UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 71 OF THE AUDIT COMMITTEE

November 26, 2003

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, November 26, 2003 at 4:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Mr. George E. Myhal (In the Chair)
Ms Paulette L. Kennedy
Mr. Richard Nunn
Mr. David Oxtoby
Professor Gordon Richardson

Mr. Felix Chee, Vice-President, Business Affairs

Ms Sheila Brown, Acting Chief Financial Officer
Mr. Mark L. Britt, Director, Internal Audit Department

Secretariat:

Mr. Neil Dobbs
Ms Christina Oke

Regrets:

Mr. Paul E. Lindblad
Mr. Gerald A. Lokash
Ms Kim McLean
Mr. Roger P. Parkinson
Mr. Robert S. Weiss

In Attendance:

Ms Jacqueline C. Orange, member, Governing Council; Chair, Business Board
Dr. George Adams, President, University of Toronto Innovations Foundation*
Mr. John Bisanti, Chief Capital Projects Officer**
Mr. Keith B. Bowman, Ernst & Young
Ms Diana Brouwer, Ernst & Young
Dr. Peter B. Munsche, Assistant Vice-President, Technology Transfer*
Mr. Pierre Piché, Acting Controller
Professor Ronald D. Venter, Vice-Provost, Space and Facilities Planning**

* In attendance for item 4.
** In attendance for item 5.

ITEMS 4 CONTAINS A RECOMMENDATION TO THE BUSINESS BOARD FOR APPROVAL

1. Chair's Remarks

On behalf of the Committee, the Chair welcomed Ms Jacqueline Orange, the Chair of the Business Board, who was in attendance at today's meeting.

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1. Chair's Remarks (Cont'd)

On the suggestion of the Chair, it was agreed to amend the order of the agenda to move forward the report with respect to capital projects to follow immediately after the annual report and financial statements of the Innovations Foundation.

2. Report of the Previous Meeting - Report Number 70 - October 29, 2003

The Chair reported that a member had a number of detailed suggestions for amendments to Report Number 70 and would draw them to the attention of the Secretary. It was therefore agreed to defer consideration of the Report for approval until the next meeting.

3. Business Arising from the Report of the Previous Meeting

(a) Item 7 - University Credit Rating

The Chair recalled that at the previous meeting, the Committee had received an oral report arising from the change in the University's credit rating by one of the rating agencies. Recent reports from three credit rating agencies had been distributed with the agenda package. The Chair observed that the reports were very interesting and good ones and that, notwithstanding the slight downgrade by Standard and Poor's (from AA+ to AA) and the negative outlook added to the Aa1 rating by Moody's, the University still retained excellent overall credit ratings.

(b) Item 11(a) - Report of the Administration: Invitation to Audit Committee members to attend Business Board briefings on the financial situation of the University

The Chair recalled that at the previous meeting, Mr. Chee had reported that he had been asked to provide the Business Board with briefings concerning the financial situation of the University. He had suggested that members of the Audit Committee might well find it worthwhile to attend. Ms Jacqueline Orange, the Chair of the Business Board, had kindly extended an invitation for Audit Committee members to sit in on these briefing sessions and to observe the Board's consideration of other financial items. The Chair said that members of the Audit Committee who would like to attend these briefings would be very welcome and would no doubt find them very informative. The Secretary said that he would distribute to members the dates and locations for the next three meetings of the Business Board, along with the topics to be covered in the briefings as well as other financial items to come forward at each meeting.

(c) Other Matters Pending

The Chair recalled that there were a number of other items arising from the October meeting that would come forward at a later date:

- a report on the University's pension funding strategy, in particular the funding of the current service cost of the pension plan;

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

(c) Other Matters Pending (Cont'd)

- advice from the external and internal auditors on the suggestion that the University produce timely interim financial reports; and
- the plan for an Audit Committee self-assessment.

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2003

The Chair said that the Audit Committee's responsibility was not to conduct its usual detailed review of the financial statements from the point of view of the adequacy of representation and disclosure. The Innovations Foundation was a separate corporation with its own Board, which was responsible for overseeing its operations and approving its financial statements. Rather, the Audit Committee's responsibility was, at the request of the Business Board, to carry out the Governing Council's - the controlling corporation's – stewardship responsibility.

Dr. Adams presented the annual report and financial statements (attached hereto as Appendix "A"). He also spoke to a comparison of the Foundation's financial results to its business plan, which plan had been presented to the Business Board in May 2002 in connection with the Foundation's request for an $8.5-million increase to its line of credit. Dr. Adams explained that the annual report was used in part as a marketing tool, with copies sent to firms in relevant industries and to venture capital firms. The report aggregated all income received, showing total revenue of $4.4-million. The financial statements showed total revenue of $3.8-million. The difference arose from the treatment of a one-time transaction involving Biox Corporation. The proceeds of that transaction were recorded in the financial statements as a reduction in expenses rather than as revenue.

Among the highlights of Dr. Adams' report were the following.

- **Revenues** were the highest in the Foundation's history.
- **Equity stakes**. The Foundation had equity stakes in 40 start-up companies.
- **Community-Sponsored Small Business Investment Funds**. These venture capital funds, in which the Foundation played a key role, had invested over $15-million in start-up companies and had attracted $35-million in co-investments from venture-capital investors, providing a total of $50-million in technology start-ups over the past four years. Those funds had a further $20-million for future investments.
- **Other licensing activities**. A further twelve licenses were being developed by companies other than those receiving investments by the small-business investment funds.

