Business Board
Item 8

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 100 OF THE AUDIT COMMITTEE

December 7, 2011

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, December 7, 2011 at 5:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Ms Paulette L. Kennedy (In the Chair)
Ms Penny Somerville
Mr. W. John Switzer

Ms Catherine J. Riggall,
Vice-President, Business Affairs

Mr. Mark Britt, Director, Internal Audit
Ms Sheila Brown, Chief Financial Officer
Mr. Louis R. Charpentier, Secretary of the Governing Council

Mr. Neil Dobbs, Secretary

Regrets:

Mr. J. Mark Gardhouse
Mr. Steve (Suresh) K. Gupta
Mr. Chris Thatcher

In Attendance:

Ms Stephanie Chung, Ernst & Young
Mr. Robert Cook, Chief Information Officer
Mr. Patrick Hopewell, Director, Enterprise Infrastructure Solutions, Information + Technology Services
Mr. Francis Low, Ernst & Young
Mr. Martin Loeffler, Director, Information Security, Information + Technology Services
Mr. Daniel Ottini, Internal Audit Department
Mr. Pierre Piché, Controller and Director of Financial Services
Mr. Allan Shapira, AON Hewitt
Ms Martha Tory, Ernst & Young

ITEM 2 CONTAINS A RECOMMENDATION TO THE PENSION COMMITTEE FOR APPROVAL. ALL OTHER ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR INFORMATION.

1. Reports of the Previous Meeting

Report Number 99 (June 15, 2011) was approved.

2. Pension Plans: Audited Financial Statements Report for the Year ended June 30, 2011

Ms Brown recalled that in previous years, the administration had at this meeting presented to the Committee a full annual financial report on the pension plans, including the audited financial statements and a summary of the actuarial report. The Committee had been asked to review the full report and to recommend to the Business Board the approval of the audited financial statements for the two registered plans: the main University plan and the plan for employees of the Ontario Institute for Studies in Education at the time of its merger with the University of Toronto. For the current year, the Committee was again being asked to review the audited financial statements and to recommend their approval – now to the new Pension Committee. There was, however, no full annual financial report. Rather, the Committee had been provided with a summary of the results of the actuarial valuation as at July 1, 2011. The preparation of the full financial report would have to await the response of the Ontario Ministry of Finance to the University's application for Stage 1 of the temporary solvency funding relief program. That application would be submitted by the end of the calendar year, and the Ministry had undertaken to respond to applications by mid-February. If acceptance to Stage 1 were not to be granted, the University would have to make payments to amortize the solvency deficit over five years, and the actuarial valuation would have to be revised to reflect that requirement. If acceptance to Stage 1 was to be granted, the time period for amortization of the solvency deficit would be longer than the five years normally required. Assuming receipt of a favourable Government response, the full financial report would be prepared and submitted to the Pension Committee at its March meeting. It would subsequently be provided to the Audit Committee, likely at its May meeting. It would also be provided to the Business Board, which would be asked to approve a new pension-plan funding strategy. The strategy currently in effect had been approved in 2004, although the Business Board had approved certain individual funding provisions more recently, and the Board had been presented with a preliminary funding and financing strategy at its meeting of January 31, 2011.

Ms Brown outlined the highlights of the audited financial statements, which provided for each of the registered plans the fair value of the assets available to pay pension benefits. For the main University plan, those assets had a value of just under $2.5-billion, as at June 30, 2011. For the OISE plan, the assets had a value of $76-million. Looking at the actuarial valuations, the two registered plans had a going-concern deficit of just under $1-billion and a solvency deficit somewhat over $1-billion. The actuarial valuation reflected a number of changes that had taken place since the previous year. The University had made a special lump-sum contribution to the pension plan of $150-million, in addition to its usual current-service contribution. The assets in the plan had earned an investment return of 12.7% for the year. Those changes had resulted in a reduction of the plan deficits, but that reduction was less than might have been the case because the actuarial assumptions had also been changed. The valuation had adopted a new mortality table, reflecting the increasingly longer lives of plan members. In addition, the discount rate (interest-rate assumption) used to calculate the present value of the plans' liabilities had been reduced from 4% real (after inflation) per annum to 3.75% real. The averaging method used to value the assets was also changed.

