



Education

October 2017

Summary

Department

Matters from current and prior audits

There are two new recommendations for the Department of Education in this report—see below and page 50.

In accordance with Section 19(4) of the *Auditor General Act*, we have compiled a summary of the results of school jurisdictions' audited fiscal 2016 financial statements and management letters—see page 52.

Northland School Division No. 61

There are no new recommendations for the Northland School Division in this report. The division implemented processes to improve its financial reporting—see page 51.

In May 2017, amendments to the *Northland School Division Act* resulted in the Auditor General no longer being the legislated auditor for the division. The Board of Trustees of the Division may now choose the external auditor, a process consistent with all other school jurisdictions in the province.

Findings and Recommendations

Department

Matters from the current audit

Enterprise Risk Management Process

Context

Enterprise risk management is a continuous, proactive and systematic process to understand, manage and communicate risk from an organization-wide perspective. Treasury Board and Finance requires every ministry to implement and document an enterprise risk management process.

Enterprise risk management process provides a ministry with:

- the capacity to make informed decisions when setting or revising priorities and allocating resources
- increased confidence in achieving its desired goals
- effective constraints on threats, bringing them to acceptable levels
- the basis to make informed decisions about exploiting opportunities

Criteria: the standards of performance and control

The department should have an enterprise risk management process through which it can:

- identify, analyze and evaluate sources of risk, areas of impact, and potential causes and consequences, regardless of whether the source of risk is controlled by the department
- implement strategies to manage risks
- document the senior executive team's consideration and approval of the key risks and mitigating strategies
- regularly monitor and evaluate its risk management process to ensure continuous improvement

Our audit findings

Key Finding

The department does not have a complete enterprise risk management process.

We found that the department has been working on developing and implementing an enterprise risk management process for the last few years, but progress has been slow.

We interviewed department staff and examined the department's draft Risk Register and Treatment Plan. We observed the plan has no comprehensive list of risks the ministry faces, the department has not assessed and prioritized identified risks based on likelihood and impact and the senior executive team has yet to approve the plan.

As the department finalizes its plan, department management should incorporate other important elements of an effective enterprise risk management process, including:

- integrating risk management at the strategic, program and operational levels
- ensuring that all staff have training in risk management and are aware of the relevance of risk to the achievement of their goals
- regularly monitoring risks and evaluating the risk management program for effectiveness

RECOMMENDATION: Implement an enterprise risk management process

We recommend that the Department of Education implement an enterprise risk management process.

Consequences of not taking action

Without an enterprise risk management process, department management will not effectively manage risks that can hinder the department's ability to meet its goals.

Capital project financial reporting processes

Context

The department is responsible for budgeting, tracking and reporting on costs for school construction projects managed by Alberta Infrastructure and school jurisdictions.

Department staff track the total approved costs and work-in-progress for each school-building project. The department reports the total school construction costs and related future obligations in its annual financial statements.

Criteria: the standards of performance and control

The department should have a process to:

- track school construction costs and future obligations accurately
- review construction cost information to ensure accuracy—The reviewer should be independent of those tracking cost information
- report obligations for school construction costs accurately and completely in the financial statements

Our audit findings

Key Finding

The department does not have adequate processes to ensure it reports complete and accurate information on cost obligations for school construction projects in the department financial statements.

We found that the department does not have adequate processes to report accurate information on the total approved school construction costs and future obligations. Department staff use a spreadsheet to manually track and report on school construction project costs. Information in the spreadsheet did not agree with supporting documents. We found no evidence of secondary review to ensure the information entered into the spreadsheet was accurate and complete. As a result, we found significant errors in the financial statement disclosure of the department's future contractual obligations under school construction contracts.

RECOMMENDATION: Improve controls over tracking and reporting cost obligations for school construction projects

We recommend that the Department of Education improve controls over tracking and reporting cost obligations for school construction projects.

Consequences of not taking action

Without adequate tracking and monitoring processes, the department will not adequately report accurate and complete information to Albertans on school construction projects cost obligations.

