn is essential for building and maintaining citizens' confidence in the organization. See Appendix 2 for guidance on good governance.

The following outlines the most critical weaknesses that the Board needs to address to become fully functioning.

1. The Board is not functioning well and is not modeling a positive “tone at the top”

Setting a positive “tone at the top” would involve Board trustees demonstrating good governance through their own behaviour with each other. This is not currently happening. Although the Board is meeting weekly and following *Robert's Rules of Order*, we were told repeatedly during interviews with trustees and senior management that the Board was not functioning well, nor modeling respectful behavior towards one another. Terms such as “lack of respect” and “mistrust” were used during our interviews. This was substantiated during our observation of Board in-camera and planning meetings.

We were advised by interviewees (and we substantiated through observation) that there are two factions within the Board: one side is seen to have an agenda to remove the Superintendent, and the other is seen to accept the perspective of management without a healthy level of questioning. Trustees' perceptions of each other and some trustees' perception of senior management (and vice versa) is generally viewed through this lens, which has contributed to a culture of mistrust.

The Board does not appear to have a complete understanding of its governance role and this has impacted its ability to fulfill its governance responsibilities. Sufficient training and orientation does appear to be provided to Board members with regard to the working knowledge of the District, but not with regard to their governance and financial management roles. The Board has received some governance training; however, it does not appear to have been wholly successful. We were advised that trustees viewed the training on governance as “discipline” and this appears to have impacted their uptake and acceptance of the training and this subject area. Trustees also have different skills and experience, but individual training and development plans appropriate to each trustee are not prepared.

The Board is fulfilling some of its governance responsibilities. For example, a strategic plan is maintained by senior management and approved by the Board. Annual reporting related to educational goals in the strategic plan is done as required by the Ministry. There is also a process for communication with stakeholders, although on a case by case basis, and the Board has initiated meetings with partners/stakeholders.

The Board does not have an overall risk management process in place. As such, the Board is not holding management accountable to formally manage risks that could threaten the achievement of the District's goals.

The Board has also not held management accountable in maintaining the systems of controls, to ensure that there are controls in place and working effectively to reduce those risks to an acceptable level. Management is accountable to the Board for developing, operating and monitoring the system of internal control, and for providing assurance to the Board that it has done so. However, the Board has the ultimate responsibility for the system of controls and for holding management accountable.

There is no internal audit function in the District relating to provincial funding. There are internal audits performed by District staff on a rotating sample of schools for school internally-generated funds (e.g. fundraising by Parent Advisory Councils). Although an internal audit function is not a requirement of the School Act (and most Districts do not have one), it has become a critical function for many organizations for evaluating their control systems and managing risk. The internal audit function generally reports *functionally* to the Audit Committee Chair and *administratively* to the Chief Financial or Executive Officer (Secretary-Treasurer or Superintendent). This provides both for independence, and the ability for a Board to receive objective information and evaluation on the control systems maintained by management.

The District also lacks a policy to allow for escalation of staff concerns regarding potential unethical conduct. Often referred to as a whistle blowing policy, it has become more common in organizations over the past few years, as described in our report *Province of British Columbia Audit Committees: Doing the Right Things* (2006). Such a policy can be tightly tied to an organization's code of conduct and provides a vehicle for staff to report potential violations of the code of conduct to an appropriate level within the organization, so that the issues may be properly addressed in a timely fashion.

Furthermore, our review of the Board minutes did not reveal examples of the Board striving for continuous improvement in critically reviewing results, managing risks, taking corrective action, and realigning strategies. The major exception to this is the Board's consideration of school closures. The Board also does not have an overall communication plan that lays out how the District would like to keep key stakeholders informed, including consideration of valuable communication opportunities.

2. There is a poor relationship between some trustees and senior management

During our interviews, Board trustees and senior management stated that there is a poor relationship between some trustees and senior management, and that there was mistrust by some trustees of senior management and vice-versa.

As previously mentioned, part of the Board is seen to have an agenda to remove the Superintendent. Several interviewees stated that trustees have not always treated management respectfully, which was substantiated during our observation of both private and public meetings.

The lack of trust in senior management also stems partly from the recent history of receiving inaccurate and/or lack of financial information from senior management, and subsequent significant errors in the budget leading to a deficit which now needs to be eliminated.

