CORRECTED

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 59 OF THE AUDIT COMMITTEE

November 15, 2000

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, November 15, 2000 at 5:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Mr. Robert S. Weiss (In the Chair)
Mr. Donald A. Burwash
Ms Christine A. Capewell
Ms Paulette L. Kennedy
Mr. Paul E. Lindblad
Mr. Richard Nunn
Mr. Roger P. Parkinson
Professor Wally Smieliauskas

Mr. Robert G. White, Chief Financial Officer

Mr. Louis R. Charpentier, Secretary of the Governing Council
Mr. Mark L. Britt, Director, Internal Audit Department

Secretariat:

Mr. Neil Dobbs
Ms Susan Girard

Regrets:

Ms Kwai Li

In Attendance:

Professor Heather Munroe-Blum, Vice-President - Research and International Relations*
Dr. George Adams, President, University of Toronto Innovations Foundation*
Mr. Geoff Behm, Ernst & Young
Ms Diana Brouwer, Ernst & Young
Ms Sheila Brown, Controller and Director of Financial Services
Mr. Paul J. Fraumeni, Manager, Strategic Communications, Office of the Vice-President - Research and International Relations*
Mr. Donald W. Lindsey, President and Chief Executive Officer, University of Toronto Asset Management Corporation**
Mr. Pierre Piché, Associate Controller
Mr. Allan Shapira, Hewitt Associates**
Ms Deborah E. Simon-Edwards, Executive Assistant to the Chief Financial Officer
Ms Karel Swift, University Registrar and Director of Admissions and Awards***

* In attendance for item 2.
** In attendance for item 3.
*** In attendance for item 5.

ITEMS 2 AND 3 CONTAIN RECOMMENDATIONS TO THE BUSINESS BOARD

REPORT NUMBER 59 OF THE AUDIT COMMITTEE - November 15, 2000

1. **Report of the Previous Meeting**

Report Number 58 (October 17, 2000) was approved.

2. **University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year ended April 30, 2000**

The Chair commented that the Innovations Foundation was responsible for the commercialization of University-developed technologies. It was an important servant of the University's research enterprise, which represented a key thrust of the University's academic activity. The Audit Committee's responsibility was not to conduct its usual review of the financial statements from the point of view of the adequacy of representation and disclosure. The statements had been reviewed and approved by the Foundation's own Audit Committee and Board. The Committee's primary task was to carry out, on behalf of the Governing Council and the Business Board, the responsibility for the Governing Council's - the controlling corporation's - stewardship with respect to the Foundation. Questions about the reliability of the statements were, however, appropriate; the financial results of the Foundation were consolidated into the University's statements.

Professor Munroe-Blum said that the Innovations Foundation had been operating for almost two decades. In the past two years, it had prepared a new business plan, signed a line-of-credit agreement to govern its financing from the University, recruited Dr. Adams as President, and recruited other key staff. Never in her seven years as Vice-President had Professor Munroe-Blum been more pleased with the progress of the Foundation.

Dr. Adams commented on the Foundation's annual report and financial statements for 1999-2000.

- **"Branching Out."** The theme of the report signaled that the Foundation was branching out to become more than a technology licensing office. It would begin to place greater emphasis on establishing businesses based on University technologies. It was also diversifying its portfolio of inventions, becoming less reliant on inventions in the biotechnology area. The Foundation had initiated work on eighteen new files in the past year, representing 40% of its total current portfolio.

- **Invention disclosures**. The number of invention disclosures from the University's faculty had doubled from the previous year, evidence that the Foundation's message was being heard in the University.

- **First start-up company**. The Foundation had assisted in the establishment of its first start-up company, an internet company called Neteka Inc. which was developing technology to make the internet fully multilingual. This was a development that went beyond computer science to involve the humanities and social sciences.

- **First sale of equity**. The Foundation had completed the first sale of equity it had taken in a start-up company, selling a part of its position in Select Therapeutics, which had

2. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year ended April 30, 2000 (Cont'd)

developed a product now in trials for stem-cell purging and treatments of certain brain cancers.

- **New operating model**. The Foundation's staff had begun to work very closely with the Business Development Officers from the University's Office of Research Services. The Foundation's Commercialization Managers and the University's Business Development Officers would undertake assignments for both organizations, with the individual with the greatest expertise in the area handling the particular technology. The combination allowed for a critical mass in both operations and for operating efficiencies. Together the two offices were able to increase the total workload with no increase in staff.

- **New venture capital fund**. In co-operation with Triax Growth Fund Inc., the Foundation had established a $2.5-million venture fund to invest in new businesses. The Foundation had initiated a business plan competition, with the winner eligible to receive an investment of up to $500,000 from the fund, as well as free computer equipment, accounting and legal services.

  In response to a member's question, Dr. Adams said that the Foundation's agreement with Triax Growth Fund provided for the Fund to invest in selected technologies and gave the Foundation a portion of the potential gains from those investments.

- **New start-up incubator**. The Foundation had established a small incubator operation to assist start-up companies. The experience with Neteka Inc. had demonstrated how useful it would be to assist inventors with the business aspects of their new operations.

- **Promotion of new paradigm among the University's researchers**. The University's faculty had traditionally taken the view that they must "publish or perish." The Foundation was promoting the alternative view that researchers should "patent, publish and prosper." Dr. Adams noted that the Foundation had been invited to present its model at various other universities and hospitals in Canada.

- **Financial results**. Revenue for 1999-2000 had increased by 46% over the previous fiscal year to $1,447,000. There had been significant revenue growth in the third and fourth quarters. The result had been a 63% reduction of the Foundation's loss from $656,000 in the previous fiscal year to $242,000 in 1999-2000. The Foundation's operational plan had projected the need to draw on its line of credit with the University in an amount over $1-million; the Foundation had in fact needed to draw only $567,000 as at the end of the fiscal year. The Foundation's plan had projected that it would be in cumulative deficit position of over $1-million as at April 30, 2000. Its actual cumulative deficit was $810,000. This positive variance had been the result of revenue of $1.1-million, which had exceeded the revenue of $570,000 projected in the plan.

2. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year ended April 30, 2000 (Cont'd)

In response to a member's question, Dr. Adams said that the Foundation hoped to bring its operations to a break-even basis in about one and one half years, or even sooner, bringing its cumulative net deficit to zero in about five years.

Dr. Adams showed a graph displaying the Foundation's revenues and expenses for the past five years. Professor Munroe-Blum noted that the Foundation's revenues had exceeded its expenditures in both 1995-96 and 1996-97, but in both cases that outcome had been the result of a high stream of royalties from one patent. More recently, the Foundation's portfolio had been much more diversified. In addition, the report of revenues and expenditures did not take into account the growing value of the equity stakes held by the Foundation.

- **Equity positions**. The Foundation held equity positions in a number of start-up companies, with the total value of those positions being approximately $4-million, an increase from approximately $2-million the previous year. The companies were small and the shares were not very liquid. The Foundation had, however, been able to sell some of its shares in Select Therapeutics, and an initial public offering of shares in GlycoDesign would soon be forthcoming, presenting an opportunity for the Foundation to sell some of its shares.