Northland School Division No. 61

Matters from the prior audit

Improve financial reporting—recommendation implemented

Our audit findings

The division has implemented our 2010 recommendation,¹ repeated in 2015,² to improve its financial reporting by:

- preparing and presenting quarterly financial information to the Official Trustee
- regularly reviewing and reconciling general ledger accounts
- preparing year-end financial statements promptly

The division implemented the first part of the recommendation in 2015, which continues to operate effectively. We followed up on the remaining two parts of the recommendation during our 2016 audit. We found that the division made significant improvements in its financial statement preparation processes. We received accurate and complete financial statements within scheduled year-end timelines. We audited the division's processes for the reconciliation of sub ledgers to the general ledger, estimation of accounts payable accruals and valuation of accounts receivable balances. We found no deviations.

¹ Report of the Auditor General of Alberta—October 2010, no.14, page 134.

² Report of the Auditor General of Alberta—October 2015, no. 10, page 86.

Management can continue to improve its financial reporting process to document its analysis of extraordinary or significant one-time transactions. Management’s interpretation and application of accounting standards on these complex transactions requires clear documentation on presentation and disclosure conclusions. We observed management did not prepare proper analysis to account for the costs and insurance recovery from damages suffered in the 2016 wildfire. Management made significant adjustments to the division’s fiscal 2016 financial reporting once analysis of this event was completed.

Summary of results—School jurisdiction audited financial statements and management letters

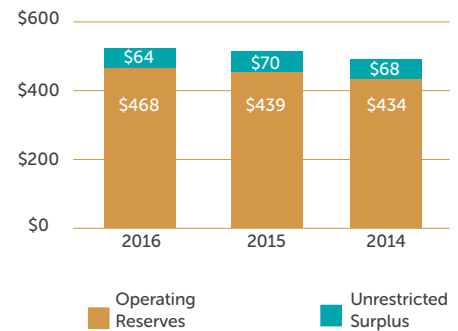
We have completed our Section 19(4) summary of results of school jurisdictions’ audited financial statements and the management letters provided by their auditors for the year ended August 31, 2016. We have also provided comparative results for the fiscal years ended August 31, 2015 and 2014.

1. Summary

Highlights are:

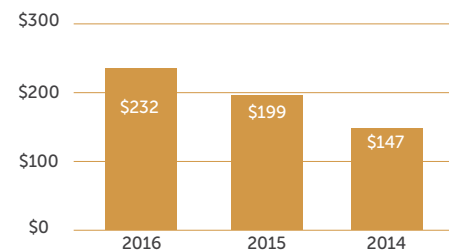
- One school jurisdiction received a qualified audit opinion on its financial statements (2015 – one; 2014 – two).
- The net consolidated accumulated unrestricted operating surplus and operating reserves³ increased to \$532 million (2015 – \$509 million; 2014 – \$502 million). No jurisdiction has an accumulated deficit (2015 – none; 2014 – one).

Total Unrestricted Surplus and Operating Reserves (in millions)



- Capital reserves⁴ increased to \$232 million (2015 – \$199 million; 2014 – \$147 million).

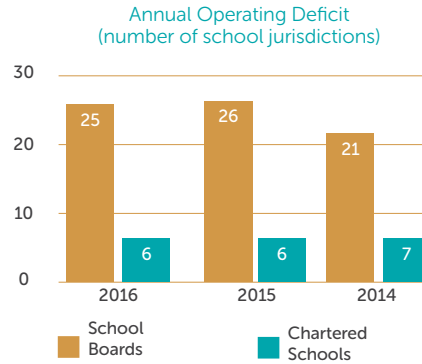
Capital Reserves (in millions)



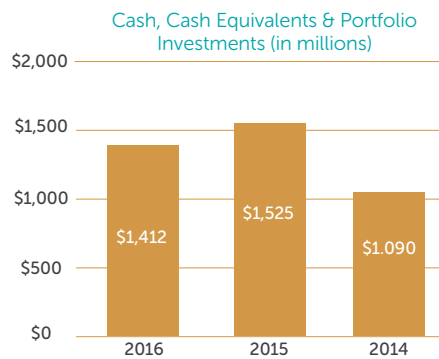
³ Reserves are an unrestricted surplus that the school trustees have internally restricted for a planned future operating or capital expenditure. The trustees restrict the unrestricted surplus into a reserve (or remove restrictions to increase the unrestricted surplus) at their discretion through an approved board of trustees resolution. Operating reserves also include school-generated funds, which are non-discretionary funds raised by the schools for a specific purpose. School-generated funds in 2016 are \$42 million (2015 – \$41 million; 2014 – \$42 million).

