



# **Toolkit for Boards of Education Accumulated Operating Surplus**

- What is an Accumulated Operating Surplus?
- Establish an Accumulated Operating Surplus Policy
- Accumulated Operating Surplus is an Indicator of Financial Health
- Categorization of Internally Restricted Accumulated Operating Surplus
- Accumulated Deficits
- Taxpayer Accountability Principles

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# Purpose of this document

All Boards of Education should discuss and approve a surplus policy that guides future years' inter-fund transfers, and ensure that stakeholders are aware of the policy and understand what it means.

It is the Ministry's expectation that this policy will be developed during preparation of the 2017-18 budget and the policies will be approved by the Board of Education no later than September 30, 2017. This will ensure that the policies are providing guidance for the 2017-18 school year.

The Taxpayer Accountability Principles referenced below provides some of the accountability framework Boards of Education must work within. Other components of the accountability framework include the *School Act* and Public Sector Accounting Standards.

For additional guidance, refer to *Ministry of Education expectations of Boards of Education regarding Financial Governance and Accountability*.

## What is an Accumulated Operating Surplus?

'Accumulated Operating Surplus' is a term defined by the Public Sector Accounting Standards (*PS1201*).

While Boards of Education may colloquially use the term Reserves to denote 'Surplus', when it comes to financial statements and budgets the term Surplus *must* be used.

Unique to other organizations in the public sector, school districts are permitted to incur annual deficits as long as they have sufficient accumulated surplus to cover the annual deficit. An accumulated surplus indicates that a school district has net resources that can be used to provide future services. It is achieved by spending less than the revenue it earns. The Board may approve restrictions on spending of the surplus. Boards of education are required by legislation to prepare balanced annual budgets, which may include use of prior year accumulated surplus.

Boards are required to prepare a balanced budget where board revenues plus any appropriated surpluses fully fund the following:

- annual operating expenses,
- annual special purpose fund (SPF) expenses,

- annual capital fund expenses,
- tangible capital asset acquisitions (from Operating, Special Purpose Funds and Local Capital),
- planned reduction of unfunded liability for employee future benefits, and
- any planned reduction of prior years' deficits.

It is important to note that although accumulated surpluses can be a source of cash for spending, it cannot sustain on-going services. The ability to carry forward unspent operating funds helps school districts budget and spend their annual operating grants more effectively. School districts also have the ability to plan and sustain services for a period longer than one year because of the accumulated operating surplus.

School districts are encouraged to provide information in the Notes to the Financial Statements, itemizing what internal restrictions they may have placed on the accumulated operating surplus. Additional narratives explaining how the funds were accumulated and what the ongoing plan is for the use of these accumulated surpluses, in addition to how the surplus supports achievement of the school district's

goals can be prepared and presented in a document known as a Financial Statement Discussion and Analysis (FSD&A).

For additional guidance on preparing a FSD&A, refer to *Ministry of Education expectations of Boards of Education regarding Financial Governance and Accountability*.

Improved reporting of accumulated operating surplus would explain the annual operating results and the plans to spend the accumulated operating surplus balances.

A number of questions should be considered by boards of education.

- Do the surplus balances indicate efficiency of spending, good practice of monitoring and managing the day-to-day finances, good planning or a sector that is not utilizing all services to support our students?
- Does our funding allocation structure support good practices?

- Is there a need to better understand the effect of changes in spending on student outcomes?
- Do the current funding levels reflect the deferred maintenance of buildings or the changes in educational programming?
- Is there too much reliance on local revenues?

How do the answers to these questions affect the levels of administration and operating reserves?

The sector needs to be in a position to be transparent and complete with the information provided so that the story of spending in public education is well understood and the above questions can be answered.

## Establish an Accumulated Operating Surplus Policy

Boards of education should discuss and approve a surplus policy that guides future years' inter-fund transfers. The policy should consider general guidelines as to how much (e.g. percentage or dollar amount) could be transferred to other funds, how much would be added to Accumulated Surplus and how much might be allocated for current year's initiatives and spent in that fiscal year. In addition to developing a policy, annual discussions on the expected surplus/deficit for the year should be held starting in the third quarter of the year to help inform decisions related to the application of the Surplus Policy for that fiscal year.