  A member noted that Polyphalt, while its shares were thinly traded, was listed on the Canadian Venture Exchange. Dr. Adams noted that there was considerable interest in the company in China. While China had traditionally had to import all of its asphalt, Polyphalt's process enabled the use of domestic materials.

  A member asked whether the Foundation sought to retain control of the spin-off companies. Dr. Adams replied in the negative. While the Foundation might retain a 10% interest, its objective was to sell its interest privately or to sell shares in an initial public offering.

- **Return on investment**. The total investment in the Foundation over the past eight years (1992 - 2000) had been $1.8-million, including $1-million from the University's operating budget and $800,000 in donations from the Royal Bank of Canada. The University itself had received a return of $3.16-million from this investment, consisting of: $1.72-million in royalty payments, $800,000 in overhead payments, and equity valued at about $64,000. In addition, inventors - the University's faculty - had received $4.2-million, consisting of $2.8-million of royalty payments and equity worth approximately $1.4-million.

  Professor Munroe-Blum added that the Foundation also served the essential purpose of ensuring that the applied benefits of the University's research were delivered to serve the community.

2. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year ended April 30, 2000 (Cont'd)

In response to a question, Dr. Adams said that University policy provided for the sharing of revenues, with 75% going to the inventor and 25% to the University. In addition, before that distribution, the Foundation itself received a share to enable it to cover the cost of its operations. That usually amounted to 50% but might be less for less costly projects. The Foundation might in certain cases agree to receive a share of the equity of a start-up company in lieu of some or all of the royalties payable to the Foundation by the start-up.

The Chair observed that the Foundation's activities had two financial impacts on the University. First, the results of its operations were consolidated into the University's financial statements. Second, the Foundation paid royalties and transferred equity in start-up companies to the University.

- **The future**. Dr. Adams predicted that the Foundation would continue to grow both through the commercialization and the business-creation models. The Foundation would need to train more commercialization officers to meet growing demand. There were few well-trained people in the field, and they were in high demand by other institutions. The Foundation's key challenge would be to handle the increase in technology-transfer opportunities and still remain within its line of credit.

Among the matters that arose in discussion were the following.

(a) Portfolio diversification. A member asked whether the Foundation's mandate included any guideline with respect to diversification. Dr. Adams replied in the negative. The Foundation worked mostly on the technologies that were developed and disclosed by the University's faculty. Within that parameter, the Foundation sought out projects in areas that would serve its objective of diversifying its portfolio. Upon his arrival, Dr. Adams had found that about 80% of the Foundation's projects were in the area of biotechnology. At the present time, 50% of the portfolio continued to be in the biotechnology area and other medical areas. About 20% were in the area of information technology and the remaining 30% in the physical sciences. Biomedical technologies were very worthwhile ones, but they frequently had a long incubation period before providing any return. Technologies in the physical sciences and information technology matured more quickly. As a result, the Foundation was building up its staff strength in the latter areas - its earlier strength had been in the biomedical area - and it was making every effort to make it known that it was now able and eager to manage technologies in the physical sciences and information technology.

(b) Relationship with technology-transfer units at other universities. In response to a question, Dr. Adams said that the other research-intensive universities had technology-transfer units, but the Innovations Foundation was one of only a few in Canada that was organized as a separate corporation. There were other models of separate corporations in the United States. The member asked whether the Foundation had considered joint operations with other universities to diversify investments and earn a more consistent return. Dr. Adams replied that

2. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year ended April 30, 2000 (Cont'd)

the idea was a good one but a difficult one to implement. The Foundation did cooperate with McMaster, Ryerson, York and Windsor in marketing inventions, but the joint marketing efforts had taken place for only a few technologies. The culture in the other universities continued to place more stress on immediate publication rather than patenting before publication to permit rewards from technology transfer.

(c) Cash flow. A member noted that the Foundation's current liabilities of $843,000 exceeded its current assets of only $484,000. Dr. Adams replied that the Foundation continued to rely on the line of credit supplied by the University. He hoped that the Foundation's operations would become profitable by the end of the next fiscal year. In response to the member's question, Mr. White and Dr. Adams said that the Foundation paid interest to the University at the University's opportunity cost, its foregone earnings from its Expendable Funds Investment Pool. That currently ranged between 6% and 7% per year. The interest payments were reported in the Schedule of Operating Expenses as "bank charges" and amounted to about $22,500.

(d) Choice of royalties or equity positions. A member observed that while the Foundation was increasingly stressing taking equity positions in companies exploiting University technologies, its revenues from royalties and licensing fees had still almost doubled. Dr. Adams replied that the Foundation was by no means abandoning licensing agreements in favour of equity positions. The Foundation did require some up-front cash flows in order to carry on with its operations. In each case, a decision was made about what made most sense: an agreement based solely on licensing in return for royalties, an agreement involving equity in lieu of royalties, or an agreement combining reduced royalties with a smaller equity position.

The Chair commented that the Foundation's annual report was very much a good-news report. The Foundation was achieving its major task, which was to encourage faculty to take to market appropriate technologies, ensuring that University participated in the rewards provided by the market to generate funding to support the University's academic activities. The Chair was particularly gratified that the discussion, for the first time, did not contain reference to the "pig project." It was pleasing that the Foundation was achieving its results from a broader portfolio.

On the recommendation of the 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, 2000 be accepted.

3. Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000

Mr. White observed that a pension stewardship report had been presented to the Audit Committee for the past ten or more years. It consisted of four parts: a general description of the plans; information on the investment policies and investment performance of the pension funds; audited financial statements for the two registered plans; and summaries of the actuarial reports on those plans and the supplemental retirement arrangement. The two registered plans were: (a) the main pension plan, and (b) the plan for employees of Ontario Institute for Studies in Education who had been enrolled in that plan at the time of OISE's merger with the University's Faculty of Education. The actuarial surplus in the two registered plans had, owing to strong investment returns, increased in spite of an employer and employee contribution holiday. In the main pension plan, the actuarial surplus had grown over the past year from $333.6-million to $391.9-million (before the surplus reserve, which was 5% of the actuarial value of the assets). In addition to the actuarial surplus, there was a further cushion, representing the excess of the market value of the assets over and above the actuarial value. The market value of the pension fund's assets as at June 30, 2000 was $2.259-billion, compared to the actuarial value of $2.072-billion, leaving cushion of $187-million. The difference occurred because the actuaries, in their valuation of the assets, used an averaging mechanism to smooth the actuarial value and to minimize the effects of the daily volatility in the securities markets. Because the securities markets had weakened since June 30, Mr. White estimated that the cushion had declined by about one half.

Mr. Shapira stated that both plans were well funded. He outlined the highlights of the actuarial valuations.

- **Three-column format**. The valuation included three columns rather than the usual two. The first column showed the previous year's valuation, based on the plan provisions in effect as at July 1, 1999. Those provisions included pension plan improvements made for academic staff, librarians, members of the Senior Management Group and other non-unionized administrative staff. The second column showed the previous year's valuation taking into account agreements with various unionized groups, which were made subsequent to July 1, 1999, all of which included identical plan improvements. The third column showed the July 1, 2000 valuation.