2. Pension Plans: Audited Financial Statements Report for the Year ended June 30, 2011 (Cont'd)

Ms Tory commented on the external auditors' letter concerning the audited financial statements. That letter provided an overview of the audit of the assets and provided certain required information about the audit. She stated that no significant issues had emerged from the audit that should be reported to the Audit Committee.

Mr. Low reported that this year's statements were the final ones that would be prepared under the current accounting principles. New accounting standards would become effective for the 2012 statements, and the auditors had begun discussions with management about the impact of the new standards. Mr. Low anticipated that there would be no impact on the numbers reported in the statements. The new principles would, however, require additional disclosures. The Chair commented that the Committee would later in the year consider the general matter of the application and impact of the new accounting standards on the University's financial statements as well as the pension-plan statements.

A substantial discussion of the financial statements took place. Among the matters that arose were the following.

- **OISE Plan statements**. A member observed that in the OISE statements, the total values shown for the individual categories of investments were the values of those categories for the entire Pension Fund Master Trust. That might cause confusion to the casual reader, who might ascribe the values only to the OISE plan. In response, it was noted that this presentation was consistent with that of previous years.*

- **Pension Fund Master Trust: Need for a Subsequent-Events Note**. A member observed that recent events might have increased the credit risk of the government-issued debt instruments held by the Master Trust. Was there need for a "subsequent events" note? Ms Brown replied that the market value of all investments had declined by only 1.5% from the July 1 date of the statements to October 31. Mr. Low added that the pension-fund investments did not include European-issued debt instruments, which were the subject of the current concern. It would, however, be worthwhile to consider some modification of the wording of the note on investment credit risk for the 2012 financial statements.

Mr. Shapira commented on the summary of the actuarial valuation. The valuation amounts were close to those used in the preliminary pension-plan funding and financing strategy presented to the Business Board in January 2011, and the amounts used in that strategy had also been used in the University's long-range budget plan. While the pension fund had earned an investment

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* The member also noted a numerical error in note 3(a) to the statements for the OISE plan, which was subsequently corrected.

2. Pension Plans: Audited Financial Statements Report for the Year ended June 30, 2011 (Cont'd)

return of 12.7% for 2010-11, interest rates had at the same time declined, leading to the reduction in the discount rate, which would require increased pension-plan contributions – both current-service and special payments. The University had developed a comprehensive plan to deal with that need. The University hoped for government approval of its application for Stage 1 of the temporary solvency-funding relief program, and it had taken a number of steps that would support a favourable outcome. Certain employee groups had agreed to increases in contributions by active members of the plans, and the University was in dialogue with the other groups in an effort to secure similar agreements. If it was granted acceptance to Stage 1 of the temporary solvency-funding relief program, the University would have a three-year period before it was required to submit another actuarial valuation and before net solvency payments (the amount required in addition to going-concern special payments) would be required.

On the recommendation of the Vice-President, Business Affairs,

YOUR COMMITTEE RECOMMENDS TO THE PENSION COMMITTEE

(a) THAT the audited financial statements for the University of Toronto Pension Plan, June 30, 2011, be approved, and

(b) THAT the audited financial statements for the University of Toronto (OISE) Pension Plan, June 30, 2011, be approved.

3. Risk Assessment: Information Technology

Messrs Cook, Hopewell and Loeffler presented the report on information technology risk and risk management. Mr. Cook said that the Information + Technology Services group provided the University-wide information-technology systems and services. Its objective was to secure the greatest possible value from the University's investment in information technology. The group established standards and consolidated services, working in collaboration with the divisions and departments where fully two thirds of information-technology spending took place. In 2009, shortly after his appointment, Mr. Cook had established the Information Security Department – a group of six staff members consolidated from across the University – to deal with a matter that required increased focus and consideration. The highlights of the report included the following.

- **Information Security Guidelines** had been developed in collaboration with the divisions and departments and with the University Archivist, the Freedom of Information / Protection of Privacy Office and the Internal Audit Department. The Guidelines set standards for information handling, classification and security, including the definition of information as

3. Risk Assessment: Information Technology (Cont'd)

confidential or not, the handling of confidential information, retention or disposal of information, and baseline information-security practices.