The overall success and future financial health of the District is dependent upon good working relationships between Board trustees and senior management. An environment of respect and support is critical for good working relationships to develop and be maintained, and for these leaders to demonstrate leadership and good governance.

Changing the culture of an organization is not an easy task, but it cannot be stressed enough how critical this is for the leadership of Langley SD. The Board and senior management must work together as a team to effectively fulfill their oversight and accountability roles to ensure that the District is successful.

The Board has recently fulfilled its responsibility to evaluate the Superintendent's performance. This is the first evaluation since 2008, although it has been an ongoing topic of discussion at Board meetings, and a committee was recently struck to re-examine the performance criteria. The Board's expectations of the Superintendent's performance are laid out in the Superintendent's contract and evaluation criteria were articulated for the 2007/08 performance evaluation. In June 2010, the Board approved and used updated performance criteria with the help of its recently formed committee, and performed an evaluation of the Superintendent's performance for 2009/10.

3. There is a lack of sufficient, appropriate and regular financial information provided to the Board to fully assess organizational performance and support Board-level decision making

The Board has received information to effectively monitor educational planning, progress and achievement, and has received some financial and other information for monitoring purposes. The Board has received and approved Langley SD's planning and reporting documents required by the Ministry and in accordance with the School Act (e.g. three readings of budget, year-end audited financial statements, strategic plan, achievement reports, etc.) However, the Board has not received sufficient and appropriate financial information to allow them to fulfill their responsibilities.

For example, while some financial information has been received, including financial reports in September 2009 and March 2010, ongoing monthly or quarterly financial reports have not been provided. Management has been working to find and address errors from the past; however, there are systemic issues that need to be resolved before these reports can be as accurate and reliable as needed. Management does not feel comfortable providing financial information to the Board (and the public) that may subsequently need to be corrected, as this would likely further erode trust between the Board and senior management, and further impact the public's loss of confidence in the District.

Timely, regular and accurate financial information is essential, however, for the Board to fulfill its responsibilities. Though management has to assume responsibility for providing Boards with the majority of the information they require, Boards must be satisfied that it is complete, reliable and tailored to their needs. If Boards are dissatisfied with the information they receive, they must develop a strategy to address the shortfalls. The guidance contained in our report, *Making the Right Decisions: Information use by the boards of public sector organizations (2009)* (see Appendix 4 for a summary of the guidelines) would be useful for the Board and senior management to consider in making improvements in this area.

The Board does not receive written assurance from management that the District is complying with all legislation, regulations, Board policies, etc. Management could include this assurance in its annual management representation letter, and should ensure that they can demonstrate with support, how they know the statements made in their management representation letter are reliable.

The setting of performance targets and the evaluation and annual reporting of organizational performance against targets has not been done for financial objectives. Even though the current Ministry template for annual reporting by School Districts does not include this type of information, it is essential for good management.

Moving Forward

- 1. We recommend that Board trustees develop ways to work together to effectively discharge their responsibilities.**

A key risk to the future success of the Langley SD is the working relationships amongst Board trustees.

The common goal of all Board trustees is the education of the children of Langley, and this focus must be remembered at all times with other agendas set aside. Respectful behavior needs to be modeled between Board members, who need to find ways to work effectively together, and this is a prerequisite for the Board to implement the subsequent report recommendations.

2. We recommend that Board trustees ensure that they understand, accept, and are addressing their governance roles and responsibilities. As part of this the Board should:

- Review guidance on good practice for board governance. A key reference should be the “House of Good Governance” framework provided at Appendix 2.
- Develop training and development plans for continuous improvement of individual Board members, including latest practices in governance as well as financial training, particularly for audit committee members.
- Continue with its recently formed audit committee.
- Develop a risk management process, tied to strategic planning and internal audit planning, and ensure that appropriate controls are in place to mitigate key risks to an acceptable level.
- Create an internal audit function. This could be contracted from a suitable external provider.

3. We recommend that the Board require senior management to provide it with sufficient, appropriate and regular information.

As part of fulfilling its governance responsibilities, the Board must meet with senior management and communicate clearly what their needs are for information. The information requests should be more strategic and not operational in nature, and be balanced with the organization’s resourcing to provide the information. Regardless of any issues of trust, management must provide this information to the Board. While systemic issues with financial reporting are being addressed by management over the next few months, the Board may need to be accepting of financial information that is not as accurate and reliable as would normally be expected.