- **Funded status**. The actuarial value of the assets in the main plan, determined (as noted above) by a formula that included an averaging mechanism, was $2.072-billion. The accrued liability was $1.680-billion, leaving a surplus of $392-million.

  In response to a member's question, Mr. Shapira described the averaging mechanism. The actuaries first assumed that the value of the assets would increase by the long-term assumed rate of 7%. They then increased or reduced the outcome by one third of the difference between the assumed and the market value of the assets. The outcome was a modified, three-year rolling average.

3. Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000 (Cont'd)

Mr. White noted that, where the market value exceeded the actuarial value, the difference was what he had described as the market reserve. In response to a question, Mr. White said that the market reserve was different from the surplus reserve of 5% of the actuarial value of the assets. The surplus reserve added a dimension of further conservatism to the valuation which was important. It would not always be possible to rely on the market reserve; there would be times in the future, as there had been in the past, when the actuarial value of the assets would be greater than the market value.

- **Assumptions and experience**. The valuation assumed inflation at a rate of 3% per year, with the assets earning a real rate of return of 4% per year for a total nominal return of 7% per year. It was assumed that salaries would increase at the rate of inflation plus 1.5% per year. For the current valuation, the plan's experience was close to the assumptions, with the increase in the surplus arising from the better investment return on the plan's assets.

- **Current service cost**. The cost of providing the pension benefits earned by members of the main University plan during the 2000-01 year was estimated to be $53-million. Were it not for the contribution holidays, employees would contribute $19.8-million and the University would contribute $33.2-million in the current fiscal year. Because of the surplus in the plan, the University was prohibited by the Income Tax Act from making any contribution to the plan. The University was, however, using its pension-contribution budget to set aside money in a special committed account to continue working towards matching its liability under the terms of its Supplemental Retirement Arrangement, in accordance with the approved operating budget plan. In addition to the $53-million current service cost of the main registered plan and the $2.3-million current service cost of the OISE/U.T. plan, it was important to bear in mind the additional current service cost of the Supplemental Retirement Arrangement, which was $3.4-million and had to be funded every year. Mr. Shapira noted that the University's share of the current service cost for the main registered plan had, for the first time in six or seven years, declined as a percent of the participant salary base. That was the result of a reduction in the average age of the active participants. That reduction was, in turn, the outcome of: (a) new appointments to the University's faculty and staff, and (b) decisions by existing faculty and staff under thirty-five years of age to join the plan, which could be done without cost owing to the participant contribution holiday.

- **Solvency valuation**. In addition to the "going concern" valuation (reported above), the actuaries were also required to perform a "solvency" valuation to ensure that the plan would have remained solvent if it had, for some reason, been wound up as of the valuation date. The market value of the assets on July 1, 2000 was $2.259-billion. The liability of the plan as of that date, in theory the cost of buying annuities to cover the benefits of all plan members earned to that date, was $1.739-billion. The outcome was a "transfer ratio" of 1.30. The exercise was not at all a realistic one simply because it would be impossible in the marketplace to purchase $1.7-billion of indexed annuities.

3. Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000 (Cont'd)

- **Supplemental retirement arrangement**. The University had established a supplemental retirement arrangement (S.R.A.) - an undertaking to pay make-up pensions to those retiring with pre-retirement salaries over $98,000 to provide them with the full pensions they had earned and would have received were it not for the limit on pension payments contained in the Income Tax Act. The University's liability for the S.R.A. was $107.9-million, mostly on account of over 1,100 active participants. As noted above, the University was continuing to budget 75% of the current service cost of the registered plans, and it was directing a part of that amount to a special fund to match the liability under the S.R.A. As of June 30, 2000, the University had set aside $80.2-million to match the $107.9-million liability. That left a further $27.7-million, plus the annual current service cost of $3.4-million, to be set aside to match the liability fully. That figure should be borne in mind in thinking about the funded status of all of the University's pension arrangements.

  In response to the Chair's question, Mr. White said that the administration had submitted a funding plan in which the money to match the S.R.A. liability would be built up over five years. That funding plan had been approved by the Business Board. It had been anticipated at that time that the liability would be $80-million. In the salary and benefits settlement that had become effective on July 1, 1999, however, benefits had been improved, increasing the liability further to the current $108-million. The amortization period for the additional liability would once again be five years. The University currently had over $80-million set aside - the lion's share of the liability - and the University would set aside sufficient additional funds to match the new liability over the next three years. In response to a question, Mr. White said that the University would be setting aside $10.6-million in the 2000-01 year, including $3.4-million for the current service cost and $7.2-million against the liability. Mr. Shapira noted that the plan improvements had also had the effect of increasing the current service cost of the S.R.A.

  Mr. White noted that the University had obtained an advance tax ruling with respect to its arrangement. To avoid the plan becoming taxable, the University could only itself assume the S.R.A. obligation and set aside its own assets to match the S.R.A. liability. It could not establish a separate trust fund, and it could not set up individual accounts for beneficiaries. The amount set aside, as part of the University's own funds, could not be protected against creditors; it would be available to creditors in the event of bankruptcy.

Mr. White noted that the full actuarial valuations of the plans were available to members from his office, and they could also be consulted in the Governing Council Secretariat.

Mr. Lindsey said that as investment manager, the University of Toronto Asset Management Corporation (UTAM) focused on the performance of the pension fund against its benchmark. It was, however, of key importance to the financial health of the pension plan, and a source of considerable satisfaction, that the fund's return was well in excess of the actuarial assumption. Mr. Lindsey reported that as of August 1, 2000, the assets of the two registered

3. Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000 (Cont'd)

pension plans (the main University plan and the plan for pre-merger employees of the Ontario Institute for Studies in Education) had been merged into a unitized, master trust fund. That permitted the smaller plan to enjoy the same economies of scale as the larger one for portfolio management and custodial fees. That would also end the discrepancy in the rates of return of the two funds. In response to a question, Mr. Lindsey said that the savings derived from the merger of the two funds would amount to something between $50,000 and $100,000 per year.

Among the matters that arose in discussion were the following.

(a) Possible basic change to the pension plan. In response to a member's question, Mr. White said that the Faculty Association had expressed strong interest in moving to a defined-contribution arrangement within the existing pension plan. The Association had proposed that the new arrangement be implemented for new faculty and librarians and for those current ones who wished to make the change. The current salary and benefits agreement with the Association ran until June 30, 2002, but the administration had agreed to negotiate with the Association, outside of the usual timetable, for an extension of the agreement to June 30, 2005. Among the items in the negotiations would be the possibility of basic changes to the existing defined-benefit pension plan. Mr. White noted that the Business Board had been briefed in closed session on the matter. Following further discussion, the Chair observed that the potential change was a very important matter that could raise questions about the financial health of the pension plan. He was confident that the administration was well aware of the financial impact of the proposed change.