- **New information-security services.** In addition to supporting such on-going security processes as anti-virus systems, the Information Technology Services Group had developed three systems for full-disk encryption of data on various portable devices.

- **Information security in system architecture**. This work identified and dealt with risks in the establishment of new systems, including the reuse of appropriate security features from existing systems.

- **Security in information-technology operations – infrastructure to deal with day-to-day risks.** Infrastructure included firewalls, an anti-virus server and a checking system for spam e-mails.

- **Assessment / response** services assisted those responsible for disciplinary processes and campus police with the information-technology component of their investigations.

- **Risk assessment**. Assessments dealt with the impact of the loss of service by the University's various systems and the impact of the loss or inadvertent divulging of personally identifiable information. They dealt with the degree of risk involved, the steps that could be taken to mitigate the risks, and their cost. Recent assessments included those associated with the University's Data Centre, the plans for the Next Generation Student Information System, the student e-mail system, and the Division of University Advancement systems.

- **Data Centre Renovation**. The move into the University's renovated data centre sought to mitigate risks, to ensure a high level of availability, to achieve efficiencies in the use of energy and space, and to provide for scalability, i.e. the opportunity to grow. The renovation had been undertaken following a business impact analysis concerning harm to the University as the result of unanticipated failures of systems. The analysis had been aided by an external audit. Steps taken included: the development of a strong physical access-control system requiring the use of both a key fob and a personalized entry number and the use of surveillance cameras; the development of an uninterruptible power supply involving redundant batteries and power modules, a dedicated transformer, and a back-up generator; environmental improvements including improved and energy efficient cooling, highly sensitive smoke detectors, a gaseous fire suppression system, flood and leakage detectors (a cause of concern because of chillers on the roof the building) all with monitored alarms; server virtualization for certain systems, for example student e-mail, enabling a massive consolidation of Data Centre equipment; and improved cabling, reducing the risk of system interruption in the event of the need to disconnect certain cables.

3. Risk Assessment: Information Technology (Cont'd)

Mr. Cook said that the Information + Technology Services group would spend the next three to four months migrating into its new environment. Risk mitigation was permeating all of the work involved.

Among the information that emerged from responses to questions was the following.

- **Security of information in divisional systems**. Mr. Cook said that he had a high degree of confidence about the security of administrative and other data in the centrally managed systems. While the University was in a better position than it had been only a few years ago with respect to research and other data in the divisions and departments, there was more progress to be made. It was encouraging that as the Data Centre upgrade was completed, the Information Technology Services group was able to offer divisions and departments alternatives that provided high standards of security and reliability at an attractive price. As a result, more academic units were coming forward to make use of the server virtualization and data-backup services available. As this process proceeded, and as more and more divisions and departments used secure central services, it would be possible to look into the acceptability of mandating that all units do so.

- **Role of Internal Audit concerning information-technology risk**. Mr. Britt and Mr. Ottini said that internal auditors did review departmental information-technology systems as part of their department reviews, commensurate with the level of the risk exposure of each. Among the factors reviewed were information security, in particular appropriate protection of privacy of information, and back-up of information. Mr. Ottini agreed that the best way to reduce risk was to offer departments the use of strong central systems. While it might well be inappropriate to mandate the use of such systems, given the culture of academic freedom, the availability of good central back-up services and systems could well lead to word-of-mouth support for their adoption.

- **Business continuity planning**. In response to a member's questions about disaster recovery and business-continuity planning, especially for mission-critical systems, Mr. Cook and his colleagues said that business continuity was a very important factor in the development of central systems. The Information Technology Services group developed cost/benefit analyses of various options to ensure business continuity and to achieve recovery in the event of disaster, with the University's management responsible for selection of options and their associated costs, which were usually greater for those solutions with least risk and fastest recovery. It would indeed be very useful to know more precisely the University's expectations with respect to recovery time for various systems. With respect to local systems in individual departments and divisions, there was an expectation that the units would address the matter of information-technology continuity. However, the central Information + Technology Services group had been concentrating its efforts with respect to decentralized services on the protection of information against loss or inadvertent disclosure, and it had not yet developed standards for local information-technology continuity plans.