4. We recommend that the Board engages in a healthy level of questioning and holds senior management accountable, in a respectful, professional and appropriate manner.

There needs to be a proper balance between the Board holding management accountable in a respectful and professional manner, and supporting senior management in moving forward.

Senior management must provide what the Board needs to discharge its responsibilities. Similarly, the Board must ask senior management what they need from the Board. This will likely include:

- Respectful treatment of the Superintendent and staff both in-camera and in public;
- Commitment from the Board to move forward together with fellow trustees and with senior management on common goals; and,
- Assurance that all trustees are acting in good faith with the Superintendent and with regard to her performance evaluation.

The following activities should be strongly considered in fulfilling this part of their governance role:

- The Board should receive and monitor management's plan to address internal control weaknesses, with regular progress updates, to ensure that strong internal control processes are in place, monitored and working.
- The Board and senior management should set, monitor and evaluate performance targets for SD's financial objectives and long-term facilities planning.
- The Board should be provided with monthly and annual financial reports and regular/annual reports on long-term facilities planning, including Annual Facilities Grants (AFG).
- The Board should provide the Superintendent with constructive performance feedback on at least an annual basis, using established criteria and measurable performance targets.
- Going forward, the Board should meet with external auditors, excluding management, to discuss and resolve any potential concerns.

Other governance improvements for the Board to consider in moving forward:

- Consider developing an overall communication plan that lays out how the District will keep key stakeholders informed and maximize valuable communication opportunities;
- Consider making strategic planning longer term, to at least a five year term; and,
- Consider implementing a whistle blowing policy in the future.

B. Internal Controls

Although some key internal controls are in place with improvements made or being made, some expected key internal controls do not yet exist or are not adequately designed. There is at least one significant internal control weakness in each of the four key financial processes examined that management has not yet addressed.

In addition to the following comments on internal control processes, we will provide a management letter containing greater detail in this area, together with related recommendations.

Why is a strong internal controls system important?

Internal control is one of the principal means by which risk is managed. Lack of effective internal controls increases risk, including the risk of fraud. Effective risk management and internal control is reliant on a regular evaluation of the nature and extent of risks, and ensuring controls are in place and working effectively to address those risks. Reviewing the effectiveness of internal control is an essential part of the Board's responsibilities while management is accountable to the Board for developing, operating and monitoring the system of internal control and for providing assurance to the Board that it has done so. See Appendix 3 for further guidance.

Budgeting Process

Langley SD management has made good progress to improve management's monthly review of actual expenditures to budget, improve staffing and supervision in the finance department, and ensure segregation of duties and appropriate authorization in the budgeting process.

However, there is a significant gap in the financial knowledge and skills of the cost centre holders, which represents a high risk to the District, particularly in terms of adequate monitoring of actual to budget financial information on a monthly basis. Although some training and support has been provided, the gap is still significant as financial monitoring is not an area of expertise for the majority of the cost centre holders. The potential impact of not ensuring sufficient monitoring is that actual costs could exceed budgeted dollars, and that there could be a further increase to the deficit. Management's monthly review of actual to budget information may partially mitigate this risk.

*The people responsible for managing budgets are called **cost centre holders**. In a decentralized system as used by Langley SD, school principals are the primary cost centre holders, accountable for their school budget and how they expend their school's allocated provincial funding.*

Management is working to address the control weaknesses identified in the Deloitte report and Grant Thornton management letters, but have not yet fully completed actions to address these recommendations. Although an update on management's progress was recently provided to the Audit Committee in mid-May 2010, management has not yet prepared an overall plan to address its internal control weaknesses with responsibilities and timelines.

Sufficient budget information and financial reporting is not yet being provided to the Board. This should include monthly actual to budget financial updates and information on options and the pros and cons of potential budget reduction ideas. See the Board Governance section A for further discussion.

Management is using excel spreadsheets for budgeting and financial reporting/monitoring. Excel spreadsheets are prone to human error, and represent a risk to the District in the accuracy of financial information, and are also not an efficient use of resources. We have been advised by management that all School Districts will be

required by government to adopt CAS/Oracle IT systems in the future and that four School Districts are currently piloting the system.

