

Good Governance for School Boards: Trustee Professional Development Program
Module 19 – Internal Audit and the Role of Audit Committees
Part C – Audit Committees

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[Overview]

Success for school boards is built on a strong foundation of financial accountability and good governance. An Audit Committee can play a key role in ensuring that your school board has strong internal controls, budgetary and legal compliance, precise and timely financial reporting and disclosure, sound business practices, and a culture of ethical behaviour.

Across Ontario, many school boards are much better served and more professional thanks to the work of their Audit Committees.

[Establishing Audit Committees]

This section of the module starts with an understanding of how Audit Committees came to be established. How did we get here?

Starting in 2007, the Ministry of Education conducted operational reviews of Ontario school boards with the goal of enhancing management capacity. The reviews showed that few school boards had a fully independent Internal Audit function or Audit Committees with external membership. To promote effective governance, the *Education Act* was amended in 2009 to require the creation of an Audit Committee in each Ontario district school board. Through sector consultation, the Audit Committee Regulation was created – this is Regulation 361/10 of the *Education Act*. The Regulation clearly spells out all aspects of Audit Committees. Each board was required to establish an Audit Committee no later than January 31, 2011.

[What are Audit Committees?]

What exactly are Audit Committees and, generally speaking, what do they do?

In a nutshell, an Audit Committee is a standing committee of the board. It assists the Board of Trustees to oversee and objectively assess the performance of the school board's management, internal audit and external audit functions.

Regulation 361/10 of the *Education Act* outlines the six main areas of an Audit Committee's duties. These are:

- Financial reporting
- Internal controls
- Internal audit
- External audit
- Compliance matters, and
- Risk management

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[What does an Audit Committee do?]

Independent Audit Committees are a vital component of an organization's governance structure. Audit Committees provide oversight through offering objective advice and recommendations to the board on whether the organization's governance, risk management and internal control processes are well designed and working effectively.

Audit Committees are intended to build trust and confidence in how the school board manages its resources. In fulfilling its oversight responsibilities, the Audit Committee should take great care in terms of demonstrating transparency and accountability. It's important to ensure that anyone sitting on an Audit Committee receives formal training on the purpose and mandate of the Committee and on the board's objectives. The Audit Committee should also establish a process of continuing education for its members.

[Benefits of an effective Audit Committee]

When an Audit Committee is operating effectively it provides a range of benefits to the board. These include improved financial practices and reporting, an enhanced Internal Audit function, and a stronger external audit process. Boards will also experience an additional level of assurance and heightened credibility among stakeholders as public confidence in the management of public education dollars is strengthened.

[Composition of an Audit Committee]

Audit Committees are comprised of members of the Board of Trustees as well as non-board members. Non-board members are individuals from the community who have an understanding of accounting and auditing standards. For greater independence, they cannot be employees of any district school board and must not have any conflict of interest (such as having a parent, child or spouse employed by the board).

All Audit Committee members must be independent from the board's management. An effective Audit Committee includes members who offer an appropriate mix of skills and experience. They must abide by the school board's Code of Conduct, and members are required to disclose any conflict of interest, or appearance of one, to the Committee.

The size of the Committee varies depending on the size and complexity of the school board. In Ontario, the average Audit Committee has four or five members, with at least two Committee members who are not trustees.

[Skills of the Audit Committee]

It is essential that non-board members of the Audit Committee bring accounting, financial management or other relevant business experience to the table. A board should seek out community members with sound judgment, objectivity, a high level of ethics and strong communications skills to fill the role.

Together, as the Audit Committee, non-board members and trustees should develop a sound knowledge of the board and, in particular, have a strong understanding of:

- The board's mission and current significant issues

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- The board’s structure, including key relationships
- The board’s culture
- Any relevant legislation, regulations and procedures
- Key risks that could affect the board’s goals and objectives
- The government environment, including accountability structures between the board and the Ministry of Education

[Selection Committee and Terms of Appointment]

The board must establish a Selection Committee to identify and recruit potential non-board members for the Audit Committee. The selection team should consist of the Director of Education, a senior business official of the school board and the Chair of the Board of Trustees. To ensure the independence of the Audit Committee, the board’s internal auditor should not be involved in the selection process.