⁴ Capital reserves are the funds set aside by the board to meet future capital expenditures. Once the capital reserves are established, the funds cannot be spent on operating purposes without ministerial approval.

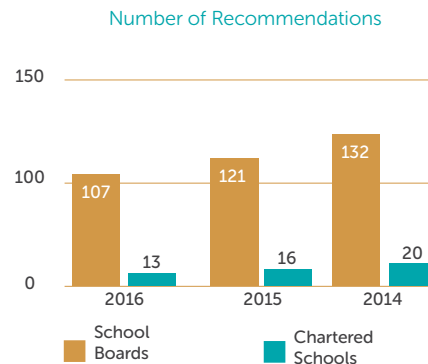
- The number of school jurisdictions that incurred annual operating deficits decreased to 31 (2015 – 32; 2014 – 28)
- The combined net operating surplus of all jurisdictions was \$79 million on a budgeted deficit of \$60 million (2015 – \$76 million on a budgeted deficit of \$94 million; 2014 – \$81 million on a budgeted deficit of \$72 million). Over the past 10 years⁵ jurisdictions incurred a total net operating surplus of \$684 million, compared to the total budgeted deficit of \$682 million.



- The total cash, cash equivalents and portfolio investments decreased to \$1.4 billion (2015 – \$1.5 billion; 2014 – \$1.1 billion). The current-year decrease relates to a new payment process the department implemented last year, where school jurisdictions receive funding as school construction is being completed.



- The total number of recommendations made to school jurisdictions by their auditors decreased to 120 (2015 – 137; 2014 – 152). School jurisdiction trustees should continue to hold their management accountable for continuing to improve identified weaknesses.
- 38 jurisdictions had no recommendations (2015 – 25; 2014 – 23).



- There were no significant changes in the type of recommendation made to jurisdictions. There were improvements in the areas of accounting, review of financial information and school-generated funds. However, school jurisdictions have had the most difficulty in sustaining adequate processes in areas related to review of financial information, cash management, implementation of policies and procedures, purchasing, and payroll.

⁵ In 2007 the combined net operating surplus of all jurisdictions was \$150 million on a budgeted surplus of \$16 million. In 2010 jurisdictions reported a combined net operating deficit of \$14 million on a budgeted deficit of \$124 million.

2. Background

We are the appointed auditor of one of the school jurisdictions, Northland School Division No. 61.⁶ For all other school jurisdictions, we examined the management letters of their auditors and the auditors' reports on the financial statements. Those audits were not designed to assess all key systems of control and accountability. The auditors do report to management about weaknesses that come to their attention when auditing the financial statements.

The composition of school jurisdictions for the past three years is:

School Board ⁷	Chartered School	Total
61	13	74

3. Findings

3.1 Financial reporting

Under Section 151 of the *School Act*, school jurisdiction auditors must send management letters, auditors' reports and audited financial statements to the minister by November 30 of each year.

Auditors' reports—One school jurisdiction received a qualified auditor's report on its fiscal 2016 financial statements (2015 – one; 2014 – two). The auditor issued a qualified report as he/she was unable to verify the completeness of gifts, donations and fundraising revenue.

Financial statements—Twenty-five school jurisdictions and six charter schools incurred an annual deficit from operations (2015 – 26 school jurisdictions and six charter schools; 2014 – 21 school jurisdictions and seven charter schools). School jurisdictions combined were budgeting to incur annual operating deficits of about \$60 million for 2016 as some school jurisdictions planned to use reserves to offset annual operating deficits. Annual deficits from operations are acceptable to the department as long as jurisdictions have sufficient accumulated surpluses available to cover the shortfall. Rather than an overall deficit, school jurisdictions had a combined net annual operating surplus in 2016 of \$79 million (2015 – \$76 million surplus; 2014 – \$81 million surplus). Over the past 10 years⁸ jurisdictions incurred a total net operating surplus of \$684 million compared to the total budgeted deficit of \$682 million.