(b) Investment performance of the pension fund relative to the median fund. A member observed that the pension fund's 13.7% annualized rate of return for the four years ended June 30 2000 was less than the 14.8% return of the median fund in the universe of comparable funds. Mr. Lindsey noted that the universe used was that managed by S.E.I. Investments, an operation recently acquired by the Royal Bank of Canada. It aggregated the returns of a large number of Canadian pension and other funds. That universe included a wide array of funds with a wide variety of asset strategies and risk tolerances. As a result, in any year when the markets overall performed well, a particular fund might turn in performance that was under the median because it used a more conservative asset mix than the median fund. That made comparisons with the median very difficult. Therefore, the proposed, revised investment policies, which would be considered by the Business Board in the next week, contained three performance objectives. The first was the achievement of a rate of return that exceeded the rate of inflation by at least 4% per year. The second was the achievement of a rate of return that exceeded that of the fund's benchmark, which was a composite of relevant securities indices that reflected the pension fund's asset mix. The third objective was to exceed, over four years, the rate of return of the median fund in an appropriate comparative measurement universe. UTAM was currently seeking a universe that would more appropriately reflect the asset strategy and risk tolerance of the University's fund.

A member asked why the proposed policy did not include, as one of its goals, top quartile performance rather than merely performance above the median. Mr. Lindsey replied that

3. Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000 (Cont'd)

consistently achieving returns above the median would likely have the outcome of a long-term ranking in the top quartile. If a pension fund were to aim consciously for the top quartile, it would have to accept more risk than was appropriate for the fund. It was always necessary to balance return and volatility risk, and the more prudent strategy for the pension fund was to aim for a solid return while controlling volatility risk.

Mr. Lindsey noted that the University's endowment fund had an almost infinite investment time horizon, and the University fully controlled its payouts. Therefore, for the endowment fund, the proposed policy did contemplate a higher level of volatility risk, with the proportion of stocks being 80% compared to the pension fund's 60%. Both funds, notwithstanding the substantial difference in risk tolerance, were compared in the same S.E.I. balanced-fund universe, in which the endowment fund ranked far higher.

A member said that measurement against the benchmark was indeed important for many purposes, including incentive compensation for UTAM's senior staff (see below). Nonetheless, measurement against a performance benchmark was also very important. It would be a way of measuring the performance of UTAM as a whole; in strong markets everyone earned good absolute returns and a comparison was necessary for an overall evaluation. Measurement against a comparative universe was also an essential way of determining the suitability of the asset mix expressed in the benchmark. Mr. Lindsey agreed that the measurement against the median fund did provide essential information about a fund: how it was performing relative to peers. A fund that performed well in any given period might, however, be doing so because it had assumed too much risk, which could cause problems in the future. On the other hand, underperformance could also show the need to explore new asset weightings or new asset classes. The ideal universes for the University of Toronto would be those consisting of large North American university endowments and pension funds. Cambridge Associates did provide a universe of large U.S. university endowments, but the University of Toronto was, at this time, the only Canadian participant.

(c) Investment performance: reporting returns relative to risk. A member commented that the report provided information on investment performance but none on risk. That caused a real problem in evaluating performance. Mr. Lindsey replied that UTAM had since May been studying the historic returns of the funds and their standard deviations and would do so on an on-going basis. The objective would be to help UTAM to adopt strategies that would achieve the benchmark returns and do so with less risk. UTAM would, among other things, calculate Sharpe ratios for the returns of each fund.

(d) Performance measurement and compensation of UTAM staff. The Chair enquired about the performance measure that would be used to determine compensation, in particular, bonuses for UTAM staff. He was concerned that the compensation structure not encourage undue risk-taking. Mr. White and Mr. Lindsey replied that incentives would be based on performance relative to the benchmark; the UTAM President and Managing Directors would not be encouraged to take excessive risks in an effort to outperform other funds. The compensation

3. Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000 (Cont'd)

policy had been very well thought out. It had been adopted on the basis of advice from an external compensation consultant, and it was administered by the UTAM Compensation Committee. That Committee was chaired by UTAM Board and Business Board member, Mr. H. Garfield Emerson, and its other members were the Chair of the UTAM Board and the President of the University, with the Chief Financial Officer of the University as assessor.

(e) Performance measurement and costs. A member suggested that UTAM should report investment returns after all costs. Improvements in returns by the new UTAM team would be of no benefit to the University if they were more than offset by increased costs. Mr. White agreed that the point was well taken. It would, however, be very difficult to determine whether the additional costs of establishing UTAM were merited because it would be impossible to know how the funds would have performed under the previous arrangements. The only measures available were those contained in the investment policies, measures against the real return objectives, the benchmarks and, less satisfactorily, against the comparative measurement universes. Mr. Lindsey noted that as investment performance improved, fees increased, but so too did the value of the assets being managed. Therefore the fee, expressed as a percent of the assets, would decline.

Mr. White said that the recent investment returns of the pension fund had been good ones, keeping the plan fully funded and increasing the surplus notwithstanding the contribution holidays. They were, however, not as good as they could have been, leading to the formation of UTAM, which had begun operation on May 1, 2000. The University had been fortunate to attract Mr. Lindsey as the first UTAM President and C.E.O., and he was in the process of hiring three new managing directors. The University's previous Assistant Treasurer was a fourth managing director. Mr. Lindsey and his managing directors would form an excellent investment-management team. Given that UTAM managed over $4-billion of assets, even a small improvement in performance, for example 1% per year, could provide a substantial payoff.

The Chair said that the Committee was being asked to recommend the two sets of financial statements to the Business Board for approval. Approval was required prior to the submission of the financial statements to the Financial Services Commission of Ontario. With respect to the other parts of the report, the Committee was asked to make known any concerns it might have. With respect to investment performance, UTAM submitted a full annual report to the Business Board. The Chair asked that the investment policies, which would come before the Business Board in the following week, be distributed to members of the Committee.

3. **Pension Plans: Annual Stewardship Report Including Audited Financial Statements for the Year ended June 30, 2000** (Cont'd)

On the recommendation of the Chief Financial Officer,

YOUR COMMITTEE RECOMMENDS

THAT the audited financial statements of the University of Toronto Pension Plan for the year ended June 30th, 2000 be approved, and

THAT the audited financial statements of the University of Toronto Pension Plan for Ontario Institute For Studies in Education / University of Toronto Employees for the year ended June 30th, 2000 be approved.

4. **Chair's Remarks**

The Chair welcomed Ms Paulette Kennedy, who was attending her first meeting of the Committee. The Chair thanked Ms Simon-Edwards, Ms Brown and all of the staff who organized and presented to the very successful Committee orientation session on November 9.

5. **Ontario Student Assistance Program Audit**

The Chair said that the Audit Committee reviewed all substantial University audit reports. This particular report was a new one and an unusual one, in that the auditors had been asked to review aspects of the University's administration of the Ontario Student Assistance Program but had not been asked to render an opinion on overall compliance.

