

Financial Statement Discussion and Analysis



Year ended June 30, 2017

Contents

Introduction	1
Composition of the financial statements.....	2
Statement of Financial Position	3
Statement of Operations	5
Operating Fund	6
Special Purpose Funds	10
Capital Fund	11
Conclusion.....	14

Introduction

This is a discussion and analysis of the financial performance of School District 22 (Vernon) (the ‘District’) for the fiscal year ended June 30, 2017. It is based on currently known facts, decisions, or conditions. This should be read in conjunction with the School District’s financial statements.

The preparation of this financial statement discussion and analysis is management’s responsibility.

Located in the Okanagan Valley of British Columbia, the District serves the communities of Vernon, Coldstream, Lavington, Lumby, and Cherryville. The District provides excellent educational services to approximately 8,300 students. These services include a strong International Program, a vibrant French Immersion Program, a Montessori Program, Distributed Learning Courses, a strong Aboriginal focus, opportunities for Trades Training and Secondary Apprenticeships, numerous sports, and specialty Academies.

The District’s mission is:

To inspire and develop lifelong learners who can communicate, think creatively, problem-solve, collaborate, and understand their personal and social responsibilities.

The District aims to allocate its resources as effectively as possible to achieve this mission. The financial statements illustrate, in financial terms, how resources have been allocated and consumed during the year to June 30, 2017.

Composition of the financial statements

The two key audited statements are:

- A **statement of financial position**, which summarises the assets and liabilities at June 30th. This provides an indication of the financial health of the school district.
- A **statement of operations**, which summarises the revenues received and expenses incurred during the twelve months between July 1 and June 30. This provides an indication of the funding received by the school district and how that funding was spent.

The Statement of Changes in Net Financial Assets (Debt), the Statement of Cash Flows and the notes to the financial statements are also audited, and provide further analysis of the District's finances.

The District manages its financial activities in three distinct areas, being the

- Operating fund;
- Special purpose funds; and the
- Capital fund.

The schedules at the end of the notes to the financial statements are in a format prescribed by the Ministry of Education. These schedules provide more detail specific to each of these funds. The balances in these schedules are consistent, when combined together, with the financial statements.

Schedule 1 illustrates the sum of the funds.

Schedule 2 provides detail on the **Operating Fund**.

The Operating Fund accounts for the District's operating grants and other operating revenues. Legislation requires that the District present a balanced budget for the Operating Fund, whereby budgeted expenditure does not exceed the total of budgeted revenue and any surplus in the operating fund carried forward from previous years.

Schedule 3 provides detail on the **Special Purpose Funds**.

The Special Purpose Funds account for grants and contributions which are directed by agreement with a third party towards specific activities. As these are targeted grants, any unspent funding is typically accounted for as deferred revenue, not as accumulated surplus.

The Special Purpose Funds also account for the operating revenues, expenses and surplus of 554210 BC Ltd, a related entity which owns a woodlot license.

Schedule 4 provides detail on the **Capital Fund**.

The capital fund accounts for:

- The capital assets of the District, including the existing buildings, furniture, computers and equipment.
- Funding targeted for the purchase of capital assets.
- Funds restricted for future capital asset purchases (local capital).

Statement of Financial Position

Cash and cash equivalents

At June 30 2017, the District held \$22m in cash, deposited in financial institutions and the Province's central deposit system. This cash balance primarily offsets the liabilities of the school district and unspent funds restricted for use on specific projects.

Accounts payable and accrued liabilities

The District's accounts payable and accrued liabilities represent expenses which have been incurred but not yet paid. They comprise the following amounts:

	June 30, 2016	June 30, 2017
Trade and other amounts payable	\$2,202,666	\$1,794,957
Wages payable – teachers' 12 month instalment plan	1,137,420	1,150,417
Pension contributions payable	1,129,932	1,256,442
Payroll taxes payable	987,922	1,003,893
Accrued vacation pay	826,117	866,089
Accrued wages and benefits	650,048	650,919
Other accrued liabilities	375,100	174,915
Total accounts payable and accrued liabilities	\$7,309,205	\$6,897,632

Unearned revenue

The District receives payment of tuition fees for international students in advance of the student commencing their studies at the District. These fees are recognised as earned revenue when the tuition is provided to the student. The unearned revenue of \$2.1m represents international student fees received prior to June 30 2017 for tuition in the 2017/18 school year.