Accumulated deficits from operations are not acceptable to the ministry. School jurisdictions with accumulated deficits from operations are expected to submit a deficit elimination plan and work with the ministry to eliminate the deficit. No school boards had an accumulated deficit from operations in the past three fiscal years. No charter schools had an accumulated deficit from operations in the past six fiscal years.

6 In May 2017, legislators amended the *Northlands School Division Act*. Starting in fiscal 2017, the auditor general is no longer the legislated auditor of the division.

7 The total number of school boards excludes Alberta Distance Learning (ADL). The Ministry of Education requires ADL to submit a separate set of audited financial statements.

8 In 2007 the combined net operating surplus of all jurisdictions was \$150 million on a budgeted surplus of \$16 million. In 2010 jurisdictions reported a combined net operating deficit of \$14 million on a budgeted deficit of \$124 million.

The combined accumulated unrestricted surplus and operating reserves increased to \$532 million (2015 – \$509 million; 2014 – \$502 million), or seven per cent of the total operating expenses for jurisdictions in fiscal 2016. The department monitors whether the school jurisdictions' combined accumulated unrestricted surplus and operating reserves,⁹ as a percentage of total operating expenses, are within a reasonable range—one to five per cent (2014 – one to four per cent). Forty-four jurisdictions were above five per cent and two jurisdictions were below one per cent at August 31, 2016 (2015 – 49 jurisdictions above five per cent and one below one per cent; 2014 – 60 jurisdictions above four per cent and two below one per cent).

The department implemented a new requirement in 2016 for school jurisdictions to outline their plans for the use of the operating and capital reserves during 2016. If it is concluded that school jurisdictions have excessive reserves, mechanisms to reduce reserve balances include recovering funding from jurisdictions, directing school boards to apply reserves to targeted areas or implementing a short-term overall funding reduction to the system. Department management examined school jurisdictions' 2016 financial reporting and investigated 30 school jurisdictions that had significant deviations from their plans. The department concluded from their investigations that none of the school jurisdictions required an adjustment to their reserve balances.

The total cash, cash equivalents and portfolio investments decreased to \$1.4 billion (2015 – \$1.5 billion; 2014 – \$1.1 billion). The department implemented a new payment process in 2016 where school jurisdictions receive funding as construction is progressing. The department's analysis indicated that cash and the unexpended deferred capital balances¹⁰ decreased after the implementation of the new payment process. The department concluded that the new payment method was effective in reducing the accumulation of cash and cash equivalents by school jurisdictions.

The net book value of tangible capital assets at school jurisdictions is approximately \$6.6 billion (2015 – \$5.5 billion; 2014 – \$5.3 billion). These assets are funded through a combination of the school jurisdictions' accumulated surplus, restricted grant funding, and debt. As at August 31, 2016, school jurisdictions funded approximately \$646 million, or 10 per cent, of these assets from unrestricted surpluses (2015 – \$624 million; 2014 – \$594 million). School jurisdictions have also set aside capital reserves of \$232 million for future capital expenses (2015 – \$199 million; 2014 – \$147 million).

Similar to our last three summary reports,¹¹ we were unable to identify any analysis in the department's annual report of the reasonableness of:

- the unrestricted surplus and operating reserve balances and the expected future performance improvements at jurisdictions from applying these funds
- cash, cash equivalent and portfolio investment balances and their correlation with future plans at the school jurisdictions to apply these funds

9 For the purposes of this analysis, operating reserves exclude school-generated funds as school trustees cannot apply discretion in the use of these funds.

10 The unexpended deferred capital balance is reported as part of the total deferred revenue line item on page 269 of Alberta Education's 2016–17 Annual Report. It represents cash paid by the department to fund school jurisdictions' capital-related expenses. As of August 31, 2016, the total unexpended deferred capital balance is \$234 million (2015 – \$333 million).

11 *Report of the Auditor General of Alberta—October 2016*, page 93, *Report of the Auditor General of Alberta—October 2015*, page 84, and *Report of the Auditor General of Alberta—October 2014*, page 122.

- surplus amounts and the expected future budgeted operating surplus/deficits at jurisdictions
- capital reserves relative to the department's future capital planning

We will consider performing a detailed examination of the effectiveness of the department's monitoring processes as part of our annual financial statement audit.