Terms of office for Audit Committee members are determined by the school board, but maximums apply. The term for non-board members can’t exceed three years and the term for board members can’t exceed four years. Terms are long enough to ensure a good measure of continuity but short enough to allow for new perspectives and insights.

Board members can be reappointed, whereas non-board members can only be appointed twice. At that point, the board is required to advertise the position to identify new potential candidates. The incumbent may be reappointed only if no candidates are identified through the advertising process. Incumbent members remain on the Committee pending new appointments.

It’s important to note that there is no remuneration for non-board Audit Committee members. Committee members may however be reimbursed for travel and Committee-related expenses.

[Role of the Audit Committee Chair]

The Audit Committee Chair has a key role in ensuring the effectiveness of the Committee. It’s important to note that any Audit Committee member may be Chair – the Chair does not necessarily have to be a trustee.

In their role, the Chair will have a sound understanding of the responsibilities of the Audit Committee and how it aligns and interacts with the board’s governance structure and work. The Chair will also make sure that Committee members have up-to-date knowledge about the board and its activities. It is essential that the Chair is skilled in facilitating discussion in ways that ensure the Committee addresses the most important issues before it. Other essential skills include the ability to plan and manage Committee meetings, and coordinate the annual Audit Committee self-assessment. It is vital that the Chair maintain an open and constructive relationship with senior managers, Internal and External Audit, and other committees.

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[Film Clip]

[John Sabo, Associate Director, Corporate Services, York Catholic DSB] – It's the role you play. I believe there are six roles I participate in, and one is a leadership role, and it is a really important one. I have to be seen to be leading and, actually, I have to go out and do the leadership as necessary. There's a coordination and facilitation role that is necessary. There are a lot of processes to be moved through the agenda, and that needs to be done. Another key role is one of being seen as a champion. One of the other main roles is one of education. Education is critical: we are in the education business, however, we are also a big business and anything that we can do to demonstrate that we are fulfilling our responsibilities and providing internal controls and business services is really important – so, that's a critical item. It's also, under the education [role], to educate people that the whole exercise of having Internal Audit, Regional Internal Audit Teams, and Audit Committees has nothing to do with a "gotcha" exercise – it's all about how can we produce better controls that are necessary for the system. And also to educate people that the Internal Audit function is actually a good idea and we all benefit from it. It's counter-intuitive to some people, but it is actually very important. Their audits and reviews are not something that is typically welcome by many, there's often disagreement, so I have to assist in that exercise. And the last role is one around "calming the waters". People are nervous, nobody likes to be audited, and once people are educated, once they understand why we are doing what we are doing, being the professionals that they are, they will come around and accept their role.

[Powers of the Audit Committee]

An Audit Committee's authority to do its work is established by Regulation 361/10. This provides for the Audit Committee to have unrestricted access to the board's management and employees and to the information it needs to carry out its responsibilities. The Audit Committee can meet with or require the attendance of individuals at Committee meetings to provide the information or explanations they have requested. The Audit Committee also has the power to require the internal or external auditor to provide reports, as well as the power to access all records examined by Internal and External Audit. With prior approval by the board, the Committee can retain legal counsel, accountants or other professional assistance it needs to fulfill its responsibilities.

The Audit Committee may also hold private sessions with the Internal Audit Team, external auditor or any staff of the board, without other board staff or trustees who are not members of the Committee.

[Audit Committee Meetings]

A minimum of three Audit Committee meetings are required every fiscal year with the first meeting taking place no later than September 30th. The Audit Committee Chair works with senior management and the Regional Internal Audit Manager to establish a work plan and agendas so the Committee can carry out its responsibilities.

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A meeting quorum is the majority of the members but the number must include a non-board member. Decisions are made by resolution – each member has one vote, with the Chair entitled to cast a second vote in the event of a tie. The Director, SBO and Regional Internal Audit Manager should attend all meetings, with the external auditor attending where appropriate.

Each board should be clear on its policy and criteria for opening or closing an Audit Committee meeting. This is determined by the individual board. It is vital that any established policy follows the principles of openness and accountability.

