ATTACHMENTS
CONFIDENTIAL

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 67 OF THE AUDIT COMMITTEE

November 27, 2002

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, November 27, 2002 at 5:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Mr. Robert S. Weiss (In the Chair)
Mr. George E. Myhal (Vice-Chair)
Ms Paulette L. Kennedy
Mr. Paul E. Lindblad
Mr. Gerald A. Lokash
Ms Kim McLean
Mr. Richard Nunn
Mr. Roger P. Parkinson
Professor Gordon Richardson

Mr. Felix Chee, Vice-President, Business Affairs

Ms Sheila Brown, Controller and Director of Financial Services
Mr. Louis R. Charpentier, Secretary of the Governing Council
Mr. Mark L. Britt, Director, Internal Audit Department

Secretariat:

Mr. Neil Dobbs
Mrs. Beverley Stefureak

Regrets:

Mr. Edward Ng

In Attendance:

Dr. George Adams, President, University of Toronto Innovations Foundation*
Mr. Keith B. Bowman, Ernst & Young
Ms Diana Brouwer, Ernst & Young
Mr. Gary Goldberg, Chairman of the Board, University of Toronto Innovations Foundation*
Dr. Peter B. Munsche, Assistant Vice-President, Technology Transfer*
Mr. Pierre Piché, Associate Controller

* In attendance for item 4.

ITEM 4 CONTAINS A RECOMMENDATION TO THE BUSINESS BOARD FOR APPROVAL

1. Report of the Previous Meeting - Report Number 66 - October 30, 2002

Report Number 66 (October 30, 2002) was approved.

2. Business Arising from the Report of the Previous Meeting

The Chair referred members to the list of follow-up items that had been included in the agenda package. A number of the follow-up items related to the risk-assessment profile, which was on the agenda. In addition, the Committee would receive a brief presentation on the external audit plan. Other matters would appear on future agendas.

3. Chair's Remarks

The Chair welcomed two new members to their first meeting of the Audit Committee: Ms Kim McLean and Professor Gordon Richardson.

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2002

The Chair recalled that the Audit Committee's responsibility with respect to the Innovations Foundation was the same as that carried out at the previous meeting vis-à-vis the University of Toronto Press. The Audit Committee was not asked to conduct a detailed review of the financial statements. The Foundation was a separate corporation with its own Board, which was responsible for overseeing its operations and approving its financial statements. Rather, the Committee's task arose from the Business Board's delegation of responsibility to the Committee to carry out the Governing Council's - the controlling corporation's – stewardship duty with respect to the Innovations Foundation. This meeting could be seen as comparable to a considerably abbreviated annual shareholders' meeting for the Foundation. The Foundation's annual report and financial statements would be on the Business Board agenda, but as a "consent" item. Given the Audit Committee's review, there would normally be no presentation of the item at the Business Board, and there would normally be no discussion, unless a member were to give notice of concerns.

Dr. Munsche said that the Office of the Vice-President, Research and International Relations and the Innovations Foundation were pleased to have the opportunity of presenting the Foundation's annual report. Dr. Adams presented that annual report and financial statements (a copy of which is attached hereto as Appendix "A") and distributed a "2002-2003 Mid-Term Update" (a copy of which is attached hereto as Appendix "B"). Dr. Adams described the work of the Innovations Foundation, which was the commercialization office for the University of Toronto, charged with facilitating and encouraging: (a) patent protection for the intellectual property developed at the University and its affiliated institutions, and (b) the commercial development of that intellectual property to the benefit of the University and its researchers. The Foundation assisted researchers in turning their inventions into businesses and finding seed and follow-on funding for those businesses. The University had provided the Foundation with a line of credit to enable it to do its work and to build up a portfolio of businesses, which would in turn provide the Foundation with a stream of future revenue to fund its work. It would usually require between five and seven years to gain both patent protection for an invention and a stream of licensing revenue from the invention or equity from a start-up company.

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2002 (Cont'd)

Dr. Adams said that the annual report covered the Foundation's work for the fiscal year ended April 30, 2002, which was his second full year as President. Among the highlights of his report were the following.