3.2 Management Letter Recommendations

There were 120 recommendations made to school jurisdictions for fiscal 2016 (2015 – 137; 2014 – 152). Auditors for 38 school jurisdictions did not report any findings and recommendations to management (2015 – 25; 2014 – 23). Some school jurisdictions improved in the areas of accounting, review of financial information and school-generated funds. However, more school jurisdictions received recommendations on IT security and change management than in the prior year. Processes related to review of financial information, cash management policies and procedures, purchasing and payroll have posed the most difficulty for school jurisdictions to sustain annually. We encourage all school jurisdiction trustees to hold management of their respective jurisdictions accountable for implementing all process recommendations identified. The department contacts jurisdictions, where necessary, to encourage them to resolve control weaknesses identified in the management letters, particularly recommendations repeated from prior years.

The following is a summary of the audit findings and recommendations reported to school jurisdictions by their auditors for the fiscal year ended August 31, 2016 compared to the fiscal year ended August 31, 2015.

We have grouped our summary of audit findings into the following categories:

- financial reporting and oversight
- internal control weaknesses
- information technology management

Users of this summary should keep in mind that the audits from which these findings came were not designed to assess all key control and accountability systems. Our summary of the recommendations made to school jurisdictions identifies trends across the sector. The Department of Education and school jurisdictions can use this information to work together to rectify identified common control weaknesses. Management of individual school jurisdictions can also use this information to proactively consider the sustainability of their jurisdictions' control environment, particularly where the trend is an increasing number of recommendations. We do not identify the school jurisdictions associated with recommendations, as this information is not necessary in order for the department and school jurisdictions to achieve their desired outcome—establishing sector-wide strong, sustainable internal controls for financial reporting.

3.3 Financial reporting and oversight recommendations

Accounting issues—Five jurisdictions (not included in the nine reported in 2015) should resolve the issues in accounting treatment relating to capitalization versus expensing items, recognizing liabilities appropriately, revenue recognition, leases and its relevant costs.

Board approval—No jurisdictions (one reported in 2015) failed to ensure that board minutes are approved appropriately.

Board information—One jurisdiction (not the one reported in 2015) should ensure that the board receives timely financial information to maintain and strengthen overall stewardship.

Budgetary process—Three jurisdictions (including one of the three reported in 2015) should improve their budgetary processes.

Review of financial information—Ten jurisdictions (including five of the 14 reported in 2015) should improve their review and approval of financial information such as bank reconciliations, journal entries, monthly financial statements, and variances between budget and actual expenditures.

Timeliness of recording financial information—Two jurisdictions (neither of which was the one reported in 2015) should ensure that accounting transactions for capital assets and capital grant expenditures, accruals and receivables are recorded accurately and financial statements are prepared promptly.

Personnel and staff shortages—Four jurisdictions (including one of the three reported in 2015) should implement succession plans or cross-training for key financial positions or review the allocation of staff resources in the accounting function.

3.4 Internal control weakness recommendations

Cash management—Eight jurisdictions (including two of the seven reported in 2015) should improve cash management processes and controls.

Capital assets—Five jurisdictions (not included in the four reported in 2015) should improve the recording and tracking of capital assets.

Goods and services tax—Two jurisdictions (neither of which was the one reported in 2015) should improve their processes for charging the appropriate amount of GST and for recording accurately the amount of GST paid and recoverable.

Payroll—Seven jurisdictions (including two of the 11 reported in 2015) should improve controls over the administration of employee payroll information, processing of expense claims, application of vacation pay policies and regular reviews of payroll expenses.

Policies and procedures—Twelve jurisdictions (including three of the 11 reported in 2015) should implement, update or follow formal procedures and policies.

Purchases—Eleven jurisdictions (including five of the 12 reported in 2015) should improve controls over the purchase cycle such as the review and authorization processes over purchases and payments, employee sign-off for goods received, and retention of supporting documentation.

Segregation of duties—Three jurisdictions (including one of the three reported in 2015) should segregate duties over authorization and recording of transactions or custody of and accounting for certain assets.

School-generated funds—Five school jurisdictions (including four of the 14 reported in 2015) should improve the processes used to collect, record, spend and report school-generated funds.

3.5 Information technology management recommendations

Computer security—Four jurisdictions (including the two reported in 2015) should improve computer security processes by having unique individual usernames and passwords, implementing a mandatory password change policy, having user access restricted for the appropriate information and backing up data at an offsite location.