Having common descriptors of Internally Restricted Operating surplus should help comparability amongst school districts. In addition, regular assessments of each operating surplus item to determine if the amount is still valid.

Assessments should include reviews of historical usage of operating surplus items. Amounts should not be internally restricted that will not likely be spent in the near term. For example, school and department

carry-forwards, supplies balances, and future year budgets beyond the next three fiscal years.

Accumulated Operating surplus should not be transferred to Local Capital without supporting detail of what capital projects these Local Capital funds will be spent on. Until such time as the funds can be identified for a specific Local Capital funded project, the funds should be retained in accumulated operating surplus.

Each year's inter-fund transfers should be subject to discussion and approval by the Board prior to the transfer being made, with a formal motion for the transfer of that year's surplus.

## Accumulated Operating Surplus is an Indicator of Financial Health

One of the key indicators of the financial health of an organization is the accumulated operating surplus. The BC Office of the Auditor General in their Report – Understanding Canadian Public Sector Financial Statements (June 2014) defined accumulated operating surpluses as:

*FINANCIAL PERFORMANCE MEASURE: ACCUMULATED SURPLUS OR DEFICIT*

*The accumulated surplus or deficit represents the net recognized economic resources (all assets and liabilities) of the entity at the date of the financial statements. This measure provides the net economic position of the entity from all years operations at a point in time.*

*The accumulated surplus or deficit is comprised of all of the past:*

- *operating surpluses or deficits; and*
- *remeasurement gains and losses.*

*When total assets exceed total liabilities, the entity is in an accumulated surplus position. An accumulated surplus position means that the entity has net positive resources that, subject to direction of the government or governing board, could be used to provide future services. However, when an entity is in an accumulated deficit position (total liabilities exceed total assets), the entity must fund past transactions and events from future revenues. An accumulated operating deficit position means the entity has borrowed to finance annual operating deficits.*

The Auditor General report outlines the following question as important to ask:

*Is the accumulated surplus or deficit of the entity increasing or decreasing, and how strong is the overall financial position of the entity?*

*It is important to understand the balance between the entity's historic revenue generation and its service delivery. This means looking at current trends to see whether the financial position (the*

*accumulated surplus or deficit) is increasing or decreasing, as well as the overall strength of the financial position in which these results occurred. An entity in a strong accumulated surplus position may be able to incur annual deficits for a longer period of time than an entity in a weaker financial position (i.e., accumulated deficit position). The strength or weakness of the accumulated surplus or deficit position is determined by the ratio of assets (financial and non-financial) to liabilities. The ratio of assets to liabilities is one of the sustainability financial condition indicators recommended in SORP 4.*

For more information on indicators of financial condition, refer to PSAB *Statement of Recommended Practice (SORP 4) – indicators of financial condition*. SORP 4 provides guidance to entities when reporting supplementary information on the financial condition of the entity including possible sustainability, flexibility and vulnerability indicators.

## Categorization of Internally Restricted Accumulated Operating Surplus

Reviewing each district's 2014/15 and 2015/16 accumulated operating surplus, we can see common 'themes' of the descriptions used for internally restricted operating surplus. Overall, almost 90% of internally restricted items are for activities that span the current school year, including contingency reserves. Appendix II – Categorization of Internally Restricted Accumulated Operating Surplus by School District, details each district's surplus by a common theme.

Overall, there are four categories of Accumulated Operating Surplus:

- Internally restricted due to nature of constraints on the funds (funds with external restrictions are to be included in Special Purpose Funds)
  - Contractual obligations (i.e. professional development)
  - Aboriginal education
  - School Generated Funds (not included on Schedule 3A)
  - Education Plan
  - Donator named funds
- Internally restricted due to anticipated unusual expenses identified by senior management
  - Exempt staff compensation
  - Staffing and labour relations
  - Employee benefits
  - NGN implementation
  - Anticipated severance
  - Contingency reserve
- Internally restricted due to operations spanning the school year
  - Future years' Operations/Budget (not beyond the next three fiscal years)
  - Schools and Department surpluses/carry-forwards (not beyond the next three fiscal years)
  - Operating projects in progress
  - Technology, utilities, equipment and Capital projects (includes amounts to be transferred to Local Capital, but have not yet been identified for specific initiatives)
  - Purchase order commitments



- Distributed learning, summer school, International Program
- Strategic planning, school reconfiguration
- Unrestricted operating surplus (includes funds that may be used in budget years beyond the next three fiscal years)

## Accumulated Deficits

Unique to other organizations in the public sector, school districts are permitted to incur annual deficits as long as they have sufficient accumulated surplus to cover the annual deficit.