Ms Swift reported that until the early 1990s, the Ministry of Training, Colleges and Universities had taken a more active role in the administration of the Ontario Student Assistance Program (OSAP), including performing audits on the universities' administration of that program. In the mid-1990s, the Ministry's staff had been reduced, and the Ministry had transferred to the universities responsibility for administration of the Program. The Provincial Auditor had observed that the Ministry was not auditing the universities on their administration of the Program, and, following a great deal of discussion, the Ministry had decided to require the OSAP compliance audit. The first audit, covering the 1998-99 OSAP program year, had been completed in the summer of 2000. The audit had been a very arduous, labour-intensive one with the sample consisting of 500 files. The audit had been completed by Ernst & Young, using the services of the University's Internal Audit Department. The audit had required examination of the University's Repository of Student Information, a smaller system set up to administer the OSAP program, and paper files. The audit had required 575 hours of Internal Audit staff time as well as 400 hours of Admissions and Awards staff time to assist the auditors in obtaining the information they required. The external auditors had supervised the process and reviewed the results, finding two minor deficiencies. Both had been remedied. In response to the Chair's

5. Ontario Student Assistance Program Audit (Cont'd)

question, Ms Swift said that with correction of the minor deficiencies, she was confident that the Ministry would not regard the University's administration of the OSAP program as being in any way inadequate.

Mr. Britt said that he was not aware of any significant systemic issues. The deficiencies that had been noted in the audit had been corrected. He stressed that all Ontario universities had been audited, and the Ministry required that such audits continue to take place every three years. In the light of the cost of the audits and the resources required, Mr. Britt would be interested to see whether the Ministry modified its requirements in any way. In response to a question, Mr. Britt said that the deficiencies had involved 31 files of the 500 sampled. A total of 15,000 students had received OSAP loans during the year.

Ms Brouwer said that the external auditors had no further information to report. A member noted the statement in the second paragraph that the external auditors expressed no opinion on compliance with the Ministry's directions. Moreover, the outcome of the audit was specified in appendices to the audit report, which had not been provided to the Committee. Ms. Brouwer replied that the Ministry had required the performance of specified procedures and not the complete audit that would permit the auditors to express an opinion on overall compliance. The appendices had not been distributed because they were voluminous and detailed. In response to a member's question, Ms Brouwer said that the external auditors anticipated that the Ministry would be satisfied with the outcome.

The Chair noted that the report was for information. Everyone involved had concluded that the procedures in place were satisfactory and that there were no weaknesses that would expose the University to loss of funding or reputation.

6. Business Arising from the Report of the Previous Meeting

Item 8 - External Auditors' Engagement Letter, 2000-01 - Audit Committee Responsibility with respect to Controls over University and Pension Plan Invested Assets

The Chair recalled that at the previous meeting, when the Committee had considered the External Auditor's engagement letter, discussion had arisen concerning the Committee's responsibility with respect to the University and pension fund assets being invested by the new University of Toronto Asset Management Corporation (UTAM). The particular question was the Committee's responsibility to be satisfied that there was proper management of risk with respect to those assets. UTAM had its own Board, and there was an Audit and Compliance Committee of that Board, consisting of very capable people. However, UTAM was a service organization, and the invested assets were on the University's financial statements and not UTAM's. The exposure was the University's rather than UTAM's. At the Committee's orientation the previous week, Mr. Lindsey, and UTAM's Director of Finance and Administration, Ms Julianna Varpalotai-Xavier, had provided a substantial presentation on UTAM's risk management structures and processes, and a good discussion had taken place. Nonetheless, it was apparent

6. **Business Arising from the Report of the Previous Meeting** (Cont'd)

Item 8 - External Auditors' Engagement Letter, 2000-01 - Audit Committee Responsibility with respect to Controls over University and Pension Plan Invested Assets (Cont'd)

that UTAM's development of risk-management controls remained a work in progress. Therefore, Mr. Lindsey had kindly agreed to provide a formal report on UTAM's risk controls at the Committee's next meeting.

Mr. Lindsey agreed that risk-control procedures remained a work in progress as UTAM was completing the recruitment of its staff. Nonetheless, significant risk-management controls were already in place, and Mr. Lindsey was confident that they were already wholly adequate. With respect to controls over the assets, a key player was the custodian/trustee. With respect to general risk control, UTAM was in the process of building a more sophisticated risk-control model. Using that model, UTAM would be able to make a reasonable prediction of the effect on the portfolios of various economic events.

A member urged that Mr. Lindsey's report to the next meeting include information on the valuation of assets, including illiquid assets such as private equity investments. Mr. Lindsey agreed to do so. UTAM was in the process of discussing that question with the new custodian. The valuation even of highly liquid assets was becoming more complicated with the advent of 24-hour trading. Reports from the custodian would, of course, follow the requirements established by regulatory authorities. With respect to illiquid assets, UTAM would have guidelines on valuing private-equity investments.

7. **Internal Audit: Semi-Annual Report - Interim Review of Audit Findings**

Mr. Britt presented his interim report.

- **Department activities**. During the first quarter of the 2000-01 year, much of the Department's effort had been focused on providing assistance to Ernst & Young in connection with the year-end audit of the University's financial statements and other related audits. For the year to date, the Department had issued sixteen reports (fourteen final and two draft), comprising ten departmental audits, three continuous audit quarterly reports and three special reviews. In addition, seven follow-up reviews had been completed. Overall, the Department had delivered 98% of the audit hours in its plan, with the shortfall arising from the departure of a staff member. The Department was, however, behind schedule by three department audits. That was the result of: (a) devoting 500 hours to the OSAP audit (described above), and (b) falling 200 hours behind on other audits. In addition, the planned absence of one staff member would cost 500 further hours. The Department would engage a contract auditor from December to mid-March to fill in for that planned absence. The Department was also actively recruiting to fill a vacancy that had arisen. The new staff member would be responsible primarily for the continuous auditing program.

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

- **Risk-assessment database**. The Department had completed the compilation of the Risk Self-Assessment Database based on a survey undertaken in January 2000. The database would be used for the development of annual audit plans and for the detailed planning of individual audits. The outcome was a determination that 6% of units had high risk exposure, 42% moderate risk exposure, 42% low risk exposure and 10% very low risk exposure. The higher risk units, would of course, be audited more frequently. The Department was considering a web-based survey that budget units would be asked to update annually. The outcome would be the opportunity for the Internal Audit Department to provide advice quickly on the basis of responses rather than awaiting audits.

  In response to a question, Mr. Britt said that he would report on the risk classification system as part of his annual report in May, 2001.

- **Findings: Administrative Accountability Reports**. As part of departmental audits, internal auditors determined the level of compliance with the requirement that individuals with financial responsibilities complete an annual administrative accountability report. Of the 162 reports that should have been completed in the ten departments reviewed, fifteen or 9.3% had not been completed, including seven required from faculty and eight required from administrative staff. In most cases, the individuals concerned had been under the impression that they were not required to submit the reports. They had thought that the reports were to be completed not by all individuals administering funds but only by individuals with budget authority.

- **Findings: Review of Administrative Management System (A.M.S.) Financial Reports**. In five of the ten departmental audits, internal auditors had found that unit heads or principal investigators,* in units that lacked segregation of duties for the business officer or administrative assistant responsible for financial transactions, did not periodically review A.M.S. Management Reports, including payroll distribution reports. That outcome compared unfavourably with the previous year, when this problem was found in only two of the nine departments reviewed. The combination of failure to review the A.M.S. reports and the inadequate segregation of duties increased the risk that errors and improprieties would remain undetected. In response to the audit findings, the management of the units had undertaken to review the monthly management reports and payroll distributions and to remind principal investigators of their responsibility to do the same.