3. Risk Assessment: Information Technology (Cont'd)

- **Budget issues and the encouragement of use of central systems**. A member observed that the use of local information-technology systems was frequent in large organizations, especially in the early years of the use of such technologies. It had, however, frequently proven to be the case that the combination of individual systems was far more expensive than the use of central systems. Two members suggested that the matter of costs and budget be used to support efforts to encourage divisions and departments to shift to use of central systems. Their doing so would in all probability both save money and reduce the risks inherent in decentralized systems.

The Chair commented that the Audit Committee, given its responsibility for understanding the control environment, would benefit from a further presentation from the Chief Information Officer and his colleagues that would provide the Committee with a framework for understanding the overall risks in the information-technology environment. What did the Information-Technology Services group see as the priorities the University should adopt for dealing with risk? What were the major needs and opportunities? The Chair thanked Mr. Cook and his colleagues for their presentation and their responses to questions.

4. Audit Committee Terms of Reference: Annual Review

The Chair noted that the Committee completed an annual review of its terms of reference. The review was of particular interest in the current year given the significant changes that had been made to the terms of reference of various Boards and Committees and given the discussions that had taken place in the Business Board on the topic of risk assessment.

Mr. Charpentier reported that the approval of the recommendations of the Task Force on Governance had resulted in changes in the terms of reference of several Boards and Committees but not to those of the Audit Committee. However, the terms of reference of the Executive Committee had been changed to include in its mandate a review of a comprehensive annual report on enterprise risk management, following the review of that report by the Audit Committee. The Executive Committee, rather than the Business Board, had been assigned that task for a number of reasons. It frequently met *in camera* and held confidential discussions on a variety of matters. The President was a member of the Committee, and both the Vice-President and Provost and the Vice-President, Business Affairs regularly attended its meetings. The Executive Committee was representative of the membership of the Governing Council and could make decisions on its behalf. The Chair observed that the purpose of the change was to escalate responsibility for risk management to a very high level of the University's governance.

Among the matters that arose in discussion were the following.

(a) Review of specific areas of risk. A member urged that the Committee continue to identify areas of risk for closer study, similar to the study at the current meeting of information-technology risk. That would provide context for the annual risk review and would help the

4. Audit Committee Terms of Reference: Annual Review (Cont'd)

Committee to complete its due diligence in the area. The Chair agreed, and she recalled the suggestion that had been made to invite any members of the Audit Committee who were not also members of the Business Board to attend meetings of the Board at which there would be discussion of areas of interest in terms of risk control.*

(b) Responsibility with respect to the pension plan. A member observed that the Audit Committee's terms of reference stated that the Committee was responsible for review of "an annual financial report on the pension plans" and of "management's assessment of the financial soundness of the pension plans." Was it intended that the Committee retain that responsibility following the establishment of the Pension Committee? Ms Brown replied that it was her understanding that the Pension Committee was responsible for administrative matters concerning the pension plan, and that the Business Board, acting for the Governing Council as plan sponsor, was responsible in the area of plan funding. The Audit Committee was responsible for reviewing the audited financial statements, as it did with other University financial statements, and (if satisfied) recommending them to the Pension Committee for approval. When the full annual financial report was available, it would be presented to the Pension Committee for approval. It would then be presented to the Business Board and the Audit Committee for their information. She was uncertain whether it would be deemed appropriate for those bodies to undertake an assessment of the financial soundness of the plans, as they had in the past. It was suggested by two members that the Audit Committee continue to receive the annual report because it functioned best when in receipt of the full context for the financial statements. However, the terms of reference should be revised, perhaps to state that the Audit Committee reviewed the audited financial statements and recommended them for approval to the Pension Committee but that it only "received" the annual financial report. It was suggested by Mr. Charpentier and agreed that it would be appropriate to spend more time considering the matter, perhaps on the basis of the experience of a year or more of operation of the new governance environment including the new Pension Committee, and that any proposal to amend the Audit Committee terms of reference come forward at a later date.

In the course of discussion, Ms Brown noted that it might not be possible in future years to prepare and present the full annual financial report in the fall at the same time as the audited financial statements, which required approval before the end of the calendar year.

The Chair stated that, apart from the further consideration of the Committee's responsibility with respect to the pension plan, there were no proposals to amend the Committee's terms of reference.

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* For the 2011-12 year, all members of the Audit Committee are also members of the Business Board.