Another area of risk is capital budgeting. In the past, authorization for work to be started on capital projects or commitments to enter capital transactions have been made prior to ensuring funding was secured. Currently, the capital budgeting area is lacking a permanent employee with ownership of this complex and financially significant area.

Financial Accounting, Management and Reporting Process

Langley SD management has made good progress in the area of financial accounting, management and reporting. Management is ensuring that user-friendly monthly actual to budget reports are prepared and provided to cost centre holders, and have made efforts to provide some training and support. Other changes made include improvements to authorization, reconciliation, and monitoring controls in the financial accounting, management, and reporting process.

The weaknesses and risks outlined above in the budgeting process also apply to the financial accounting, management, and reporting process. The most significant risk is the considerable lack of financial knowledge among cost centre holders (mainly school principals).

As well; financial training of Board members has not been provided, an internal audit function does not exist in the District, and the Board has not met with its external auditors (excluding management) to discuss any issues the auditors may wish to raise. The risk is that the Board will not have complete and reliable information to properly evaluate senior management's performance, particularly regarding the District's control systems. Another good practice that has not been followed is for the Board to post a Request for Proposal every five years for external auditors.

Payroll Process

Controls are in place designed to ensure appropriate security access and accuracy of payroll information. However, there are risks regarding lack of segregation of duties and authorization controls, which increases the potential to make inappropriate payments.

There is also a very significant risk in the lack of detailed monitoring of actual to budget information for payroll costs, which account for the majority of the District's total expenditures. Even if the cost centre holders were provided with more detailed payroll information, there is still a risk that they will not perform an adequate level of review given their significant gap in financial knowledge and current IT system limitations.

Going forward, management advises us that they will also be performing a comparison of estimated to actual salary and benefit costs in the Fall to ensure that changes in average cost are reflected in the budget, as recommended in the Deloitte report.

Purchases/Payables/Payments Process

Controls are in place designed to ensure the validity, accuracy and approval of purchases and payments. However, there are still risks regarding lack of segregation of duties, monitoring, and cut-off, which increases the potential for inappropriate payments to be made and for accounting cut-off errors.

A lack of segregation of duties means that individual members of staff are more able to initiate, approve, and make payments. This significantly increases the potential risk of error, misstatement, and fraud.

There are also weaknesses in the area of capital purchases including authorization controls and cut-off issues. There is a risk that operations, maintenance and AFG work can be done without authorization from the District that there is sufficient budget in place beforehand. There is a risk that schools could request work to be done by the Facilities department, and not have sufficient funding available in their budgets. These risks are partially mitigated by management's review of monthly financial reports.

Recommendations – Internal Controls

The following are high-level recommendations related to our findings in the area of internal controls.

5. We recommend that senior management prepare and action a plan including responsibilities and timelines to address identified control weaknesses, including those outlined in our detailed management letter, and provide regular updates on progress to the Board.

6. We also recommend that the Board ensures that it receives regular updates from senior management and ensures that a strong system of controls is in place and working effectively to mitigate risk to an acceptable level.

C. Long-term Planning

Long-term planning for financial viability and capital management purposes can be further improved.

The District prepares and updates enrolment and facilities information annually, including its ministry required five year capital plan. However, longer-term planning is not performed, including preparation of a 10-year School District Facilities Plan. The District's strategic plan does not have a longer-term focus and its education-related goals are not linked to financial resource planning. The District does not incorporate facilities planning or financial management into its annual reporting on organizational performance. Additional information on longer-term strategic and facilities planning and progress would be helpful in strengthening the understanding of Board trustees in this area.

The District engages in annual forecasting of full-time equivalent (FTE) student enrolment and facility planning, and prepares a five-year capital plan for the Board's approval. However, a longer-term view in strategic and facilities planning is not done. A 10-year School District Facilities Plan (SDFP) is not prepared or provided to the Board for approval.

According to the Ministry's capital plan instructions, a comprehensive SDFP must form the basis for Board of Trustees' capital investment decisions and outline plans for a 10-year horizon, although submission of SDFP's to the Ministry is not required. Such plans take into consideration education program requirements and trends; operating capacities and current condition of existing facilities; current and anticipated changes in land use; student yield rates; community demographics; local community and economic development strategies; and other long-term planning considerations. In terms of capital plan submissions to the Ministry, the SDFP provides the rationale for specific projects that may be proposed as part of a Board of Trustees' five-year capital plan. In addition, the SDFP provides a district-wide framework for other key local decisions, such as school consolidations, locations for district programs, and maintenance priorities.