Deferred revenue

Deferred revenue represents the unspent portion of grants which are targeted for a specific purpose.

	June 30, 2016	June 30, 2017
Scholarships and bursaries – balances administered by the District and amounts awarded but not yet claimed	357,715	\$343,775
School generated funds – amounts raised by schools for specific projects, such as class trips and PAC financial contributions	759,846	\$745,684
Other unspent targeted funds	112,028	81,176
Total deferred revenue	1,229,589	1,170,635

Deferred capital revenue and tangible capital assets

The deferred capital revenue balance is closely linked to the tangible capital asset balance. Tangible capital assets are things owned by the District which have a lifespan of more than one year. This includes school buildings and sites, furniture, and most computer equipment.

The majority of the District's capital expenditure, such as the construction of new schools, is funded through specific grants provided by the Ministry of Education. Once an asset is built or acquired and is in use, the cost of that asset is amortized over the expected life of that asset. Any grants targeted towards the acquisition of that asset are also amortized over the expected life of that asset.

After allowing for amortization, the District has \$110,577,154 of tangible capital assets. \$92,256,960 (being the deferred capital revenue balance) was funded through targeted grants. The remainder was funded through operating grants and other non-targeted funding.

This inclusion of deferred capital revenue is not consistent with generally accepted accounting principles. The inclusion of this balance is a requirement of the Provincial Government. This is explained in more detail in note 2 to the financial statements.

The capital fund section later in this document provides a more detailed explanation of the accounting for capital assets and associated grants.

Employee future benefits

The employee future benefits liability of \$3,386,165 accounts for amounts or benefits owed to current employees as a result of past service. The liability amount is calculated by actuaries based on District employee numbers, age, length of service, contract terms, and established actuarial assumptions.

86% of this amount is associated with retirement benefits earned by employees. Support staff and certain members of school and district administration are entitled to a one-time payment from the District on their retirement. The amount of payment is dependent on years of service and final salary.

The District sets aside a liability each year to reflect expected future payments on retirement. The amount set aside during the year is reflected as an expense, and is based on the service to date of employees. The liability is reduced when employees retire and payments are disbursed.

The remainder of the employee future benefits liability is associated with teachers' sick leave and death benefits earned but not yet paid.

Net financial assets (debt)

This is the total of the District's financial assets and liabilities. It implies that the District has a net debt of \$82.7m. This is heavily skewed by the deferred capital revenue liability of \$92.3m. As there is no future cash flow associated with the deferred capital revenue balance, a more meaningful measure of net financial assets or debt excludes that balance, giving a figure of net financial assets of \$9.5m. This is a healthy balance, indicating that the District is well positioned to meet its financial liabilities as they fall due.

Accumulated surplus

Broken down by fund, the accumulated surplus comprises the following amounts:

	June 30, 2016	June 30, 2017
Operating fund	\$ 2,373,697	\$ 1,602,957
Special purpose funds	-	151,460
Capital fund – local capital (amounts available to spend on future capital asset purchases)	6,679,289	7,271,641
Capital fund – invested in tangible capital assets (being the cost of assets owned by the district, net of amortization and targeted grants)	19,065,445	18,934,352
Total accumulated surplus	\$ 25,744,734	\$ 27,960,410

These surpluses are discussed in more detail later in this document.

Statement of Operations

The statement of operations is the sum of the revenues and expenses of the District's various funds.

Ministry of Education grant funding increased from 2016 by \$3.9m. This is a consequence of increased enrolment, new grants received during the year and increased funding to offset wage increases.

Expenses increased approximately in line with revenue, as wage increases were implemented and additional educational resources were allocated.

Overall, the District's expenses exceeded its revenues by \$175,420. Broken down by fund, this variance arises as follows:

Fund	Surplus or deficit for the year	Commentary
Operating fund	\$770,470 deficit	\$600,000 of surplus carried forward from 2015/16 was budgeted for expenditure in 2016/17. In addition, the District utilised about \$400,000 of its contingency reserve to cover a fine, discussed later in this document.
Special purpose funds	\$151,460 surplus	The District's woodlot harvested and sold a lot of timber during the year, generating a surplus of revenue over expense.
Capital fund	\$443,859 surplus	\$400,000 transferred to the capital fund from the operating fund for new software was not spent during the year. This is expected to be spent later in 2017/18.
Total	\$175,420 deficit	

Revenues, expenses and surpluses of the individual funds are discussed in more detail below.