[Reporting to the Board and Ministry of Education]

Board by-laws usually require the Audit Committee to present a report to the Board of Trustees after each Committee meeting. A report often includes items recommended for the board's approval. Additionally, Regulation 361/10 requires that an annual report be submitted to the board. This report should contain a summary of the work the Committee performed and matters addressed at meetings, an assessment of the Committee's progress in addressing audit observations and recommendations, and attendance records.

The board must also provide reports on Internal Audit to the Ministry of Education. The board should provide a summary of the work actually performed by the internal auditor in the year, compared to the planned work. This provides the Ministry with information on the use of the Internal Audit funding allocation. Based on the multi-year internal audit plan, the board should also report on whether any enrolment audits are expected. This will assist the Ministry in planning its own enrolment audits, with the objective to avoid enrolment audits by the Ministry and Regional Internal Audit in the same year. Enrolment is a significant factor in generating funding and the Ministry will audit a sample of boards each year.

The report to be submitted to the Ministry should go to the board by November 30th each year and be sent to the Ministry by the following January 15th.

It's important to note that the Ministry does not require the full audit plan or audit results.

[The Six Main Duties of Audit Committees]

Now that we've reviewed the "nitty-gritty" on Audit Committees and have an understanding of how they function, let's dive deeper into the role of the Audit Committee. Specifically, each Audit Committee has duties in the following six main areas:

- Financial reporting
- Internal controls
- Internal audit
- External audit
- Compliance matters
- Risk management

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[Duty # 1: Financial Reporting]

Each school board has the responsibility to prepare consolidated financial statements in accordance with the *Financial Administration Act*. It is the role of the Audit Committee to review and, as it deems appropriate, recommend the approval of these financial statements to the board.

Audit Committees also have the responsibilities to review the results of the annual external audit and look at any difficulties the external auditor may have encountered in conducting their work and any significant changes that were made to the audit plan.

The Committee must also review with the Director of Education, a senior business official and the external auditor all matters that the external auditor is required to communicate to the Audit Committee under generally accepted auditing standards. They must review with the external auditor any written communications between the external auditor and the Director or a senior business official and are required to ask the external auditor about whether the financial statements of the board's reporting entities, if any, have been consolidated with the board's financial statements.

[Duty # 2: Internal Controls]

A school board's internal control system is made up a network of systems established to provide reasonable assurance that the board's objectives will be achieved. A simple example of an internal control could be the requirement of a purchase order for procurement of items over a certain dollar amount.

Board management, external auditors and internal auditors will provide the Audit Committee with the information it needs to review internal controls. With this information, the Audit Committee has the duty to:

- Review the overall effectiveness of the board's internal controls;
- Review the scope of both the internal and external auditors' reviews of the board's internal controls; and
- Discuss with the board's officials any significant financial risks and the measures taken to monitor and manage these risks.

There are a number of resources available to assist Audit Committees with their duties related to internal controls. The Audit Committee receives reports from Internal Audit which contain observations, recommendations and responses from board staff, action plans and timelines. The Committee also receives the Internal Audit's annual report which provides assessment of the board's processes for control and risk management. Additionally, the external auditors will present a management letter that contains risks identified during the audit.

[Duty # 3: Internal Audit]

The Audit Committee has the duty to oversee the work of Internal Audit. Regional Audit Teams and internal auditors report to the Audit Committees established at school boards within their region.

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With regard to Internal Audit, a board's Audit Committee has the duty to review the annual and multi-year audit plans from Internal Audit and to make recommendations to the Board of Trustees for approval of these plans. The Audit Committee also reviews Internal Audit findings and recommendations as well as management's response to these, and conducts a performance review of the Regional Audit Manager and audit team members.

Additional reports presented by Internal Audit to the Committee for review include:

- Annual risk assessments, and
- Follow-up reports on the progress of management's action plans.

[Film Clip]

[John Sabo, Associate Director, Corporate Services, York Catholic DSB]

Processes you do review and you identify weaknesses and recommendations to address those weaknesses. Six years ago, we, as a province, could not have met certain standards that our Auditor General expected of the sector. We are in a better position now to meet those standards by having Audit Committees in place, by having a formalized Internal Audit Program provincially. I believe this initiative has helped us to be in a better position to meet our fiduciary responsibilities. Fiduciary responsibilities are something we always have to pay attention to. This is a tool that has moved us forward.