- **Findings: Taxation of Payments - Employee/Employer Relationships**. Audits had continued to find cases concerning payments to individuals who should have been paid as self-employed individuals (and issued T4A income tax information slips) or who should

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* Principal investigators are the faculty members who lead research groups funded by external research grants. They are responsible for administering the use of their grants.

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

have been paid as employees (and issued T4 slips). Instead, the individuals had submitted invoices for their services and were incorrectly paid as suppliers. Those service providers were involved in part-time instructional activities, research-related activities, administrative activities, and long-term, continuing consulting arrangements. In some cases, they were already employees of the University performing additional work. In many cases, agreements with the service providers were not appropriately documented. That led to the risk of the University's being held liable for withholding taxes, Canada Pension Plan and Employment Insurance premiums, interest and penalties. In addition, there was a risk of liability for benefits, severance costs and Workers Compensation premiums. The lack of properly documented service agreements could result in disputes about the terms, conditions, and responsibility for deliverables and indemnification of any contingent liabilities. The Controller and Director of Financial Services had revised the *Taxation of Payments Manual*, which would soon be re-issued, and in September 2000 she had initiated training sessions to assist department administrators in better assessing employee/employer relationships and therefore in providing payment for services in the appropriate manner.

Mr. White commented that the University was fortunate to have a good and thorough Internal Audit Department headed by an outstanding Director. That fact allowed the President and the Chief Financial Officer to sleep better at night. Mr. White responded to the main items in the report, and a substantial discussion took place.

(a) Accountability reports. Mr. White noted that the program of accountability reports was, among universities, unique at the University of Toronto. The reports cascaded up from level to level up to the President. While the University was still encountering problems in achieving full compliance, there had been a significant improvement in the level of compliance, and the administration was working on achieving further improvement. The Vice-President and Provost was making every effort to secure compliance in the academic divisions. The fact that so many reports had been completed indicated that the program was assisting in promoting a focus on financial-administrative duties.

(b) Review of Administrative Management System reports. Mr. White was disappointed that the internal auditors had found that in five of ten departments there had been a failure to review A.M.S. management reports, combined with an inadequate segregation of duties. This was especially disappointing in view the extensive training programs provided to heads of budget units. A significant source of problems was the large turnover of incumbents in academic administrative positions in a university. While the budget unit heads who had failed to carry out the appropriate reviews had in all cases undertaken to commence the practice, new unit heads sometimes did not. On balance, financial administration in the units was fairly good. The University would, however, always face problems but would always strive to improve overall performance.

Ms Brown added that administrators were asked on the administrative accountability reports whether they regularly reviewed the A.M.S. reports, and most often they responded that they did

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

so. Cases of negative responses would, of course, be dealt with at once. Additional training was being offered. For the third year, the orientation for new academic administrators had been expanded to include a full day of training on financial management. For non-academic administrative staff, a business management program provided three days of training on financial management. Both she and Mr. Britt participated in those programs, and both emphasized the importance of review of A.M.S. management reports. While turnover remained a key problem, the central administration was making a concerted effort, and it was clear that the effort was having an effect. Training sessions led to discussions with others in comparable positions, which in turn led to enquiries and requests for assistance in carrying out the appropriate procedures.

(c) Payments to service suppliers. Mr. White reiterated that the Controller had completed a major revision of the *Taxation of Payments Manual* and was offering special training sessions in its application. Mr. White therefore hoped that subsequent audits would show improving performance.

In response to a question, Ms Brown said that there was no impediment in the University's budgetary policies to making payments properly. Units were free to move monies among their accounts, including to and from salary accounts, with the exception of monies from research grants.

Ms Brown noted that personnel administration was also decentralized in the University. As a result, she was making every effort to provide training to the human resources staff in the divisions and to provide examples of the most common situations to assist them in making judgements about the proper form of payment to service providers. This matter was also stressed in the training sessions for divisional business officers.

A member asked whether the University had faced re-assessments arising from improper payments. Could the directors of the corporation - the members of the Governing Council - face personal liability? Mr. White and Ms Brown replied that the Canada Customs and Revenue Agency did carry out frequent audits, but the University had been assessed only for the Ontario Employer Health Tax and that assessment had arisen from an unusual situation. Directors would not face personal liability. Members of the Governing Council and it Boards and Committees were indemnified by the University except in cases of "willful neglect or willful default." In addition, the University carried officers' and directors' liability insurance.

(d) Audit reports. A member asked whether units received an overall assessment of their administration, or a grade, along with their internal audit report. Mr. Britt replied in the negative. The internal auditor did discuss with the unit's officers its performance according to various criteria, but it was not thought to be appropriate to discuss performance relative to other units. The member thought that discussion of relative performance might well be healthy, as might discussion of performance relative to the previous audit, if that had not taken place too long ago.

Mr. Britt stated his view that the problems revealed in his report were best dealt with through the provision of training, written materials, and assistance to the responsible staff. The

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

most important response was to make it known to everyone that they could draw on various resources to assist them in performing their duties. Mr. Britt also stressed that follow-ups were completed from twelve to eighteen months after the issue of audit reports. He had found no cases of repeat offenders.

The Chair agreed that better orientation and training efforts were appropriate. If there was turnover in the staff responsible for financial administration in a particular unit, that fact would presumably be taken into account in the risk assessment, and the department would be more likely to receive the attention of the Internal Audit Department. The Chair also stressed the importance of there being consequences for failure to comply with appropriate procedures.

8. **Accountability Reports: Annual Report on the Program**

The Chair said that the Committee had dealt with the matter of accountability reports as part of its discussion of the Semi-Annual Report of the Internal Audit Department. He applauded the initiative.

A member said that the accountability reports were very good ones, focusing on specifics. She was, however, concerned that notwithstanding a June 30 deadline to submit reports, some people had still not done so. In her corporation, employees were required to submit the reports and to do so on time. Mr. White responded that the University environment was very different from the private sector.

The Chair concluded that the program was a very good one, the report forms were very good ones, and the program formed an important part of the control environment. All of that was, however, inadequate in the light of the lack of compliance by a significant number of administrators.

It was AGREED that the Audit Committee continue to encourage the President to introduce negative consequences in cases where individuals failed to complete administrative accountability reports appropriately or failed to submit them on a timely basis.

9. **Financial Statements: Accounting Treatment of Employees' Future Benefits**

Mr. Piché said that Generally Accepted Accounting Principles (GAAP) in Canada would now require employers to account for employees' future benefits for the accounting period in which those benefits were earned. When the employer undertook a commitment to provide certain benefits, it must record a liability in the accounting period in which the commitment was made. The employer would also record any funds set aside to deal with the cost of the future benefits.

Mr. Piché said that the new provision would involve three groups of benefits.