- **The Excelor@tor business incubator** had been established in November, 2001 to provide support to start-up information- and communications-technology companies. The facility, located within the Foundation's offices, provided a location, advice and support for fourteen start-up companies as of April 30. That number had since grown to 25. The establishment of this facility had required the use of $500,000 of the Foundation's line of credit, which had not been provided in its business plan, bringing the financial results for the year $500,000 below target. The management and Board had, however, concluded that moving forward with the Exceler@tor was an essential step to the University's effective participation in the innovation agenda, and the Exceler@tor had proven to be very successful. It not only provided shared services but also assisted in finding financing for these companies as well as serving to mobilize various sources in the community to support their development. In addition, the Foundation was seeking to build a community of companies in the Exceler@tor that would help each other. The facility was now full, with the 25 companies having been selected from 75 screened. The Foundation was looking for opportunities to expand it.

- **Community small-business investment funds**. This program was sponsored by the Government of Ontario. As of April 30, 2002, the University, through the Foundation, had participated in the establishment of four early-stage venture capital funds to support spin-off companies developing intellectual property. Those funds were available to companies begun by University of Toronto inventors (among others), and the Innovations Foundation was represented on the boards of the funds. They were managed by venture capital firms. As of April 30, those funds had made sixteen investments in fourteen companies, ranging between $250,000 and $1-million, totaling $8.5-million. Those investments had generated co-investments from venture capitalists of an equal amount, resulting in investments of $17-million in those fourteen companies. Since that time, two additional funds had been established in the energy and environment sectors in collaboration with Queen's University and the University of Guelph, with a combined value of $7-million. The result was six funds having $30-million invested or available for investment. To date, the six funds had made 24 investments, deploying $11.5-million and attracting $13.5-million of co-investments from venture capital firms. They had an additional $18.5-million for new investments. Dr. Adams noted that fourteen of those investments had been made in companies located in the Exceler@tor.

- **New business plan**. The Foundation's new business plan, covering the period 2002-07, had been reviewed by the Business Board on May 9, 2002, and that Board had approved an increase in the Foundation's line of credit from $2.5-million to $11-million. That increased line of credit would enable the Foundation to deal with the large increase in the

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4. **University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2002** (Cont'd)

flow of opportunities being brought to it. (The annual report now being reviewed by the Audit Committee was for the year ended April 30, 2002, prior to the period covered by the new business plan.)

- **Invention disclosures**. For the quarter ending June 1998, about ten inventions per quarter were being disclosed. By the quarter ending June 2002, that number had grown to well over 40 per quarter. The faculty of the University had a reputation for generating many great ideas; it was the aim of the Foundation to develop a comparable reputation for helping faculty to license those ideas and to develop businesses exploiting them.

- **Co-operative arrangements**. Bringing together the technology-transfer efforts of the universities and hospitals of Ontario would provide highly beneficial economies of scale. Dr. Munsche had therefore initiated outreach efforts some years ago. The Foundation operated the Intellectual Property Management (I.P.M.) Group, which provided services to assist in bringing university-based discoveries to the commercialization stage. This service had been operated in conjunction with Brock, McMaster, Ryerson, Windsor and York universities, and the group had recently been expanded by the participation of Laurentian, Trent and Carleton universities. It was funded by a $1.3-million, three-year grant from the Natural Sciences and Engineering Research Council and the Canadian Institutes of Health Research. The I.P.M. Group had been very successful. The Foundation's expertise in selecting viable projects had resulted in the I.P.M. Group's leveraging its own funding with follow-on funding from traditional financing sources.

  Similarly, co-operation was growing in the commercial development of medical science discoveries. The partners in the Discovery District Community Small-Business Investment Fund were originally the Hospital for Sick Children, Mount Sinai Hospital and the University Health Network. That group had expanded to include the Sunnybrook and Women's College Health Sciences Centre and the Bloorview-MacMillan Centre.

  The expansion of cooperation demonstrated that Ontario universities and hospitals were able to work together in the commercialization of ideas, sharing best practices.

- **Outreach instruments**. The Foundation had initiated a newsletter, *The Better Mousetrap*, which had received a very positive response. It had hosted Canadian and world business incubator conferences, which had proven the source of a highly valuable national and international network for testing ideas.

- **Licensing to Seaphire International**. Professor Eduardo Blumwald of the Department of Botany had isolated a gene that conferred salt tolerance on plants. The discovery was leading to the development of new strains of plants that could be grown successfully in soil that had become salty as a result of irrigation, which soil now formed over 30% of the arable lands globally. The technology to exploit this discovery had been licensed, and

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2002 (Cont'd)

there were high expectations of the benefits the license would bring. The benefits would, however, take time, with three to four years being required to bring a significant quantity of seed to market.

