APPENDIX CONFIDENTIAL

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 63 OF THE AUDIT COMMITTEE

November 28, 2001

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, November 28, 2001 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 Paulette L. Kennedy
Ms Kwai Li
Mr. Paul E. Lindblad
Mr. George Myhal
Mr. Richard Nunn
Professor Wally Smieliauskas

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

Secretariat:

Mr. Neil Dobbs
Ms Beverley Stefureak

Regrets:

Ms Christine A. Capewell
Mr. Felix Chee
Mr. Gerald A. Lokash
Mr. Roger P. Parkinson

In Attendance:

Mr. Geoff Behm, Ernst & Young
Mr. Keith B. Bowman, Ernst & Young
Ms Sheila Brown, Controller and Director of Financial Services
Mr. Eric Fleming, Director, Risk Management and Insurance*
Mr. Graham Kemp, Director, Administrative Management Systems*
Mr. Pierre Piché, Associate Controller
Ms Deborah E. Simon-Edwards, Executive Assistant to the Vice-President - Business Affairs
Ms Cheryl Wessel, Audit Manager, Internal Audit Department

* In attendance for item 6.

ALL ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR INFORMATION

1. **Report of the Previous Meeting**

Report Number 62 (November 7, 2001) was approved.

2. **Chair's Remarks**

The Chair welcomed Mr. George Myhal, who was attending his first meeting of the Committee.

3. Business Arising from the Report of the Previous Meeting

(a) Item 2 - University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year ended April 30, 2001

The Chair recalled that at the previous meeting a question had arisen concerning the accounting treatment of the sale of a major technology - a colon-cancer screening technology - to Procyon Biopharma. Mr. Bowman said that the Foundation had received, as the result of the sale: (a) cash of $1,500,000, of which $1,032,000 was receivable as at the April 30 year-end, and
(b) 407,292 shares of Procyon Biopaharma Inc. The proceeds of the sale were treated as revenue during the year because such a sale was not an extraordinary event for a technology-transfer company. Such sales were expected to continue as part of the normal course of the Foundation's business. The Foundation's shares in Procyon Biopharma were recorded as follows. 277,084 shares had been received by the Foundation and recorded as investments, but they could not be traded for a period of one year following the closing date of the transaction. The other 130,208 shares would not be received by the Foundation until 30 months after the closing date. The latter shares had been recorded on the balance sheet as a long-term receivable valued at $250,001. A cross-reference had been added to the balance sheet item recording the long-term receivable to refer readers to note 3, investments, which explained all aspects of the arrangement.

The Chair recalled that he had raised a second question concerning the accounting for patent activity. Mr. Bowman said that patent income was recorded as revenue and patent costs as expenditures rather than netted out - again because of the nature of the organization. Incurring patent costs and earning recoveries was an integral part of its on-going activity. The Foundation therefore preferred to account for such activity on a gross basis rather than netting out the costs, which were often incurred well in advance of the receipt of the revenue for a particular invention. In addition, not all costs were recovered. While such accounting would not be seen in a usual business, the nature of the Innovations Foundation made such accounting acceptable.

4. Internal Audit Department: Semi-Annual Report, May 1 to October 31, 2001

Mr. Britt presented the Internal Audit Department's semi-annual report.

- **Audit activities**. The Department had submitted six final departmental audits and a further three draft reports. Another five departmental audits were in progress. The Department had also submitted two quarterly reports on the continuous auditing program (an on-going review of selected transactions in all budget units), and a third report was in progress. Finally, the Department had submitted reports on four special reviews. The University had suffered no significant loss in any of the four cases.

  In the first quarter of the fiscal year (May 1 to July 31), the Department's principal work had been assisting the external auditors with the year-end financial-statement audit and other statutorily required audits: the enrolment audit and the audit of capital spending.

  The Department also: had evaluated the SAP 'e-Procurement' system presently in development; had assisted with the development of a cash-flow and control-reporting process for capital projects; and had participated in the compilation of the University's risk assessment profile.

- **New system module**. Internal Audit Department staff had worked with the Administrative Management Services (A.M.S.) staff to configure the S.A.P. Audit

Information System module. The new module enabled auditors and A.M.S.

4. <u>Internal Audit Department: Semi-Annual Report, May 1 to October 31, 2001</u> (Cont'd)

administrators to find, evaluate and download appropriate information from the systems and provided reporting capabilities for both systems and business-process audits. The Internal Audit Department was working to integrate this new functionality into its audit approach.

- **Staffing**. The Department had incurred a loss of about 1,000 hours of staff time because of two health-related leaves of absence and the retirement of a senior auditor on June 30, 2001, combined with a very competitive market for permanent and contract replacements. Mr. Britt had engaged contract auditors to make up for some lost time, but that had provided only an imperfect solution because of the cost of contract auditors and their unfamiliarity with the University. As a result, it would not be possible to complete between four and seven of the departmental audits included in the 2001-02 plan. The Department would focus on audits of the high-risk units as well as some moderate-risk units. Mr. Britt would be meeting in early December with Mr. Chee and Mr. Charpentier to discuss long-term staffing needs.