5. Audit Committee Calendar of Business, 2011-12

The Committee received for information the planned calendar of business for 2011-12. She noted that it included for each meeting (except the June meeting) a session on risk management in an individual area. She would welcome suggestions from members, at the present time or going forward, on items that could be added to the calendar of business.

6. External Auditors: Engagement Letter, Audit Plans, Report on Accounting Developments and Audit Fees

Ms Tory said that there had been no significant changes to the audit approach from the previous year. The written report provided information on the items of audit significance discussed with management. The external auditors were in the process of working with management to achieve agreement on the items noted in the report. The most significant item arose from the change made by the University of Toronto Asset Management Corporation (UTAM) to establish pooled funds for investments in the major public-market asset categories for both University funds and the pension funds. To avoid duplication of effort, the same audit team that would audit the pooled funds as at UTAM's December 31 year end would also complete the audit of the University's investments in those funds as at its April 30 year end.

Ms Tory recalled that new accounting standards would come into effect for the financial statements for the year ending April 30, 2013. The University would have to make a number of choices on its application of those standards. Mr. Piché and his colleagues were completing analyses to inform those choices, which might well provide leadership for other Ontario universities. The Ontario universities would, under the new rules, adopt accounting standards very similar to those for private companies. Those standards would require relatively few changes in the University's accounting. Universities in several other provinces would, however, be considered to be parts of government systems and would be required to use public-sector accounting rules, which would differ substantially from those used by the Ontario universities.

Ms Tory said that the fees proposed for the main University audits were somewhat less than those of the previous year. Because of the additional audit work in connection with the establishment of the UTAM pooled funds, however, the total fee for University and University-related audits would increase.

Ms Tory asked whether the Committee was aware of any matters not reflected in the report before it, including illegal acts or acts of fraud, that the auditors should be aware of. Members replied that they were aware of no such matters.

Ms Brown directed members' attention (a) to Appendix "C" to the external auditors' report, listing their fees for supplementary work, primarily work in connection with tax matters, and (b) to the annual report from the Council of Ontario Universities on audit fees charged to Ontario universities from 2007-08 to 2009-10.

6. External Auditors: Engagement Letter, Audit Plans, Report on Accounting Developments and Audit Fees (Cont'd)

On motion duly made and seconded and carried

YOUR COMMITTEE RESOLVED

THAT the Audit Committee accept the external auditors' audit plan and engagement letter for the year ended April 30, 2012, as contained in the report from Ernst & Young dated December 1, 2011.

7. Administrative Accountability Reports: Annual Report on the Program, 2010-11

The Committee received for information the annual report on the program of administrative accountability reports. Mr. Piché reported that he had reviewed the reports of all members of the University's executive group and had observed that there had been no negative responses. He had included in the Committee's agenda package the report completed by the President. He had also reviewed the reports completed by those officers reporting directly to the Vice-President and Provost, which included the Principals and Deans, and he had observed only two negative responses. In answer to a member's question, Mr. Britt said that in departmental audits, the internal auditors checked on the completion of the accountability reports. While it was difficult to make judgements about the veracity of responses, the responses were viewed in the light of other audit findings.

8. Enrolment Report to the Ministry of Training, Colleges and Universities: Audit, 2010-11

The Committee received for information the external auditors' report on the enrolment data submitted by the University to the Ministry of Training, Colleges and Universities for the 2010-11 academic year.

9. Internal Audit Department: Semi-Annual Activity Report for the Six Months Ended October 31, 2011

Mr. Britt presented the Internal Audit Department activity report for the first six months of the 2011-12 fiscal year. He commented on: the Department's staffing for the period; the distribution of audit work (which had been consistent with the audit plan); the work to assist the external auditors with their annual audit of the University's financial statements; the absence of requests during the period to initiate new special audits; the progress made on departmental audits; the continuous audit of a sample of financial transactions; and work with the Information + Technology Services group on systems and information security. In the course of his report, Mr. Britt reminded members that no formal general conclusions were communicated to the