A board of education may not plan to incur an accumulated deficit (i.e. insufficient accumulated surplus to cover the annual deficit) when setting its budget for the next school year. School districts may, however, occasionally find themselves in circumstances during the school year where an accumulated deficit is anticipated. Under section 156 (12) of the *School Act*, a school district must then seek the approval of the Minister of Education to incur a deficit.

Under current Ministry of Education policy, a request to incur an accumulated deficit will only be approved if it is submitted by the Board Chair, or on a motion from the board of education, and only if the board can explain why the accumulated deficit has been incurred. The board must not have a history of multi-year accumulated deficits, must have retired any previous accumulated deficits as required, and must:

- indicate that the accumulated deficit was unforeseen
- provide a reasonable explanation for why the accumulated deficit will be incurred
- demonstrate that the accumulated deficit will be repaid within one year
- indicate that the accumulated deficit is under a set percentage (1%) of budgeted expenditures
- have appropriated, to the current year, all accumulated operating surplus from prior years
- submit a deficit retirement plan.

If the Minister were to approve an accumulated deficit prior to having the audited figures, the amount approved may either be too high or if too low the district would have to re-submit their request.

Should a school district not meet the above criteria, the Minister may seek more information in order to consider the Board's request. Approval will be considered on a case-by-case basis if the circumstances are exceptional and extenuating.

Until such time as the audited financial statements are completed, and the total actual accumulated deficit is known, the Minister will suspend a decision to approve, or not approve, the accumulated deficit.

## Taxpayer Accountability Principles

The BC Government's *Taxpayer Accountability Principles* (TAP) are intended to apply to the broader public sector which includes school districts. All trustees, superintendents and senior administrators should receive training on the expectations of TAP and the expectations established by TAP should be incorporated into the school district's Code of Conduct.

These principles support establishment of policies at the school district for establishing a reasonable level of accumulated surplus, being accountable for decisions made in establishing and using surplus, and transparency in the reporting of accumulated surplus.

Implementing the concepts of the *Taxpayer Accountability Principles* may require additional capacity, which includes sufficient staffing with appropriate expertise. This may require incremental investments in administration.

The six principles are:

- 1. Cost consciousness (Efficiency)** Strengthen cost management capabilities and foster a culture of cost-consciousness at all levels of public sector organizations. Provide public services and programs as efficiently and effectively as possible to "bend the cost curve" and support sustainable public policies and programs as a lasting legacy for generations to come.
- 2. Accountability** Transparently manage responsibilities according to a set of common public sector principles in the best interest of the citizens of the province. By enhancing organizational efficiency and effectiveness in the planning, reporting and decision making, public sector organizations will ensure actions are aligned with government's strategic mandate.

- 3. Appropriate Compensation** Comply with a rigorous, standardized approach to performance management and employee compensation, which reflects appropriate compensation for work across the public sector that is consistent with government's taxpayer accountability principles and respectful of the taxpayer.
- 4. Service** Maintain a clear focus on positive outcomes for citizens of British Columbia by delivering cost-efficient, effective, value-for-money public services and programs.
- 5. Respect** Engage in equitable, compassionate, respectful and effective communications that ensure all parties are properly informed or consulted on actions, decisions and public communications in a timely manner. Proactively collaborate in a spirit of partnership that respects the use of taxpayers' monies.
- 6. Integrity** Make decisions and take actions that are transparent, ethical and free from conflict of interest. Require the establishment of a strong ethical code of conduct for all employees and executives. Serve the citizens of British Columbia by respecting the shared public trust and acting in accordance with the taxpayer accountability principles.