  In response to a member's question, Mr. Britt said that permanent staff would concentrate on departmental audits in the high-risk units, but it might be necessary to use contract auditors to some extent for those audits. He reviewed the specific adjustments to the Internal Audit Plan that would be made in the light of the staffing problems.

  The Committee expressed both concern and support for the achievement of appropriate staffing levels in Internal Audit so that the audit plan could be carried out.

- **Administrative accountability reports**. As part of the departmental audits, the internal auditor reviewed the level of compliance with the requirement for individuals with financial responsibility to complete an annual accountability report. On the basis of the rather small sample, there had been some improvement in the completion rate. Of the 73 reports to be completed in the departments that had been reviewed, only six had not been completed, most often because the individuals concerned had not recognized that their administrative duties were at the level where a report was required.

- **Audit findings**. The Department had identified some 'operational' and 'information-for-decision-making' risks related to internal controls and compliance with policies and procedures. Those risks included: (a) cash flow/budget risk caused by weak cash-handling and reconciliation controls; (b) information-processing-integrity risk and employee-fraud risk caused by some lack of segregation of duties, failure to reconcile accounts on a timely basis, and failure to review A.M.S. reports; (c) liquidity risk caused by weak inventory accounting and safeguard controls; and (d) taxation risk caused by the processing of payments to some individuals as non-employment income. None of the risks were considered to be critical or warranting immediate attention by senior management. The audit findings pointed to the need to improve existing controls and compliance with policies, procedures and laws. The heads of the units had in all cases agreed to implement the recommendations included in the audit reports.

Invited to comment, Ms Brown said that one of the main methods used to encourage greater compliance with policies and procedures, especially budget-unit heads' regular review of centrally produced financial reports, was the University's ever-growing training programs. Those programs included regular financial-administration seminars for new academic and other administrators. All new administrators were encouraged to attend those seminars. Those

4. Internal Audit Department: Semi-Annual Report, May 1 to October 31, 2001 (Cont'd)

programs, along with reviews at the level of the individual department, were used to encourage the regular monitoring of financial reports and other appropriate procedures.

In the course of discussion, in response to a question, Mr. Britt elaborated on the Department's risk-based audit approach. He said that under ideal circumstances, the Department would focus its reviews on the risk-management processes in place in each unit. At this time, however, it was still necessary to review the internal controls and policy compliance of each unit.

At the conclusion of the discussion, the Chair observed that Mr. Britt had concluded that none of his findings required the immediate attention of senior management. The Committee could therefore conclude that there was no immediate risk that required its action.

5. Administrative Accountability Reports: Annual Report on the Program

Ms Brown said that accountability reports were designed for each level of management, with reports to be completed by: the President; the vice-presidents; the principals, deans and academic directors; and the department chairs and administrative directors. More detailed reports were to be completed by principal investigators (the faculty members responsible for individual research grants), business officers, and other administrative staff. Copies of those reports had not been included in the Audit Committee agenda materials, but they were available on the University's web site. The materials included the President's signed accountability report, indicating his receipt of reports from all of the vice-presidents and other officers reporting directly to him. Similarly, the Vice-President and Provost had received reports from all of the principals, deans and other officers reporting to him. Ms Brown said that the administration had been very pleased with the process for the previous year. The primary improvement to be sought for the current academic year would be the increased timeliness of reports. While reports had been completed more promptly for 2000-01 than previous years, there was need for further improvement. Where reports had not been completed, this had occurred, in most cases, because the individuals had not been aware of their responsibility to complete a report. Those individuals' financial responsibilities had often formed a relatively minor part of their jobs. The Vice-President and Provost and the rest of the central administration continued to stress the importance of the reports.

The Chair expressed concern that, notwithstanding the favourable comments, the internal auditor had still identified 8% of cases where reports had not been submitted. There was clearly need: to tighten the program, to identify in advance the positions where reports were required, and then to require that they be completed. Ms Brown reiterated that the problem was not the failure of managers to complete reports but rather of individuals in positions with limited financial responsibility, for example people in primarily secretarial or clerical positions with some financial responsibilities. There was a large turnover in academic administrators each year, and some new administrators were unaware that reports were required of staff at a relatively low level. There was now an extended program of training for new administrators: a 1¼-day orientation session, including material on financial administration, followed by two half-day sessions devoted solely to financial administration. The full package of accountability reports was provided to administrators during the training sessions along with instruction on the completion of the program. Academic administrators were advised that failure to secure completed accountability reports from their staff represented the superiors' assuming responsibility for any duties that had not been carried out properly. That would be the case because the administrator would not have completed an essential step of due diligence - review of the accountability reports - a step that could have identified the problem. At the training

5. Administrative Accountability Reports: Annual Report on the Program (Cont'd)

sessions, the officers making the presentations stressed not only the importance of the accountability reports but also the importance of other responsibilities such as regular review of centrally produced financial reports. Mr. Britt made administrators aware of problems that had actually arisen in various departments when financial responsibilities had not been carried out properly. Mr. Britt added that administrators were advised that the reports served two very important purposes for them, providing both a sign-off by their staff and a check-list of the expectations for those staff with respect to financial-management duties.