9. Internal Audit Department: Semi-Annual Activity Report for the Six Months Ended October 31, 2011 (Cont'd)

Committee at this stage; they came forward in the annual report made in May or June. No major issues that merited report to the Committee had arisen in the departmental audits completed over the period. The continuous auditing process had revealed, consistent with previous experience, a high incidence of missing documentation to support expense claims. However, the missing documentation was often relatively minor, for example boarding passes in connection with claims for reimbursement of claims for travel expenses. That documentation was not seen by the University as of central importance. It was, however, required by the granting agencies. A review of a sample of executive expense claims had raised no concerns. Mr. Ottini reported that he continued to work actively with the staff of the Chief Information Officer, and in particular with Mr. Loeffler, the Director of Information Security. Mr. Ottini served on the Information + Technology Services Process and Technical Committee, which reviewed proposed and on-going processes to offer advice on controls and risk. He worked with Mr. Loeffler to encourage the adoption throughout the University of the payment-card industry's data-security practices. He worked to encourage the adoption of the Control Objectives in Information Technology (COBIT) – a well known governance and control standard. He responded to a substantial number of *ad hoc* enquiries from the divisions and departments about information-security matters, often arranging introductions to the appropriate staff in the Information + Technology Services group who could deal with the particular enquiries.

Mr. Ottini referred to the stress in the private sector and more recently in the University on virtualization of servers and on storage of programs and data in remote computer servers in "the cloud." He stressed that while such arrangements did not present greater risks than the use of on-site servers, they did nonetheless present different risks. It was very important to mitigate those risks in the contracts for the services used, which would make clear the ownership and control of the data and its security particularly if and when the University might choose to end the contractual relationship. Mr. Britt stressed the value to the Internal Audit Department of Mr. Ottini's participation as a resource-person in the work of the Information + Technology Services group. It was very advantageous to be able to provide advice on information-security before decisions were made and before money was committed in contrast to seeking to remedy problems after the fact. He observed that the Department's participation in the implementation of one new system – the Next Generation Student Information System – could prove to be very time consuming and might require that additional resources be made available to the Internal Audit Department.

In the course of discussion, a member referred to the stress placed by Mr. Cook, in his report to the Committee, on efforts to achieve the greatest possible value from the University's investment in information technology. While that stress was admirable, he was concerned that the value focus not inadvertently cause the devotion of inadequate resources to controlling risks with respect to information security and controls. Adequate funding to ensure risk control in the area should be regarded as a high priority. The Chair commented that the question should be

9. Internal Audit Department: Semi-Annual Activity Report for the Six Months Ended October 31, 2011 (Cont'd)

referred to the Vice-Provost, Academic Operations, who was responsible for both information technology and budget. The matter of information-technology risk would no doubt continue to be a matter for the Committee's attention.

10. Report of the Administration

Ms Riggall, Ms Brown, Mr. Britt and Mr. Piché said that they knew of no other matters that should be drawn to the attention of the Audit Committee.

11. Date of Next Meeting

The Chair reminded members that the remaining regular meetings of the Audit Committee for the 2011-12 year were scheduled for Wednesday, March 21, 2012, Wednesday, May 9, 2012, and Wednesday, June 13, 2012. The March meeting would consider the annual risk-assessment report as well as a special risk-assessment report on student-crisis management.

12. Catherine J. Riggall

Speaking on behalf of the Audit Committee, the Chair thanked Ms Riggall for her years of service to the Committee and to the University. The Chair would miss her practical, informed and succinct answers to questions. She offered Ms Riggall the Committee's best wishes for her retirement.

Ms Riggall thanked all members, who had devoted a great deal of time and effort to the work of the Audit Committee. She noted that her experience on the University's Audit Committee would serve her well as she would continue to Chair the Audit Committee of the Y.W. C.A. and she had been asked to serve on the Finance and Audit Committee of the Stratford Shakespeare Festival.

THE COMMITTEE MOVED *IN CAMERA.*

13. *In Camera* Meeting with the Internal Auditor

The administrative assessors other than Mr. Britt and Mr. Ottini absented themselves, and the Chair invited Mr. Britt to comment on any matters that should be drawn to the Committee's attention and to respond to any questions.

13. *In Camera* Meeting with the Internal Auditor (Cont'd)

Mr. Britt and Mr. Ottini subsequently absented themselves and the Committee members continued their *in camera* meeting.

THE COMMITTEE COMPLETED *ITS IN CAMERA* SESSION.

The meeting adjourned at 7:25 p.m.

Secretary	Chair

January 20, 2012