Long-term planning appears to be properly understood by management. However, there does not appear to be open and regular dialogue with the Board on longer-term facilities planning. The Board trustees' understanding in this area could be further strengthened with additional, regular information on the District's longer-term strategic direction, facilities planning, and assumptions used.

FTE enrolment projections and facilities planning information is used by management and the Board to inform shorter-term decision making; however, longer-term information is not prepared or provided by management to the Board for approval. Long-term planning information managed by the Planning and Financial Control Officer is updated annually with regard to FTE enrolment projections, population growth/decline by area, and changes in developments in the Township and City. Updates to enrolment projections are reflected in the District's annual budget; however, long-term planning is not updated regularly.

The District's strategic plan is based on the three principles of:

- improving educational opportunities for students;
- proactive planning for maintaining healthy and sustainable schools; and,
- responsible stewardship of resources.

The strategic plan contains goals and strategies on facilities planning. However, there is no link between educational goals and financial resource planning, nor further reference to responsible stewardship of resources. The District's strategic plan appears to have an outlook of one to three years, and could have a longer-term focus of at least five years.

The Ministry's template for annual reporting only requires reporting on the educational goals, objectives, and related performance indicators as outlined in the District's Achievement Contract. Langley SD does not incorporate facilities planning or financial management into its annual report, and therefore does not provide accountability for

these areas compared to its strategic plan. Although not required by the Ministry, it is important for leadership to plan and evaluate financial management of the District, linked to its long-term strategic planning.

Longer-term planning in Langley SD would enable more robust strategic planning and proactive decision making. The District has areas of both population growth and decline to consider in long-term planning. While potential school closures or reconfigurations are not easy decisions, they are sometimes necessary to ensure proper financial management. Increased longer-term and proactive information and analysis for the Board, combined with commitment to the District's long-term plan, could help diffuse the emotion involved in the decision making process, thereby allowing for more objective and properly informed decision making.

Recommendations – Long-term Planning

The following are recommendations related to our findings in the area of long-term planning.

7. We recommend that senior management and the Board move to a longer term period of at least five years for strategic planning, and that the District's strategic plan include a link between its educational goals and financial resource planning.

8. We recommend that management provide more regular information to the Board on longer term strategic and facilities planning and progress, including annual evaluation of its facilities planning and financial management.

9. We recommend that the District prepare a 10-year School District Facilities Plan.

Sources of Examination Criteria

The criteria developed for this examination were based on our review of best practice documentation and guidance, and the sources below are by scope area.

A. Board Governance

Developed from:

- Canadian Council of Legislative Auditors, Crown Agency Governance –Audit Objectives and Criteria, May 2007

Supplemented by:

- Internal Control Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), 1992 (three of five components: information & communication, control environment, risk assessment)
- Internal Audit and Advisory Services, Office of the Comptroller General of BC, Model for Effective Performance Management and Accountability

B. Internal Controls

Developed from:

- Internal Control Integrated Framework published by COSO, 1992 (two of five components: internal control activities and monitoring)
- Canadian Institute of Chartered Accountants Performance Engagement Manual – guidance on main types of control activities and typical expected key controls at the business process level

C. Long-term Planning

Consistent with good practice and:

- Ministry of Education’s 2010/11 Capital Plan Instructions for School Districts
- Ministry of Education’s Companion Document to the Capital Project Funding Agreement, November 2009
- Internal Audit and Advisory Services, Office of the Comptroller General of BC, Model for Effective Performance Management and Accountability

Good Governance

Appendices 2 and 3 are included to provide context on good practices in governance and internal controls. These good practices were the basis for our criteria against which we assessed the current practices of the Langley SD (see the Key Findings and Recommendations section of this report).

High profile financial scandals in the past decade in both the public and private sectors (e.g. Enron, WorldCom) have highlighted the need for stronger governance arrangements. Regulatory responses include the *Federal Accountability Act* in Canada and the U.S. *Sarbanes-Oxley Act*, and have had worldwide implications for the duties and responsibilities for Boards and audit committees of publicly traded companies (including those in Canada) and have impacted the public sector as well. The aim of these new regulations has been to significantly strengthen corporate governance, reporting, accountability, and control systems.