Operating Fund

Grant funding and enrolment

93% of the District’s operating funding is from Provincial Ministry of Education (‘MoE’) and direct funding from the Okanagan Indian Band through a Local Education Agreement (‘LEA’).

The majority of this funding is calculated based on student enrolment. The table below shows historical trends for this funding and enrolment.

Increase from previous year	2013/14	2014/15	2015/16	2016/17
Student FTE	-2.0%	2.5%	1.8%	1.1%
MoE Grants and LEA revenue	-3.6%	2.7%	5.5%	4.5%

The teachers’ strike in 2013/14 and 2014/15 reduced the grants received by the District for those years. This offset any expense reductions created by not paying wages during the strike period.

Typically, funding needs to increase by between 1.5% and 2.5% over and above enrolment growth each year to offset the costs of wage increases and other inflationary pressures.

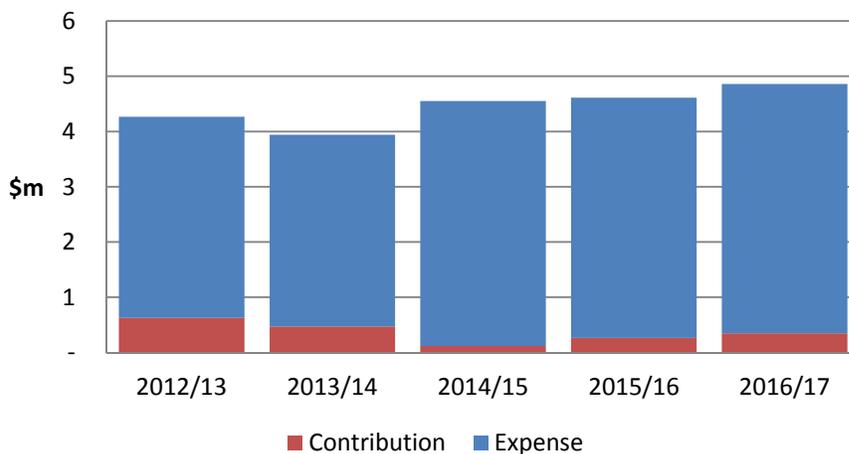
Funding in 2015/16 and 2016/17 increased faster than enrolment and wage growth. This is driven by two factors: a number of additional grants were received in 2016/17, and the number of students identified by the District as being eligible for additional special needs funding increased.

International program

The District hosts an international program. International students live with homestay families in the region and attend District schools. Their families pay a fee to the School District.

The chart below illustrates this fee revenue, broken out between the associated expense and overall contribution to the District’s other activities.

Chart: International fee revenue and expenditure



Fee revenue grew in the 2016/17 school year, driven by an increase in international students in the District. This led to a greater amount of the fee revenue being available for use in other School District activities (indicated by the ‘contribution’ in the chart above). This contribution remains lower than in years prior to 2013/14, as the international program has had to increase teaching resources to remain competitive.