- **Biodiesel**. The Foundation had collaborated with various stakeholders to assist in the establishment of BIOX, a company that was developing a technology to convert waste cooking grease, animal tallows and plentiful plant oils like palm oil into clean-burning biodiesel fuel. The company had obtained $20-million of financing to build a plant in Oakville, and it had won an award as the most innovative agricultural company in Canada. The company had exercised its option to take the assignment of rights to the invention, for which the Foundation had received $2-million. That amount could be used to buy further equity in BIOX, bringing the Foundation's equity in the company from 10% to 15%. The Foundation also had an option to buy a further 5% of the equity in BIOX.

- **Financial results as at September 30, 2002**. Revenues for the first five months of the 2002-03 fiscal year had been just under $3-million, with expenses at $1.6-million. With distributions to the University and to inventors of over $1-million, net profit was $273,000. Retained revenue as at September 30, 2002 was $1.9-million compared to the plan target of $1.6-million at April 30, 2003.

- **Financial results as at fiscal year end, compared to the 1999-2004 plan**. The annual report included a comparison of the fiscal year results to the 1999-2004 business plan for the three years 1999-2000, 2000-01 and 2001-02. The outcome had been consistent with the plan except in 2001-02, when the Foundation had made its $500,000 investment in the Exceler@tor incubator. The Foundation had the opportunity within its line of credit and within its cash flows to undertake this initiative, and it had done so.

Among the matters that arose in discussion were the following.

(a) Foundation's long-term objectives. Two members asked about the Foundation's long-term objectives. One noted that Columbia University's technology-transfer office had annual revenue of U.S. $155-million. Another noted the long-term objective stated in the Foundation's new business plan of "achieving top echelon ranking," for example placing tenth in North America in 2005. Dr. Adams replied that high levels of revenue arose from individual "gushers" - inventions that produced an exceptionally high level of royalty income or capital gains. For example, Columbia University's very high revenues derived from two such inventions - a genetic sequencing technology and a microelectronic standard used in television sets. The next highest levels of revenue amounted to about $30-million to $40-million U.S. dollars per year. The revenue of leading technology-transfer operations had been growing by about 50% over five years. Simply to maintain the University's current ranking, therefore, the Foundation would have to match that growth. (For 2000, the University of Toronto ranked 65th in North America in gross revenue from technology commercialization.) Dr. Adams would like ultimately for the Foundation to have sufficient revenue to enable it to assist with the development of all good

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2002 (Cont'd)

opportunities, to earn a net income while doing so, and to be able to provide a good return to the University while doing so. Dr. Adams said that he hoped that the Foundation would be generating annual revenue of at least $10-million in a period of about seven years. The objective was a realistic one in the light of the opportunities arising from the work of the researchers at the University and its affiliates and in the light of the willingness of the financial community in Toronto to invest in those opportunities.

(b) Intellectual property at the University. A member who also served on the Dean's Advisory Board in the Faculty of Applied Science and Engineering recounted criticisms he had heard concerning the transfer of intellectual property developed at the University. Dr. Munsche, Mr. Goldberg and Dr. Adams replied that inventions policies differed among universities. At the University of Toronto, intellectual property was co-owned by the University and the inventor. The inventor could decide whether to take assignment of the invention and responsibility for its development, in which case the University would receive a one-quarter share in the proceeds. Similarly, the inventor could decide whether or not to submit the invention to the Foundation for its review and (if accepted) its commercialization services. At some other institutions, such as the University of Waterloo, the inventor held full ownership of the invention; no disclosure to the University was required. At other universities, such as the University of British Columbia, the institution had full ownership. With respect to the work of the Foundation itself, no company had left behind an opportunity for reason of difficulty in making arrangements. Some inventors were dissatisfied that the University did not agree to their companies acquiring 100% ownership of the intellectual property. The University resisted such arrangements because of the danger of financial failure on the part of the new company. If a company failed, including a company owned by an inventor, its intellectual property could be purchased from the receiver, and the inventor could be prevented from continuing with her/his research, which could be deemed an infringement on the purchaser's patent. Dr. Munsche noted that many of the concerns on the part of members of the Faculty of Applied Science and Engineering were with University policy rather than with the Foundation. He had met with the Chairs and Directors in that Faculty and hoped that the problems were well on the way to solution.