Not surprisingly, Boards and their audit committees have a critical role to play in implementing applicable reforms, as they have an increasingly pivotal role in ensuring sound corporate governance, accountability and control. Although the School Act does not require that Boards of Trustees have an audit committee or an internal audit function, it has become accepted good practice in both the public and private sector to do so.

What is Governance?

“Governance” refers to the structures and processes by which an organization is directed, controlled and held to account. The structures and processes are not ends in themselves. Rather, they are the means to help an organization achieve its objectives. Whether in the private or public sector, good governance occurs when an organization has in place structures and processes that ensure the organization is able to:

1. deliver goods, services or programs effectively and efficiently — “good performance”; and
2. meet the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness — “good conformance”.

When governance is poor, a host of problems can arise, leading to the decline of an organization. Good governance is essential for ensuring that an organization is allocating resources wisely, and that it is serving the public interest in an open and transparent manner — which in turn is essential for building and maintaining citizens’ confidence in the organization.

Principles of Good Governance

Good governance is underpinned by five core principles. An organization that uses good governance is one that always, in word and action, demonstrates accountability, leadership, integrity, stewardship and transparency (the A.L.I.S.T.).

A

Accountability is the process whereby organizations, and the individuals within them, take responsibility for their decisions and actions.

L

Leadership is setting the "tone at the top" which is absolutely critical if an entire organization is to embrace good governance.

I

Integrity is acting in a way that is impartial, ethical and not misusing information or resources, which is reflected in part through compliance with legislation, regulations and policies as well as the instilling of high standards of professionalism at all levels.

S

Stewardship is the act of looking after resources on behalf of the public and is demonstrated by maintaining or improving capacity to serve the public interest over time.

T

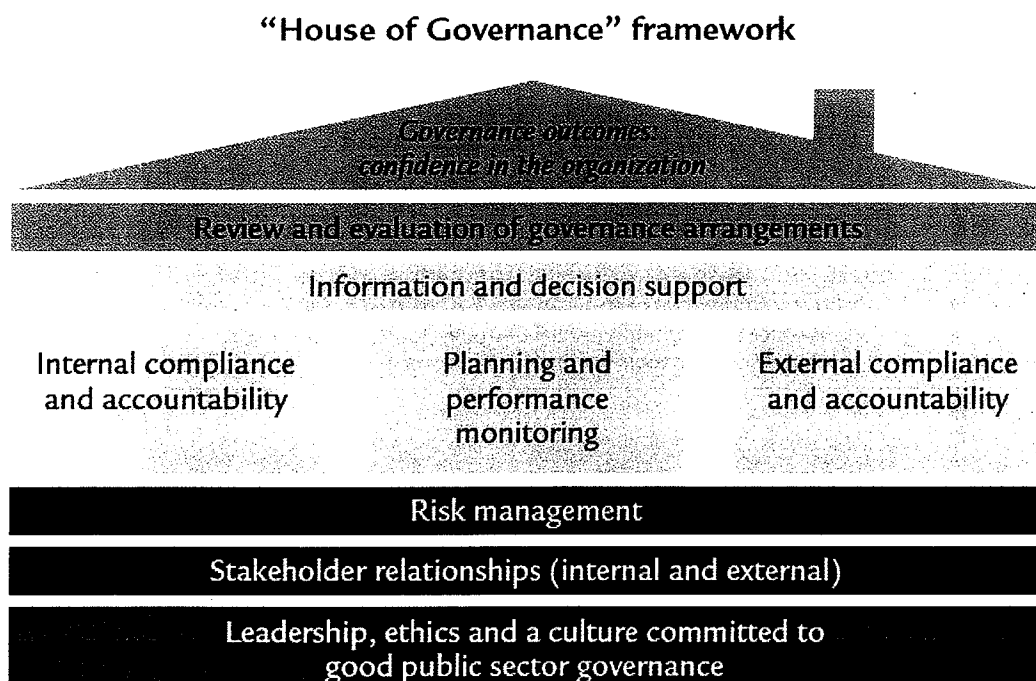
Transparency is achieved when decisions and actions are open, meaning stakeholders, the public and employees have access to full, accurate and clear information on these matters.