Operating expenditure

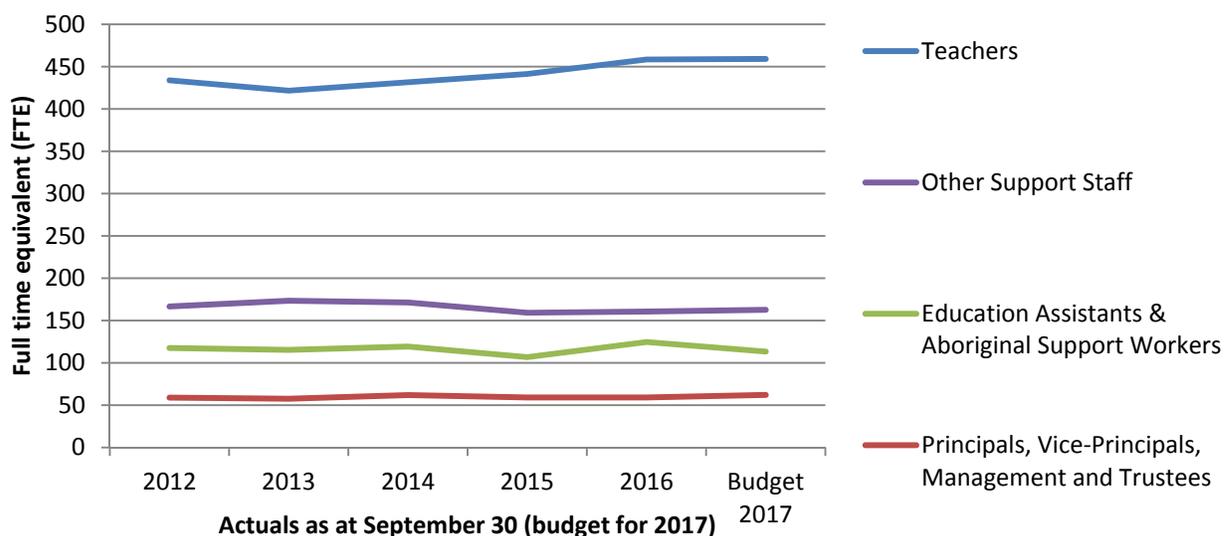
Function	2016/17 \$	2016/17 % of total	Prov. Av. % of total*	Comments
Instruction	68,023,181	83.3%	83.2%	Consistent with the Provincial average.
District Administration	3,105,253	3.8%	3.5%	This is greater than normal due to a fine of \$620,000 received during 2016/17 from Worksafe BC relating to a workplace asbestos exposure which occurred in 2015/16. The District is appealing this fine, and the likely outcome of the appeal is not known.
Operations and Maintenance	8,776,960	10.7%	11.4%	This continues to be significantly lower than the Provincial average.
Transportation	1,802,544	2.2%	1.9%	This expenditure is greater than the Provincial average due to the wider geographic distribution of schools in the District.
Total	81,707,938	100.0%	100.0%	

*2015/16 school year, being the last year for which financial information is currently available

Staff

87% of the District’s operating expenditure is spent on salaries and benefits.

Chart: Staff FTE paid for out of the operating fund



Teacher FTE at September 30 increased at a greater rate than student enrolment in 2016/17, as illustrated in the following table. This was primarily driven by an increase in non-enrolling teachers, including counsellors, school based resource teachers, career program teachers and reading support teachers.

Increase from previous year	2013/14	2014/15	2015/16	2016/17
Teacher FTE (operating fund only)	-2.8%	2.4%	2.2%	3.9%
Student FTE	-2.0%	2.5%	1.8%	1.1%

Some additional teacher positions are funded through special purpose funds described later. These positions are not included in the above totals or the chart. Including these positions leads to an increase of 8.6% in teacher FTE from June 2016 to June 2017, and 3.4% budgeted for 2017/18.

Other support staff comprises bus drivers, maintenance staff, custodians, school secretaries, clerical staff, and noon hour and bus supervisors.

Operating surplus

The operating deficit for the year to June 30, 2017 was \$770,470. This deficit decreased the operating fund balance from \$2,373,697 at the beginning of the year to \$1,602,957 at June 30, 2017.

The cause of this deficit can be derived from the movements in the restricted components of the operating fund surplus, broken out below.

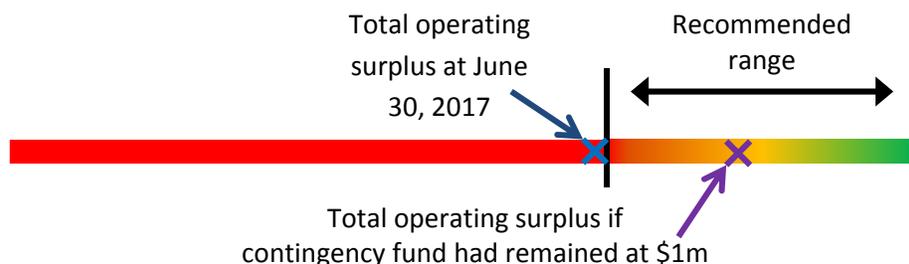
At June 30	2016	2017	Increase / (decrease)	Purpose of restriction
School and department budget balances	247,442	226,953	(20,489)	These funds are internally restricted to fund school-level projects.
Student learning grant commitments	-	293,334	293,334	The School District received targeted Student Learning Grant funding from the Province in the Spring of 2017. The District is committed to spending the balance remaining in line with the terms of the grant.
Appropriated for next year's budget	600,257	-	(600,257)	The 2016/17 budget consumed \$600,257 of surplus from June 30, 2016. The 2017/18 original budget does not anticipate consuming any surplus.
Contingency reserve	1,000,000	595,337	(404,663)	The unexpected Worksafe BC fine of \$620,000 was not budgeted for, and necessitated the use of the contingency reserve.
Union commitments	356,106	447,315	91,209	This balance is restricted to fund contractual obligations in collective agreements with employee unions