(c) The Foundation's service to the external community. In response to a question, Dr. Adams said that the Foundation served the external community as well as the University community. It did so by bringing intellectual property and investment opportunities to that community. The Foundation added value by ensuring that the intellectual property brought to market for licensing or spin-off company formation was ready for those steps. The Foundation had won a good reputation in the external community, with investors resting assured that the intellectual property would be worth considering and that there would be no "skeletons in the closet." To perform this function well, the Foundation required more, highly trained staff to examine ideas carefully and to evaluate them well for their suitability for commercialization. The internal community of University researchers benefited from the Foundation's good reputation, through better access to capital to develop and commercialize their inventions.

(d) The Foundation's governance. In response to the Chair's questions, Mr. Goldberg said that the Foundation's Board included fourteen directors, with seven being members of the University

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2002 (Cont'd)

and seven others external to the University. All were appointed by the University. The Board had an Audit Committee including Mr. Chee, Mr. Brendan Cunneen (a Vice-President of the Business Development Bank of Canada) and Mr. David Crane (economics editor of the *Toronto Star*). The Board also had a governance committee. The decision to spend $500,000 over budget to establish the Exceler@tor had been approved by the Executive Committee of the Board; Mr. Chee and Dr. Munsche were both members of that Committee. The Foundation's budget was reviewed by its Executive Committee and approved by the Board. The University had a number of opportunities to comment on the budget prior to its approval. Mr. Bowman confirmed that the decision to develop the Exceler@tor was properly approved. In response to a final question,
Mr. Bowman said that the Foundation had no internal audit function.

(e) Investments by the community small-business investment funds. In response to questions, Dr. Adams said that while the Foundation assisted with the establishment of the funds, each fund was managed by an external venture-capital investment manager, who made decisions concerning investments. After their establishment, the Foundation build up a non-exclusive relationship with the funds, bringing them both investment opportunities and other venture firms as potential co-investors. A condition for Government support of the funds was that they set aside a given amount of money for investment in the intellectual property developed by the relevant community, in these cases the University of Toronto. The funds typically invested in about one in three opportunities presented by the Foundation. If they chose not to invest, the Foundation would look to other investors. If the funds chose to invest in the opportunity, the Foundation would receive a 10% interest in the investment. If the new company developing a University invention required further funding, the management had to raise it. The Foundation could and would help with advice and referrals. Mr. Chee characterized the work of the Foundation as taking the new companies through a "finishing school" so that they would attract investment and so that they could succeed.

On the recommendation of the Acting Vice-President, Research and International Relations,

YOUR COMMITTEE RECOMMENDS

THAT the annual report and audited financial statements of the University of Toronto Innovations Foundation for the year ended April 30, 2002 be accepted.

The Chair, on behalf of the Committee, thanked Mr. Goldberg, Dr. Adams, and Dr. Munsche, and he congratulated them and the staff of the Foundation on its fine results.

5. Internal Audit Department: Semi-Annual Report - Interim Review of Audit Findings

Mr. Britt presented the Internal Audit Department's semi-annual report for the six months ended October 31, 2002, which included a summary of the Department's activities, a summary of its more important findings, and an evaluation of areas of risk relating to systems of internal control and compliance with policies and procedures. The highlights of his report included the following.

- **Productivity Summary**. During the six months ended October 31, 2002, the Department had issued nine Departmental audit reports (eight final and one draft). A further six Departmental Audits were in progress at October 31, 2002. The Department had issued one final quarterly report on its continuous audit process - auditing a sample of selected transactions by all budget units. The Department had issued four reports on special reviews (one final and three draft). One further special review was in progress as at October 31. Only one of the special reviews involved a financial loss, which loss was insignificant. Finally, the Department had completed nine follow-up reviews.

  During the first quarter of the year, most staff time had been used to assist the external auditors with the year-end financial-statement audit. Information systems work had been directed at the continued evaluation of the design and functionality of the new electronic-procurement module of the S.A.P. information system.

- **Staffing**. Health related absences had forced the Department to engage contract auditors. for 670 hours. However, the time required to recruit and train those auditors had impeded the completion of the audit plan. As a result, it was likely that the Department would be unable to complete at least one quarter's continuous audit and two departmental audits that had been included in the 2003 internal audit plan. In response to the Chair's question, Mr. Britt said that the two departmental audits would not be in departments classified as having high risk exposure.