- The first group consisted of **benefits to be paid during retirement**. The most important of those was pension benefits. While the University currently accounted for the cost of

9. **Financial Statements: Accounting Treatment of Employees' Future Benefits** (Cont'd)

pension benefits, the new rules would nonetheless have a major impact relating to accounting for pension benefits. In addition, the University would now have to account for future medical-insurance benefits provided to pensioners, including semi-private hospitalization, extended health care benefits, and dental care.

- The second group was **benefits paid after employment** that terminated for reason other than retirement. Those benefits included severance pay and long-term disability pay.

- The third group was **benefits paid during compensated absences**, including maternity leave, vacations and sick leave.

Mr. Piché said that in cases where the post-employment benefit vested, that is in cases when the employee had the right to the benefit when leaving the University, the liability would be recorded in the accounting period in which the benefit was earned. Similarly, when the employee could accumulate the benefit - carry it forward from one year to the next - the benefit would be recorded in the accounting period in which the benefit was earned. On the other hand, if the benefit neither vested nor accumulated, the liability would be recorded when the need to make payment was established. For example, when a staff member left on maternity leave, the University would accrue the full cost of the leave.

Mr. Piché said that the University could chose to deal with this new requirement in one of two ways.

- **Retroactive method**. Using the retroactive method, the University would record the entire impact of the accounting change in the 2000-01 statements, or it would restate the 1999-2000 statements.

- **Prospective method**. Using the prospective method, the University would record the impact of the accounting change over the estimated average remaining service life of current employees, which was fourteen years, beginning with the 2000-01 statements.

Mr. Piché reviewed the impact of the change in accounting rules on the three benefits programs where the impact would be the greatest.

- **Pension benefits**. There would be three major consequences of the new rules. First, the University would be required to use market rates, such as long-term government bond rates, to estimate the cost of its pension plan liability. Second, the University would now be required to record the cost of the employee pension-contribution holiday as a pension expense instead of the previous practice of simply reducing that amount from the pension-plan surplus. Third, and most significant, the University, in making the transition, would have to record the previously unrecorded pension-plan surplus in its statements. The overall impact would be an increase in the University's assets of $427-million, either recorded at once or spread out over fourteen years. Mr. Piché stressed

9. Financial Statements: Accounting Treatment of Employees' Future Benefits (Cont'd)

that there would be no budgetary impact. The University would continue to provide in its base budget for approximately 75% of the current service cost of the pension plan.

- **Medical insurance benefits** for retirees would be accounted for in the same manner as pension benefits because employee's current service entitled them to future medical-insurance benefits. This would mean that the University would have to estimate and record a medical-insurance benefit expense in the year in which the benefit was earned. The initial impact on the financial statements would be a liability of $146.7-million as at April 30, 2000, or the booking of the liability could be spread out over fourteen years. There would again be no budget impact. The University would continue to budget for medical-insurance plan premiums on a pay-as-you go basis. The University did not intend to fund that liability.

- **Survivor income benefit: cost-of-living adjustment**. The University would have to record the estimated cost of the cost-of-living adjustments to the survivors of employees and pensioners holding University life-insurance policies. This liability was not currently recorded, but a fund of $5.4-million for this benefit was on the books. In terms of impact on the financial statements, the estimated cost of the cost-of-living provision was $3.7-million, which would be offset by the committed funds. Again, there would be no budget impact, with the cost-of-living adjustments being paid from the trust fund.

Mr. Piché said that the administration proposed to adopt the prospective method of implementing this change as the more appropriate of the two options. The retroactive method would result in a sudden $400-million increase in assets and net assets because of the increased accounting value of the pension-plan surplus. That increase in assets and net assets would not in fact strengthen the University's financial position because the assets would not be accessible for spending. The apparent increase, however, could confuse external readers. The prospective method would, therefore, be better, because the increase in assets would be relatively small from year to year. At the same time, readers could also see the liability grow from year to year, and they could therefore better understand the change over time.

The Chair said that the University had no real choice but to adopt the new GAAP requirements. The only real choice was to adopt the new accounting by the retroactive or prospective method. The administration's proposal was to adopt the prospective method because the sudden appearance of new net assets would cause confusion.

Discussion focused on the following items

(a) Retroactive or prospective method. A member expressed concern about the complexities involved in using the prospective method and therefore introducing the change over fourteen years. As new employees joined the plan and other changes took place, the need to account for both the new liabilities and the old would be sure to cause confusion. Mr. White, Ms Brown and Mr. Piché replied that the choice of accounting method was not an easy one and the

9. Financial Statements: Accounting Treatment of Employees' Future Benefits (Cont'd)

administration was by no means wedded to its recommendation to use the prospective method. While there would be questions over time on the effect of accounting for both the old and the new changes, on balance the method that caused the least impact on the financial statements appeared to be the easiest to understand. In making its recommendation, the administration had studied the impact of combining on-going change with the fourteen-year introduction of the 2001 change, and it had concluded that the prospective method would be best. In fact, the difference between the outcome of the two methods would decline over time. If the University used the retroactive method, the large increase in its assets and net assets would decline as employer and possibly employee pension contribution holidays continued. If the prospective method were used, the increase in net assets would, for the same reason, not grow by the full $400-million. The actual net assets recorded by the two methods would converge. The benefit of the prospective method is that the statements would arrive at the ultimate number without the wide swing that would take place using the retroactive method. In any event, the outcome of accounting by both methods would be disclosed in the notes to the financial statements.

A member asked what approach was being taken by peer universities. Ms Brown replied that among the universities that had made the decision, those with defined-benefit plans enjoying significant surpluses were planning to adopt the prospective method. Those with defined-contribution plans were adopting the retroactive method.

(b) Other assets or liabilities that could require recognition. A member noted that the recording of employee future benefits was being undertaken because of a decision of the Canadian Institute of Chartered Accountants. He asked whether there were any other assets or liabilities, not now recorded in the financial statements, that might have to be recorded in the future and that the University should consider putting on the books at this time. Mr. White replied that U.S. universities accounted for the cost of deferred maintenance as a liability. He knew of no other assets or liabilities that might be considered for inclusion in the future, but the Canadian Institute of Chartered Accountants was always active in seeking ways to improve financial accounting. The member commented that accounting for deferred maintenance as a liability might well help to promote action to reduce the liability and the serious problem. He wondered whether the University of Toronto should in fact begin to account for deferred maintenance. The Chair thought that an innovation such as accounting for deferred maintenance as a liability, or accounting for the value of the University's human resources as a key asset, would not be permitted unless and until such accounting was introduced into the Generally Accepted Accounting Principles.

The Chair concluded that the accounting treatment adopted for employees' future benefits would be before the Committee as part of the complete financial statements at the June 20 meeting, at which time the Committee would deal with a motion for approval. No formal action was required at this time. The purpose of the discussion of the matter at this time was to give the Committee the opportunity to tender its advice if it had a strong view on the matter. The Chair invited members who had any further feedback to be in touch with Mr. White or Ms Brown as soon as possible.