At June 30	2016	2017	Increase / (decrease)	Purpose of restriction
				to provide certain future funds for employee professional development and collective agreement administration.
Aboriginal Education commitments	169,892	40,018	(129,874)	The District receives targeted funding from the Province to enhance the education of Aboriginal students. The District is committed to spending the balance remaining in line with the terms of this funding.
Total Operating Fund	2,373,697	1,602,957	(770,740)	

As the table above shows, a portion of the contingency reserve was consumed during the year.

When setting the contingency reserve, a balance is struck between mitigating the risk of unforeseen expenses and releasing funds to maximise the educational opportunities of students.

The MoE’s Special Advisor’s Review of the Vancouver Board of Education (District 39), prepared by Ernst and Young in 2015, identified a range of 2% to 3% of operating expenses as a reasonable amount of total accumulated surplus. The total operating surplus of \$1,602,957 is 1.96% of operating expenses, slightly below this range.



Had the contingency fund not been utilised, and so remained at \$1m, the operating surplus would be comfortably in the mid-point of the recommended range. This suggests that \$1m is a reasonable target for the District’s contingency fund.

The June 30, 2017 contingency reserve of \$595,337 is not sufficient to adequately mitigate the risk of unforeseen circumstances. The original 2017/18 budget anticipates a net surplus of \$nil, so there is no budget to replenish the contingency fund.

The District will consider plans to replenish the contingency fund as part of the amended 2017/18 budget cycle and the 2018/19 budget cycle. Any year-end annual operating surplus at the end of the 2017/18 school year may also be restricted to the contingency fund.

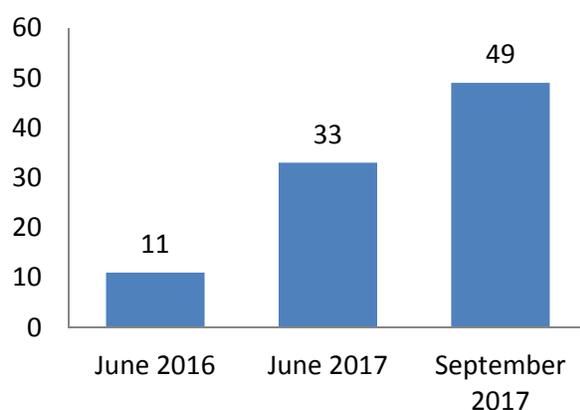
Special Purpose Funds

The District received the following grants in the year to June 30, 2017:

Fund	Surplus from previous year	Grants and revenues received	Expenses	Surplus at end of year
Annual facility grant	98,441	386,857	-485,298	-
Learning Improvement	-	1,530,417	-1,530,417	-
Scholarships and bursaries	357,715	135,544	-149,484	343,775
School generated funds	759,846	2,694,678	-2,708,840	745,684
Strong Start	-	128,982	-128,982	-
Ready, Set, Learn	-	34,300	-34,300	-
OLEP	-	174,736	-174,736	-
Community LINK	13,587	654,309	-667,896	-
Coding and curriculum implementation	-	85,445	-15,036	70,409
Priority Measures	-	768,040	-768,040	-
Other grants	-	56,281	-45,514	10,767
Total	1,229,589	6,649,589	-6,708,543	1,170,635

In addition to the 459 FTE teachers paid for out of the operating fund, the District employs teachers who are funded through the special purpose funds. This FTE has increased significantly since 2016. The increase is primarily driven by special purpose funding targeted to address class composition issues.

Chart: Teacher FTE funded by special purpose funds



The operating results and surplus of 554210 B.C. Ltd, a company controlled by the District, are also reflected as a special purpose fund. The company facilitates the District's delivery of its forestry career education program.