- **Audit findings: Accountability reports**. The percentage of non-completion of the reports was consistent with the previous year. The incidence of non-completion had been discussed with the relevant department head who undertook to obtain the completed reports and to ensure that future reports were completed in a timely manner. The reports not completed by the eight faculty members resulted from retirements (3), research and other absences (3) and failure to follow-up by the department administrator (2). With respect to the three administrative staff reports not completed, there was misunderstanding about what activities comprised financial administration/management.

- **Evaluation of risks relating to internal control systems**. The results of departmental, continuous and special-review audits indicated the existence of some residual risks relating to systems of internal control and compliance with policies and procedures. Those residual risks related to: ineffective cash-handling and reconciliation procedures; lack of segregation of duties; lack of reconciliation of reports produced by the

5. Internal Audit Department: Semi-Annual Report - Interim Review of Audit Findings (Cont'd)

administrative management system; reliance on unreconciled shadow systems and *ad hoc* reports for decision-making; and the existence of apparent employee/employer relationships where payments to individuals had been processed as non-payroll payments.

Mr. Britt concluded that none of the residual risks were considered significant, and they did not require the immediate attention of senior management. The primary need was to improve existing controls and compliance at the divisional level, and management of the audited units had stated their intention to implement the recommendations included in the audit reports.

Mr. Chee concurred fully with Mr. Britt's report. At one level, the items cited in the report – such as cash handling matters and use of shadow systems - were of a routine nature and unlikely to cause a major loss. At another level, they were symptoms of an extremely decentralized system, which required very good management information systems to provide the glue needed for management controls. Management information systems at the University were not yet as strong as they should be. The University had been working to integrate its management information systems. Controls could be applied at three stages: the commitment to a transaction, the requisition of a cheque to pay for the transaction, and the payment itself. Mr. Chee was concerned that there be better controls at the front end of this process. He was also concerned that overall management control be strengthened by the improvement of the management information systems to enable them to provide consistent, timely reports, with data integrity, to high-level management.

Among the items that arose in discussion were the following.

(a) Accountability reports. The Chair noted that the Committee had in previous years received at one of its fall meetings the annual report on the program of accountability reports by faculty and staff with financial responsibilities. Ms Brown replied that she had recently assumed responsibility for the preparation of this report, and she required some further time to consider appropriate procedures. She assured the Committee that the delay in making the report was not a manifestation of problems with respect to the program or the outcome of the reports. The Chair reiterated his hope that the administration's goal would be to ensure a completion rate of 100%, and he urged the administration to continue to make all relevant faculty and staff members aware of the importance of completing the reports.

(b) Resources for the Internal Audit Department. A member recalled that the Chair had written to Mr. Chee to express the Committee's concern that the Internal Audit Department lacked the staff resources necessary to review at least all of the high-risk budget units annually. Mr. Chee replied that the matter would be considered in the budget cycle that was about to begin. The Chair observed that Mr. Chee and the administration in general were well aware of the Committee's concerns. The Chair planned to speak with the Vice-President and Provost, who carried a great deal of responsibility for the operating budget, to reinforce the Committee's view.

5. Internal Audit Department: Semi-Annual Report - Interim Review of Audit Findings (Cont'd)

(c) Assistance to the external audit. Members asked whether, in view of the Department's constrained resources and the importance of its usual reviews, its assistance to the external auditors represented the best use of its time. While the work performed by the Internal Audit Department in assisting with the external audit was no doubt valuable to achieving the Department's goals, it presumably focused more on the reliability of the University's financial reporting than on controls. Could the Department engage part-time contract auditors who were familiar with the University for the year-end auditing? Mr. Britt noted that the commitment to assisting the external auditors had already been reduced from 900 hours to 700 hours. Those hours used could certainly be put to good use for reviews focusing on internal controls, but the assistance to the external auditors did save the University an amount well in excess of $100,000 per year in audit fees. The Internal Audit Department was, moreover, able to make its contributions to the annual financial-statements audit in a particularly efficient and effective way. Its work focused on particular tasks, such as the review of enrolment reporting and capital-project spending, which depended on a good knowledge of the University's operations. Mr. Chee observed that a reduction in the Internal Audit Department's assistance to the external auditors, accompanied by an increase in the external audit fee, would not ultimately benefit the work of the Internal Audit Department because the University would no doubt take the view that the additional external audit costs had to be met by reduced internal audit costs. It would be most desirable to focus attention directly on the need for increased resources for the internal audit function.