In response to the Chair's question, Ms Brown said that there had been no changes in the reports since the previous year. The Chair asked the Internal Auditor if his Department had identified any instances where reports had been completed inaccurately or dishonestly. Mr. Britt replied that in most cases, reports were completed accurately and honestly, apart from the reports completed by those who had committed the frauds that had been discovered and brought to the attention of the Committee. He noted that the Internal Audit Department did follow up where the accountability reports indicated a failure to comply with appropriate policies, procedures and duties.

The Chair stated his continued view that until all accountability reports were completed, the substantial worth of the program was diminished. The achievement of full accountability was important to the University's proper stewardship of the resources provided by the taxpayers, benefactors and students, and accountability should be regarded as an ethical priority in the University. It was however, encouraging to see continuing progress, monitoring and training.

6. Risk Assessment Profile

The Chair drew members' attention to the risk-assessment profile. (A copy of the risk-assessment profile is attached hereto as Appendix "A". It is classified as confidential.) The Chair observed that the preparation of the risk-assessment profile had arisen from the Committee's earlier discussion of the matter of business interruption risk / disaster recovery. The Audit Committee was not responsible for all of the areas of risk covered in the report, but it was concerned to see that all risks were being assessed and dealt with somewhere in the administration or the governance system. The Secretary of the Governing Council was looking into the question of the appropriate location in the governance system for ensuring overall monitoring of any appropriate action in response to the risk assessment - for ensuring that items of unmitigated risk were being dealt with - especially with respect to business-interruption risk and a business-recovery plan.

Ms Brown said that the report had been based on broad consultation with various University officers and the external and internal auditors. A draft had been reviewed by the committee of the President and Vice-Presidents, and the judgements of the executive officers had informed the document, in particular with respect to the level of risk in each area. The starting point for the risk assessment had been templates developed by Ernst & Young and Arthur Andersen. The templates had been adapted from those designed for businesses to an assessment format suitable for the University. The risk self-assessment questionnaire developed by the Internal Audit Department had also been consulted. The starting point for the risk-assessment itself had been the University's mission statement, which led to an understanding of the more significant risks to the achievement of that mission. The aim was: to identify the risk, to determine the governance and reporting mechanism with respect to the risk, to identify the area of management responsible for dealing with the risk, to determine the key processes that mitigated the risk, to assess the level of risk, and to provide additional useful

6. Risk Assessment Profile (Cont'd)

comments. The outcome of the process was a risk inventory much like a snapshot at a given time. The process of dealing with the risk was, however, an on-going one. While the exercise had been a very useful one, the facts were always changing.

The Committee reviewed the risk-assessment profile in detail.

7. Report of the Administration

THE COMMITTEE MOVED *IN CAMERA*.

Mr. Britt reported *in camera* on the four special reviews undertaken in the period covered by his semi-annual report, May 1 to October 31, 2001.

In the course of discussion, it was proposed by the Chair and AGREED that the Vice-President - Business Affairs and the Secretary of the Governing Council give consideration, in each case of proven wrong-doing, to giving appropriate publicity to the act, its discovery, and the University's response. The objective would be to deter others by making it clear that wrong-doing was uncovered and dealt with firmly by the University.

THE COMMITTEE CONCLUDED ITS *IN CAMERA* SESSION

Ms Brown, Mr. Charpentier, and Mr. Britt stated that there were no other matters they thought should be drawn to the attention of the Committee.

8. Dates of Next Meetings

The Chair reminded members that the next regular meeting of the Committee was scheduled for Wednesday, May 22, 2002 at 5:00 p.m. At that meeting, the Committee would: consider the notes to the financial statements; review the annual report of the Internal Auditor for 2001-02; review the Internal Audit Plan for 2002-03; and hold the annual private meeting with the Internal Auditor.

The Chair also asked members to set aside a "reserve date" for a possible meeting on March 6, 2002 at 5:00 p.m., in the event that any business were to arise requiring the Committee's attention.

Finally the Chair recalled that the Committee had traditionally at the November meeting received a report on the external audit plan and on external audit fees. Because discussions about audit fees between the administration and the external auditors were continuing, it would have been premature to consider those items at the current meeting. Because the May 22, 2002 date of the next meeting would be too late, the Chair asked that these items be distributed to members as soon as they were available, and he asked that members let Mr. Chee know of any concerns.

The meeting adjourned at 7:45 p.m.

________________________ Secretary

________________________ Chair

January 8, 2002

REPORT NUMBER 63 OF THE AUDIT COMMITTEE - November 28, 2001

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