T

How can these principles be put into practice?

The “House of Governance” Framework

In December 2008, we published *Public Sector Governance: A Guide to the Principles of Good Practice* which included the “House of Governance” framework for the public sector. The structure and process elements that constitute good public sector governance can be thought of as being made up of the interconnecting elements in a house. The eight elements in this framework are summarized below, starting from the foundation. Further information on the foundational piece of leadership, ethics and culture is also included below.



(source: Australian National Audit Office “Public Sector Governance”, 2003)

1. ***Leadership, ethics and a culture committed to good public sector governance*** supports the entire house. Without this element, there would be no governance foundation to build on.
2. ***Stakeholder relationships (internal and external)*** influence the success and effectiveness of the model’s three central components: internal compliance and accountability, planning and performance monitoring, and external compliance and accountability. Effective stakeholder management is also key to risk management.
3. ***Risk management*** ensures that risks are identified and managed appropriately within the model’s three central components (the “windows” in the house).

4. & 5. *Internal compliance and accountability* is related to *external compliance and accountability* in the sense that the information reported externally would normally be a sub-set of the information generated internally to manage the organization.
6. *Planning and performance monitoring* provides the management framework from which both external and internal compliance and accountability processes occur.
7. *Information and decision support* is provided to the three central components, ensuring that the right information gets to the appropriate people in a timely manner.
8. *Review and evaluation of governance arrangements* is an ongoing process. Its goal is to continuously improve the organization's governance structure and processes and, as a result, this process could potentially impact all elements of the House of Governance.

Leadership, Ethics and a Culture Committed to Good Public Sector Governance

The foundation of the House of Governance reflects that an organization's leadership, ethics and culture must be committed to good governance for the house to stand. An organization's governing body is ultimately responsible for good public sector governance.

In effecting good governance, an organization's leaders take charge by:

1. ensuring that appropriate governance structures and processes are implemented, evaluated and improved; and
2. demonstrating good governance through their own behaviour (setting the "tone at the top").

Leaders must lead by example, displaying to internal and external stakeholders a commitment to instituting and supporting good governance structures and processes, ethical behaviour throughout the organization, and an organization-wide commitment to good governance.

Good governance cannot be fully achieved simply by complying with a set of rules. The spirit or ethos of good governance can be expressed as values and demonstrated in behaviour. A hallmark of good governance is the development of shared values that become part of the organization's culture, underpinning policy and behaviour throughout the organization. The governing body should keep these values at the forefront of its own thinking and use them to guide its decision making.

Information as the Currency of Good Governance

The windows of the House of Governance (the three central components of internal and external compliance and accountability and planning/performance monitoring) are impacted by information and decision support. Without timely, accurate and useful information to inform these areas for evaluation and decision making, risks facing the organization can increase significantly and poor decisions may be made.

As a result of increased responsibilities and other challenges, difficult and risky decisions are a constant for Boards. To navigate these challenging waters they require access to quality information, a sufficient understanding of its contents and the ability to execute decisions based on it, in order to steer their organization toward short-term success and long-term viability. Though management has to assume responsibility for providing Boards with the majority of the information they require, Boards must be satisfied that it is complete, reliable and tailored to their needs. If Boards are dissatisfied with the information they receive, they must develop a strategy to address the shortfalls.

High-quality, full information is not simple to come by. It is up to Boards to create a culture that supports the use and dissemination of such information. While good information cannot guarantee the effectiveness of decisions or their outcomes, it provides the best chance that all decisions made will have been well informed. This will lead to greater public and stakeholder confidence in organizations, and Boards will be seen to have fulfilled their due diligence responsibilities. The above can be succinctly stated in the phrase “information is the currency of governance.”

Overview of the Board Use of Information Guidelines

The distance of the Board from the agency's daily operations, the limited number of board meetings a year, and the high level of responsibility have all made it important for a system that ensures Board members receive information that supports effective and efficient decision making. Board members are typically busy individuals with a great deal of responsibility. They often have limited time and resources to obtain, read and understand the information they require to make well-informed and well-thought-out decisions. For this reason, the information they are provided must be correct, reliable, accessible, up-to-date and understandable.