10. External Audit Plan, 2001

Ms Brouwer said that it was important that the auditors, the University's administration and the Committee work together to develop shared expectations with respect to the external audit. She stressed that the traditional way of performing audits was no longer to be followed by Ernst & Young. Rather, the auditors would work initially to gain a high-level understanding of the University's business processes and the key issues and drivers that would affect its financial position, operating results and economic viability. The auditors would then work to understand the risk factors that could come into play. Using this high-level knowledge, the auditors would establish customized procedures to look into the areas of significant risk. The external auditors, in completing the audit, would work with the University's management and its Internal Audit Department, recognizing the work that they did, eliminating unnecessary duplication, and focusing the external auditors' attention on the right things needed to issue an opinion on the University's financial statements. The external auditors would, of course, continue to attend meetings of the Audit Committee, be prepared to answer questions on the audit, issue their management letter, and receive feedback from the Committee. In response to the Chair's question, Ms Brouwer said that she did not anticipate any major departures from the prior year in terms of the actual audit procedures used, unless new risks were to appear.

Among the matters that arose in questions and discussion were the following.

(a) Relationship with the Internal Audit Department. The Chair asked whether the external auditors made use of the Internal Audit Department's risk assessment. Ms Brouwer said that the external auditors would meet with the Internal Audit Department, make use of its risk-assessment work, and ensure that there was no unnecessary duplication.

A member asked whether the Internal Audit Department would provide the same level of assistance to the external auditors for the 2001 audit as it had in the past. Mr. Britt replied in the affirmative; his Department would continue to devote 900 hours of staff time to assisting the external auditors. He hoped and anticipated that the Department would be back to full strength in time for the financial-statement audit.

(b) Performance/value scorecard. The Chair noted the reference in the Ernst & Young document to the new "performance/value scorecard" to be used for measuring the auditors' progress against expectations. He commended the idea, commenting that obtaining client assessments in writing could be very helpful. There was often a diversity of expectations, with the external auditors not recognizing client concerns. It was AGREED that the external auditors be asked to provide the Committee with a copy of the completed performance/value scorecard at the end of the audit cycle.

11. Report of the Administration

THE COMMITTEE MOVED *IN CAMERA*.

Mr. Britt reported *in camera* on the outcome of a special audit.

11. Report of the Administration (Cont'd)

THE COMMITTEE COMPLETED ITS *IN CAMERA* SESSION.

Mr. White and Mr. Britt stated that they knew of no other matters that should be drawn to the attention of the Committee.

12. Dates of Next Meetings

The Chair noted that next regular meeting was scheduled for Wednesday, May 23, 2001 at 5:00 p.m. At that meeting, the Committee would, among other things:

- consider the notes to the financial statements;
- receive a report from the University of Toronto Asset Management Corporation on its risk control procedures; and
- review the annual report of the Internal Auditor, review the Internal Audit Plan for 2001-02, and hold the annual private meeting with the Internal Auditor.

The Chair noted that members were normally asked to set aside a "reserve date" for a possible meeting before May 23, in the event that any business arose requiring the Committee's attention. Because it had not yet been possible to establish a "reserve date" in the spring of 2001, the Secretary would be in touch with members about scheduling if a meeting became necessary.

13. Other Business

Robert G. White

The Chair stated that this was a historic meeting; it was the final regular meeting of the Audit Committee Mr. Robert G. White would attend before his retirement at the end of January, 2001. Mr. White had served the University since 1969. He had served as Comptroller; Assistant Vice-President, Finance; and Chief Financial Officer. Mr. White's devotion to the University had been legendary. He was known to respond to voice-mail messages during the day, at night, on weekends, from his office, from home, from his cottage, and sometimes from more exotic locales when on holiday.

The Chair said that the list of Mr. White's accomplishments was a long one, which would no doubt be enumerated later in another forum. He would comment on several recent highlights from the point of view of the Audit Committee. Mr. White had led in the regular adaptation of the University's financial reporting to new *Handbook* requirements: new pension accounting, accrual of the vacation pay entitlement, the amortization of capital assets, accounting for restricted grants and contributions, accounting for investments at market value, and now accounting for employee future benefits. Most significantly, he had led in the simplification of

13. **Other Business** (Cont'd)

Robert G. White (Cont'd)

the most complex statements imaginable - with one column for each of the four funds - to new, simple, comprehensible statements, illuminated by a crisp, and very valuable, supplementary financial report.

Mr. White had managed an outstanding financial services organization. He had led in the transformation of the University's procurement department from a transaction-processing service to a highly specialized group, negotiating good deals for divisions and departments, assisting them, and ensuring that they were following appropriate procedures in making their purchases. With Mr. White's support and guidance, the University's Insurance and Risk Manager had enabled most of the universities in Canada to survive a major crisis in liability insurance by establishing a nation-wide university co-operative insurance exchange. The outcome had been not only the availability of insurance but also better rates and occasional rebates. Mr. White had played a key role in bringing the financial management of the University through a major decentralization, including implementation of a new financial information system, development of new controls, provision of extensive training programs both for line staff and budget unit-heads, and implementation of the program of accountability reports. As the key University liaison officer, Mr. White had helped to turn around the Press into a profitable business that was able to pay "participating interest" to the University on its investment, contribute to a scholarly publishing trust fund and, most importantly, publish every scholarly book deemed worthy of publication, without regard to financial constraints. Not to be underestimated was Mr. White's role in keeping a lot of financial operations going smoothly and, when other operations did not go smoothly, putting out a lot of fires: dealing with the financial fallout of a library automation company that was divested at a loss, dealing with the financial fallout of a supercomputer operation that did not work out as planned, dealing with a visit from the Provincial Auditor, and dealing with lot of crises in individual academic units.

The Chair continued that Mr. White was responsible for the management of the financial aspects of the pension plan. On his watch, the consistently solid investment returns on the pension fund enabled the University to provide: steadily improving benefits; voluntary pension augmentations that have kept payments fully indexed to inflation; a lengthy employee contribution holiday; and an employer contribution holiday that provided the wherewithal to establish a supplemental retirement arrangement and that provided the wherewithal for University funding to match donations. That matching funding has been instrumental in the great success of the fundraising campaign, facilitating the establishment of dozens of endowed chairs and student awards, and the completion of a great deal of construction.

The management of financial aspects of the pension plan, of course, included investment management. That brought to mind Mr. White's most recent and perhaps most important contribution: the establishment of a properly resourced, high-level, entrepreneurial, investment management corporation to look after the University's pension funds, endowment funds and operating funds - something likely to bring the University enormous financial benefits for decades to come.

13. Other Business (Cont'd)

Robert G. White (Cont'd)

The Chair hoped that as Mr. White approached his retirement and reflected on his career, he would know that he had done his job exceptionally well and that he had made an enormous contribution to the well-being of a very important national and international institution. The Chair had admired and appreciated, and knew his predecessors and all members of the Audit Committee over the years had admired and appreciated, Mr. White's availability and openness, and the wisdom and candor of his advice. The University was a much better place for it.

Mr. White thanked the Chair for his remarks. He said that his years at the University had been "a great trip."

The meeting adjourned at 8:10 p.m.

Secretary

Chair

May 16, 2001