[Duty # 4: External Audit]

In addition to overseeing the work of Internal Audit, the Audit Committee also has the duty to oversee the work of the board's external auditor. The Committee must make recommendations to the board on the content of the external auditor's plan and on all proposed major changes to the plan. The Audit Committee must also conduct a performance review of the external auditor annually.

Where there are any disagreements about financial reporting between the Director of Education, a senior business official and the external auditor, the Audit Committee should work to resolve these.

[Duty # 5: Compliance]

An Audit Committee has duties related to the board's compliance matters. This includes reviewing the effectiveness of the board's systems for monitoring compliance with legislative requirements and with the board's policies and procedures. For example, with assistance from management, it is the responsibility of the Audit Committee to review how the board is communicating and administering processes around the board's Code of Conduct in order to ensure compliance with the Code.

There are approximately 200 statutes that impose liability in various situations (for example the *Income Tax Act*, *Employment Standards Act*, *Occupational Health and Safety Act*, etc.). Those who are in charge of the board's governance are held accountable if there is a lack of compliance.

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The Audit Committee must obtain confirmation from the board's Director of Education and supervisory officers that all statutory requirements are being met, and should have regular updates on compliance matters.

There may be reports that are received from other parties such as regulators, and any significant findings in these reports must also be reviewed.

Where there have been instances of non-compliance, the Audit Committee should review any action taken by the board to address the non-compliance.

[Duty # 6: Risk Management]

Audit Committees have a number of duties surrounding risk management at their board. It is the responsibility of the Audit Committee to stay informed on significant risks to the school board. The Audit Committee must review the board's risk assessment and risk management policies, assess the risk management process of the school board, and review risk assessments that have been provided by the internal and external auditors.

To fulfill these duties, it helps to have a formalized risk management framework in place at the board. This includes a formal risk identification and assessment process, a risk register and ongoing monitoring and reporting on risks. The Director of Education, senior business officials, and internal and external auditors all contribute to providing assurance on risk management to the Audit Committee.

[Linking Internal Audit and Audit Committees]

The duties of the Audit Committee are vast and varied, but generally speaking the role of the Audit Committee is one of oversight. As we draw closer to the conclusion of the presentation, let's take a moment to review the linkage between Internal Audit (the group that performs the work) and Audit Committees (the group that oversees the work).

The role of the internal auditor and the Regional Internal Audit Team is to be on the ground working – doing things like developing and executing the internal audit plan and reporting on results. The Audit Committee has the role of review and oversight. The Committee recommends approval of the internal audit plan and reviews Internal Audit findings and recommendations.

Together, both entities work to ensure effective, accountable and transparent financial governance.

[Film Clip]

[Michael Barrett, President, OPSBA, and Chair, Durham DSB]

The independence of the Audit Committee is an important element, and then being able to ensure that the goals of both the Audit Committee and the board are aligned. Although we are both independent, the reality is that both are there ensuring that dollars are spent the way they are to be and that processes such as RFPs [requests for proposals] are done correctly and properly. So I think that certainly there does not have to be confrontation, there does not have to be an element of having two separate boards.

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What they do is they harmonize and they complement each other in their goals. So it is really having another set of eyes being able to look at the operations of the board, ensuring that we are operating within our fiscal and financial mandate.

[Kathy Burtnik, President, OCSTA, and Vice-Chair, Niagara Catholic DSB]

Number one – and probably the single most important benefit – has been risk mitigation. As we go through the processes we really look through a microscope at a particular function of the board and realize that there are processes that we could indeed do better to lessen the chance of risk – operational risk, reputational risk – all of those factors that then boost our confidence in our system.

[Wrap-up]

This concludes Part C and our presentation on the role of Audit. At this point, you will have gained a better understanding of how Internal Audit and Audit Committees function and how they provide the opportunity to modernize and streamline governance.

We thank you for taking the time to view this presentation and for your commitment to the effective management of school boards. We hope this information has deepened your knowledge of the structures that assist you in effective stewardship of your board's resources, a vital underpinning in supporting success and well-being for Ontario students.