(d) Decentralization and controls. Mr. Chee observed that, unlike the private sector model of a company with several divisions, the financial officers in the University's divisions reported solely to the unit heads in their divisions and not the Chief Financial Officer of the University. Mr. Chee noted that, for capital projects, the approval of the Chief Financial Officer was necessary for spending increases greater than 10% of the project cost or $2-million, whichever was less. In the operating budget, divisions could vary spending on an item by 30% or 40% without any review or approval.

(e) Use of students. A member urged Mr. Britt to consider the engagement of accounting students to assist with the work of the Department. This would not only provide assistance to the Department but would also provide both income and experience for the students.

6. Risk Assessment Profile, 2002

The Chair recalled that its new terms of reference called upon the Committee to review "an annual management report on significant business, financial and regulatory risks and [to] monitor the University's processes for identifying and controlling those risks. In carrying out this responsibility, the Committee focuses primarily on the adequacy of key controls over those vital risks considered to be, currently or in the future, more significant and likely to occur, meets with management and the internal or external auditors to come to a fuller understanding and better assessment of management's response to controlling important risk situations, and reports any concerns to the University's senior officer reporting to the Vice-President responsible for financial matters [i.e. to Mr. Chee], to the President, or to the Business Board, as appropriate."

6. Risk Assessment Profile, 2002 (Cont'd)

The Chair stressed that the Committee's responsibility was not to deal with the risks but rather to monitor the University's processes for identifying and controlling those risks and be assured that these were appropriate. He commended Mr. Chee and Ms Brown for the quality of this important report and for the improvements included in the current year's report.

The Chair invited Mr. Chee to introduce this item. Mr. Chee noted that a report on risk assessment had come to the Committee for the first time last year. The report this year was improved. It described the perceived risks, how those risks were being mitigated and who had responsibility in each case. The Risk Assessment Report was the collaborative outcome of input from multiple sources and participation by many individuals. The next step would be to inform the Audit Committee of an action plan related to the six areas of risk where there was not yet satisfaction that risk had been mitigated to appropriate levels and to the extent possible. He would speak to these later in the meeting.

Ms Brown was invited to review the Risk Assessment Profile. She began by saying that the Profile was similar to last year's, but with the addition of some elements of methodology developed and implemented by the University of Texas. In particular, this year's profile had added the measures related to potential impact and probability of occurrence; those additional measures, when combined, had yielded a matrix of nine risk categories from High Probability of Occurrence/High Potential Impact (HH) to Low Probability/Low Impact (LL), which provided a better categorization of risks. It also provided a better sense of where mitigation efforts needed to be directed. Ms Brown said that, rather than review the entire Profile, she would highlight those risks which had been newly identified or separated out.

The Committee received Ms Brown's report. It reviewed elements of the risk-assessment profile in detail, and it heard Mr. Chee's report on actions planned with respect to those six areas of risk where there was not yet satisfaction that risk had been mitigated to appropriate levels and to the extent possible.

7. External Auditors' Management Letter to the Administration and the Administrative Response

The Chair noted that the external auditors had advised that "there were no significant weaknesses discovered as a result of our audit program for fiscal 2002." Since, this was straightforward, the management letter had been proposed as a consent item. No questions had been posed by members and there were none at the meeting. The management letter was received for information.

The Chair noted that the auditors had also provided detailed advice to management concerning security of the management information systems and concerning computer disaster recovery, both of which subjects had been included in the risk-assessment profile. The auditors' letter to management had also been distributed to members of the Audit Committee for information.

8. External Audit Plan and Engagement Letter, 2002-03

The Chair invited Mr. Bowman to speak. Mr. Bowman indicated Ernst & Young's pleasure at again being engaged as the University's auditors and noted that members had requested a review of the audit plan at this meeting. He deferred to Ms Brouwer, who was assigned to oversee the audit, to review the plan.