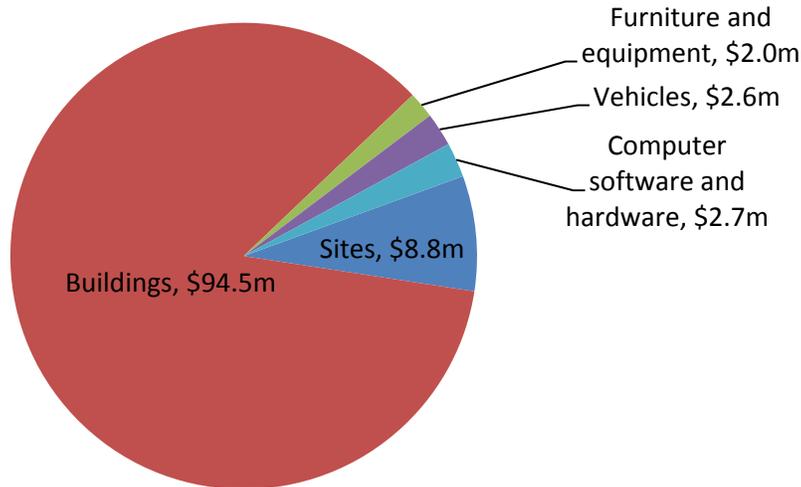
At June 30, 2017, the company had an operating surplus of \$151,461, generated through the sale of timber. This was an unusually high surplus as a large volume of timber was harvested in the year.

Capital Fund

Capital assets

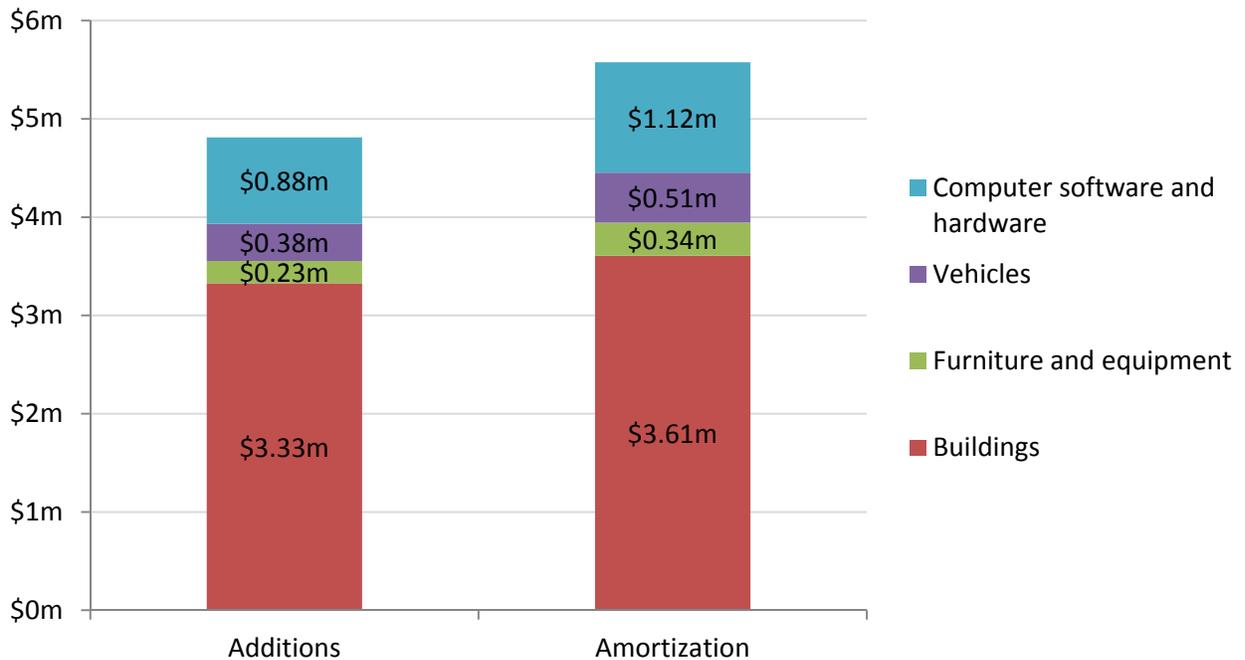
The District has \$110.6 million of funds invested in its capital infrastructure. The chart below shows how this is distributed.

Chart: Net book value (being cost less amortization) of tangible capital assets



The amortization expense recognises the depreciation of an asset over its useful life.

Chart: Asset additions compared to asset amortization



The amortization expense is higher than the additions, particularly for buildings and computers. This suggests that assets are depreciating faster than they are being replaced.