Six conditions must be met to ensure that boards can make fully informed decisions (see Appendix 4 for further details of the six conditions). Boards must:

1. know what information they need;
2. have access to the information;
3. have high-quality information;
4. understand the information;
5. use the information in decision making; and
6. evaluate the quality and quantity of the information they receive.

Good Practices in Internal Controls

Internal control is *one* of the principal means by which risk is managed. Other devices used to manage risk include the transfer of risk to third parties, sharing risks, contingency planning, and the withdrawal from unacceptably risky activities. In today's world, both public and private sector objectives and the environment in which organizations operate are constantly evolving, and the risks are also continually changing. A successful system of internal control must be responsive to such changes. Effective risk management and internal control is therefore reliant on a regular evaluation of the nature and extent of risks, and ensuring controls are in place and working effectively to address those risks.

An **internal control system** encompasses the policies, processes, tasks, behaviours and other aspects of an organization that, taken together:

- facilitates its *effective and efficient operation* by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the organization's objectives;
- includes the *safeguarding of assets* from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;
- helps ensure the *quality of internal and external reporting*. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organization; and,
- helps ensure compliance with *applicable laws and regulations*, as well as internal policies, with *respect to the conduct of operations*.

Another source of information is the Internal Control Integrated Framework, developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This is a model of accepted good practice in both the public and private sector, against which companies and organizations may assess their control systems. The internal control framework includes five components: (1) control environment, (2) risk assessment, (3) control activities, (4) monitoring, and (5) information and communication. This framework also demonstrates that strong internal controls are closely linked with strong governance and the tone at the top, and that controls permeate through all levels and functions of an organization.

Maintaining a Sound System of Internal Control – Roles/Responsibilities

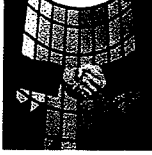


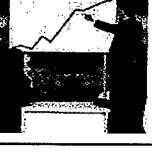


The Board is ultimately responsible for the system of internal control. Boards will normally delegate to management the task of establishing, operating and monitoring the system, but they cannot delegate their responsibility for it.

The Board should set appropriate policies on internal control and regularly assure itself that appropriate processes are functioning effectively to monitor the risks to which the organization is exposed and that the system of internal control is effective in reducing

those risks to an acceptable level. It is essential that the right tone is set at the top of the organization - the Board should send out a clear message that control responsibilities must be taken seriously. The Board, however, does not have sole responsibility for a company's system of internal control.

While the tone at the top is set by the Board, it is the role of management to implement the policies adopted by the Board. In fulfilling its responsibilities, management should identify and evaluate the risks faced by the organization – for consideration by the Board – and design, operate and monitor an appropriate system of internal control. Reviewing the effectiveness of internal control is an essential part of the Board's responsibilities, while management is accountable to the Board for developing, operating and monitoring the system of internal control and for providing assurance to the Board that it has done so.

Summary of the Guidelines for Board Use of Information

	<p>[1] The board knows what information it requires</p> <ul style="list-style-type: none"> 1.1 Board members understand their responsibilities 1.2 Board members understand their organization 1.3 Board members understand their organization's operating environment and clients
	<p>[2] Board members have access to the information they require to fulfill their requirements</p> <ul style="list-style-type: none"> 2.1 Board members have access to all of the information they require 2.2 The board gathers information in a cost-effective manner
	<p>[3] Board members have access to high-quality information</p> <ul style="list-style-type: none"> 3.1 Information is tailored to their needs 3.2 Information received by board members is complete 3.3 The information presented to the board is substantially correct
	<p>[4] Board members understand the information they receive</p> <ul style="list-style-type: none"> 4.1 The board has the ability to understand the information 4.2 Information presented to boards is clearly explained
	<p>[5] Board members use the information they receive</p> <ul style="list-style-type: none"> 5.1 Board members have adequate time to discuss and debate information pertaining to decisions prior to making them 5.2 The board uses sound decision-making processes, such as a decision-making framework 5.3 Appropriate information is used to make decisions
	<p>[6] Board members evaluate the quality and quantity of the information they receive</p> <ul style="list-style-type: none"> 6.1 The entire board and its committees devote time to scrutinizing the quantity, quality and the timeliness of the information they receive from management and other sources

See OAG website for full Guidelines and the Board Use of Information report, published December 2009:
www.bcauditor.com/pubs/2009/report6/board-use-information