Ms Brouwer said there would be no change from last year in the way the audit would proceed. She appreciated the efforts of management to identify and categorize risk since the audit was conducted primarily with a risk-based approach. The auditors began by holding discussions with management and attending meetings of the Audit Committee to understand the University environment. They considered the risk-assessment profile and reviewed the work done by the Internal Audit Department to understand how the various risk factors related to the financial statements. More time would be spent where risk was high; less time where risk was low. In the University of Toronto audit, the external auditors were able to find comfort in a high degree of third party confirmation of data. For example, a substantial part of the University's revenue streams could be confirmed by the enrolment audit. The auditors would review controls and determine how they could be relied upon. They would review the work done by Internal Audit and they would rely on staff in that department for aspects of the audit. The internal auditors' understanding of the University would enable them to carry out parts of the audit very efficiently. She stressed that ongoing discussions with management and the high degree of disclosure they provided usually ensured that there would be no surprises during the audit. Discussions with management included expectations and deliverables from the audit.

In response to a member's question, Ms Brouwer said that two new auditing standards had been established for this year. One was for increased discussion concerning fraud and error; the other was for increased communication with the audit committees. The external auditors viewed the latter as already met by the discussions at regularly scheduled Audit Committee meetings throughout the year. The Chair asked that the external auditors report to the Committee all changes of auditing standards or substantial changes to auditing procedures as they took place.

A member indicated an interest in seeing a more detailed audit plan. One particular interest was how the auditors would consider the risks with respect to the valuation of investments on the balance sheet. The Chair responded that a detailed presentation of the audit plan had been eliminated some years ago as a means of cost savings. Invited to comment, Mr. Bowman confirmed that Ernst & Young had in 1996-97 agreed to reduce the scope of its presentation of its audit plan as a means of reducing its audit fee. The University of Toronto Audit Committee reviewed the external audit plan in less detail than average, although many other audit committees reviewed external audit plans in less detail still. At the University of Toronto, however, there was a high level of on-going dialogue between the Audit Committee and the external auditors, making a detailed review of the external audit plan less important. The Chair asked if the external auditors thought there was anything they should be doing and couldn't do because of fee constraints. Mr. Bowman responded in the negative. He and Ms Brouwer further confirmed that a review of donations took place, which included testing for the completeness of the accounting for all donations, the issuance of receipts, and the use of donations pursuant to donor instructions, and that the auditors were satisfied with the controls in place. The very good control system had enabled the auditors to avoid a qualification of their audit opinion with respect

8. External Audit Plan and Engagement Letter, 2002-03 (Cont'd)

to the completeness of accounting for donations, which was often required for charitable organizations. Accounting for investments was examined, including the reasonability of their valuation. With respect to research funds, the auditors reviewed the total amount reported on the income statement and reviewed the use of grants pursuant to the grantors' conditions.

Mr. Bowman noted that the engagement letter was largely the same as last year with the addition of two clauses: one prohibiting the University's soliciting Ernst & Young staff for employment for a period of at least one year after the completion of the audit engagement, and a second stating auditors' newly legislated duty to report to the relevant authorities any suspicious transactions that might relate to the laundering of the proceeds of crime.

Responding to a question, Ms Brouwer confirmed that all University of Toronto related audits leading to reports issued under the name of Ernst & Young had been disclosed in the attachment to the engagement letter. All were conducted by the external auditors' staff except for four - the enrolment, capital spending, OSAP and UTAM audits - in which Internal Audit staff assisted, working under the direction of Ernst & Young staff.

There was brief discussion about signature of the engagement letter, accepting it on behalf of the University. Mr. Charpentier indicated that the Senior Assessor was the appropriate individual, as an authorized signing officer of the University.

On motion duly made and seconded it was RESOLVED

> THAT the Audit Committee accept the external auditor's engagement letter for 2002-03, dated November 4, 2002.

9. Report of the Administration

Mr. Chee reported, as an example of risk-control, on steps being taken by the administration to ensure safety and security during demonstrations on campus. Mr. Charpentier, and Mr. Britt stated that they had no items to report.

10. Dates of Next Meetings

The Chair reminded members that the next regularly scheduled meeting of the Committee would be on Wednesday, May 21, 2003. Currently there appeared to be no need for a meeting before then, but Wednesday, March 5, 2003 was to be held as a reserve date if required.

The meeting adjourned at 7:40 p.m.

REPORT NUMBER 67 OF THE AUDIT COMMITTEE - November 27, 2002

Secretary	Chair

December 19, 2002