Change management—Five jurisdictions (including one of the two reported in 2015) should implement or enhance formal, documented policies and procedures for managing and testing changes to system and network software or hardware.

Outstanding Recommendations

Department

The following recommendations are outstanding and not yet ready for follow-up audits:

Systems to improve student attendance in Northland School Division: Oversight by the department—March 2015, no. 2, p. 23

We recommend that the Department of Education exercise oversight of Northland School Division by ensuring:

- the division develops and executes an operational plan to improve student attendance
- the operational plan identifies the resources needed and how results will be measured, reported and analyzed

Education & Infrastructure—School-building Program: Clarify roles and responsibilities—April 2016, no. 1, p. 9

We recommend that the Department of Education improve its oversight of the school-building program by:

- working with the Department of Infrastructure to clarify the roles and responsibilities of each
- developing clear decision making authorities for the program

Education & Infrastructure—School-building Program: Improve the planning and approval process—April 2016, no. 2, p. 12

We recommend that the Department of Education improve project approvals for new schools and modernizations by:

- implementing a gated approval process
- identifying the approval gates, required deliverables and responsibilities for completion of the deliverables

Education & Infrastructure—School-building Program: Improve systems to manage and control projects—April 2016, no. 3, p. 13

We recommend that the Department of Education improve its systems to manage and control school capital projects by:

- agreeing on project expectations promptly with school jurisdictions and Infrastructure, including scope, budget and key milestones
- developing and implementing change management policies and procedures

Education & Infrastructure—School-building Program: Improve reporting systems and controls—April 2016, no. 6, p. 16

We recommend that the Department of Education define and report on the key performance indicators of the school-building program.

Education & Infrastructure—School-building Program: Match capital funding to project progress—April 2016, no. 8, p. 19

We recommend that the Department of Education improve its cash flow forecasting systems and ensure capital funding requests are supported by assumptions tied to project progress.

Education & Infrastructure—School-building Program: Submit revised plan for approval—April 2016, no. 9, p. 19

We recommend if Treasury Board adjusts the Department of Education's funding request, the Department of Education should submit its revised school-building program plan to the Treasury Board for approval. The revised plan should align with the approved funding and should clearly identify the impact on project progress.

Enterprise risk management process —October 2017, Financial Statement Auditing, p. 50

We recommend that the Department of Education implement an enterprise risk management process.

Capital project financial reporting processes—October 2017, Financial Statement Auditing, p. 51

We recommend that the Department of Education improve controls over tracking and reporting cost obligation for school construction projects.

Education and Infrastructure

The following recommendations are outstanding and not yet ready for follow-up audits:

Education & Infrastructure: School-building Program—Improve systems to manage and control projects—April 2016, no. 4, p. 14

We recommend that the departments of Education and Infrastructure improve the planning process by:

- identifying who must review and approve project planning deliverables and formally communicate these approvals to school jurisdictions or the Department of Infrastructure's contractors
- basing oversight of projects managed by school jurisdictions on risk

Education & Infrastructure: School-building Program—Improve reporting systems and controls—April 2016, no. 7, p. 16

We recommend that the departments of Education and Infrastructure improve reporting on the school-building program by:

- defining reporting requirements, including measures to assess project performance
- using a common reporting system that specifies where information will be retained, who will update it and how it will be updated

Northland School Division No. 61

The following recommendations are outstanding and not yet ready for follow-up audits:

Systems to improve student attendance in Northland School Division: Develop plan to improve student attendance—March 2015, no. 1, p. 23

We recommend that Northland School Division develop an operational plan with short- and long-term targets to improve student attendance. The operational plan should include:

- measurable results and responsibilities
- a prioritized list of student-centered strategies, initiatives and programs
- documentation of the costs and resources required to action the strategies, initiatives and programs
- a specific timeline for implementation
- reporting on progress and accountability for improved attendance results

Systems to improve student attendance in Northland School Division: Monitor and enforce student attendance—March 2015, no. 3, p. 30

We recommend that Northland School Division improve its guidance and procedures for schools to:

- consistently record and monitor student attendance
- benchmark acceptable attendance levels
- manage and follow up on non-attendance