Advances in technology are allowing the District to replace existing computer hardware which has reached the end of its life with lower-cost devices or cloud solutions which are better oriented to the education sector.

The building additions during the year were primarily major renovation projects to existing buildings, including roof replacements and interior renovations. There were no new facilities built or replaced during the year.

Deferred capital revenue

Grant revenue targeted to the purchase of capital assets is recognised over the expected useful life of the asset.

For example, consider a school which costs \$20m, of which \$16m is funded through targeted grants, and has an expected life of 40 years. The school opens at the beginning of year 1.

Year	0	1	2
Amortization expense recognised in year	0	\$ 500,000	\$ 500,000
Tangible capital asset value at end of year	\$20,000,000	\$19,500,000	\$19,000,000
Grant revenue recognised in year ('amortization of deferred capital revenue')	\$ 0	\$ 400,000	\$ 400,000
Deferred capital revenue at end of year	\$16,000,000	\$15,600,000	\$15,200,000
Transfer from operating fund to capital fund to offset grant difference	\$4,000,000*	\$ 0	\$ 0

*this may be an accumulation of transfers made over a number of years in anticipation of the capital acquisition

Historically, the Province has provided targeted funding for major school renovations and replacements and buses. The Province does not typically provide targeted funding for any other capital assets, including the purchase or construction of technology, classroom furniture and equipment, administrative buildings, maintenance equipment.

The spent deferred capital revenue balance at June 30, 2017 is \$91.6m, indicating 83% of the District's assets were purchased with targeted grant funding.

Local capital

The Board approves transfers of funds from the operating fund to the capital fund in anticipation of necessary future capital expenditure which will not be funded by additional targeted grants from the Province. In doing so, a balance must be struck between ensuring the District has the necessary assets to effectively function, and using operational funds to directly provide education for students.

The District has allocated local capital to fund the following projects in future years:

Project	Estimated cost
Board office – renovation	\$ 3,200,000
Board office – replace portables	4,100,000
District software (accounting, HR, payroll, absence management)	400,000
School classroom improvements	3,000,000
Total forecast project costs	\$ 10,700,000

The forecast project costs exceed the local capital balance of \$7.2 million by \$3.5 million. The School District anticipates funding this shortfall through the sale of surplus District properties.

Long Term Facility Plan

The District's Long Term Facility Plan can be found at:

<http://www.sd22.bc.ca/District/FacilityPlan/Pages/default.aspx>

This Long Term Facility Plan identified the Board Office as being in worse condition than any other District building, including schools. It identified the need to renovate the Board Office and replace the portables currently being utilised at the Board Office site. The Province will not provide targeted grants for projects of this nature, so these two projects are addressed through local capital funds.

This Long Term Facility Plan also identified the need to expand and / or replace four schools in the District. These projects are incorporated into the District's capital plan. The combined cost of these projects is approximately \$50 million.

The District does not have the funds to implement these school projects or to contribute towards their implementation. Historically, projects of this nature have been entirely funded through project-specific capital grants provided by the Province. However, the Province has not yet approved funding for any of the school replacement or expansion projects currently in the District's capital plan.

In the Spring of 2017, the Province indicated that it will expect School Districts to contribute a portion of capital project costs. No details as to expected contributions have been provided. Since then, the Provincial Government has changed.

The District does not currently set aside operating funds for the replacement or expansion of schools

Conclusion

Some key points identified in this document are:

The District has increased learning opportunities for its students.

Teacher FTE increased by 8.6% from June 2016 to June 2017, compared with an increase in student enrolment of 1.1%. This has allowed the District to provide more learning opportunities for students, enhancing teacher's ability to achieve the District's mission to inspire and develop lifelong learners who can communicate, think creatively, problem-solve, collaborate, and understand their personal and social responsibilities.

Funds have been set aside for certain capital projects.

The District has local capital funds set aside to fund certain capital projects, including improvements to school classrooms and to the Board Office. The ability to fully fund these projects depends on the sale of surplus District properties. The District does not currently have funding for future major school replacement or expansion.

The accumulated operating surplus is not sufficient to mitigate the risk of unforeseen expenditures.

The District's contingency fund was partly utilised during the year. This has led to the District's accumulated operating surplus being lower than desired. The District will identify ways of replenishing the contingency fund so that the risk of future unforeseen expenditures can be reasonably mitigated.