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2003 (Cont'd)

- **Retained revenues** both on an annual and a cumulative basis were very close to those projected in the business plan. Retained revenues were those retained by the Foundation after payments to inventors and to the University.

- **Line of credit**. The balance on the Foundation's line of credit with the University had tracked closely that projected in the business plan. As at the end of the 2002-03 fiscal year, the balance on the line of credit was some $500,000 under the amount projected.

- **Portfolio**. The monies borrowed on the line of credit had helped to secure the Foundation's equity in forty start-up companies, including equity in 12 companies that had been founded with the direct aid of the Foundation, another 16 that had been founded by the Community-Sponsored Small Business Investment Funds in which the Foundation participated, 17 in which the Foundation had received equity (in the form of warrants) in lieu of cash for incubation services, and a further 6 in which equity was received from licenses. (Equity in some companies was obtained by more than one mechanism.) The current value of this portfolio was estimated to be $7-million. The most important equity holdings as at year-end were those in (a) Biox Corporation, a company that was using a new process to convert agricultural seed oils, recycled vegetable oils and other waste facts into biodiesel, and (b) Interface Biologics, a biomaterials company producing technologies to make medical devices more compatible with the human body. Dr. Adams expected the companies in this portfolio to mature without the need for a further inflow of investments from the Foundation.

- **Ranking in Association of University Technology Managers (AUTM) surveys**. A survey of North American technology-transfer managers was completed annually by the managers' association. In the most recent survey for which data was available, the University of Toronto had improved its rank in each category, moving from 42nd to 24th in the number of inventions disclosed, 64th to 41st in the number of licenses and options, and from 21st to 11th in the number of start-up companies arising from University-developed inventions. On average, universities were able to patent one invention for each $2-million in research funding. Dr. Adams hoped that the University of Toronto would reach that average level in 2003-04.

Among the matters that arose in discussion were the following

(a) Transaction with Procyon Biopharma Inc. In response to member's question, Dr. Adams described the transactions with Procyon Biopharma concerning a colon cancer screening technology, which resulted in a $417,000 write-down in the value of shares in the Company. The Foundation had taken ownership of this technology and had sold it to Procyon for $1.5-million plus shares valued at $782,000, producing a gain of nearly $2.3-million. Pursuant to the arrangement that gave the Foundation control of the technology, it paid all of the cash from the sale of the technology, minus legal costs, to the inventors, and the Foundation retained ownership

4. University of Toronto Innovations Foundation: Annual Report and Financial Statements for the Year Ended April 30, 2003 (Cont'd)

of 80% of the Procyon shares received in the transaction, with ownership of the remaining 20% going to the University. As part of the arrangement, the Foundation's shares could not be sold at once, and they declined in value by $416,000 by year-end, with that loss in value being written off. The value of the shares had increased substantially since the end of the fiscal year, but the write-down in their value would not be altered. Dr. Adams anticipated that the shares would increase in value further. Some shares had been sold, and the Foundation hoped to recover at least their original value. The company was an excellent one with four products in phase II clinical trials, and Dr. Adams kept in close contact with management. The Foundation did not have a policy with respect to the sale of its equity positions but exercised judgement in each case.

(b) Ownership of intellectual property arising from contract research. In response to a question, Dr. Munsche commented on the ownership of intellectual property arising from contract research. Previously, ownership of such intellectual property had sometimes been transferred to the sponsoring company. Under revised University policy approved in 2002, ownership was retained by the University and the inventor. The invention could, however, be licensed to the contractor in return for an agreed consideration. While this change had caused some consternation at first among companies that arranged for contract research, it was now becoming more accepted.

(c) Funding of start-up companies. In response to a member's question, Dr. Adams said that the Community-Sponsored Small Business Investment Funds were managed by venture-capital firms that invested in them and made the decisions about which companies to invest in. If a start-up company that was seeking to develop a Foundation-owned invention was not successful in obtaining an investment by one of the funds, the Foundation would seek to help the company find investors elsewhere. The Foundation had a 10% carry from the profits of the funds. If the Foundation signed an agreement to license a technology directly to a company, the Foundation, the inventor and the University shared the revenue according to fixed formulae. The Foundation had four ways to obtain its reward for its role in technology transfer: receiving a share of royalties, receiving a portion of the equity in start-up companies, sharing in the earnings of the Community-Sponsored Small Business Investment Funds, and receiving revenue or warrants from companies in the Foundation-sponsored incubator operation, the exceler@tor.

On the recommendation of the Vice-President, Research and Associate Provost,

YOUR COMMITTEE RECOMMENDS

THAT the annual report and audited financial statements of the University of Toronto Innovations Foundation for the year ended April 30, 2003, a copy of which is attached hereto as Appendix "A", be accepted.

5. Capital Projects: Control Environment

Ms Brown said that the University had underway a very large capital construction program amounting to approximately $800-million. In response to a question, she said that this program made the University the second largest developer in the City at this time, second only to the Pearson airport. The University was not quite half way through the program, with about 60% of the buildings with high priority on the approved capital plan either under construction or at the tender or pre-tender stages. A large amount of building was underway or required at the Mississauga and Scarborough campuses. On the St. George Campus, the three largest projects were the $112-million Bahen Centre for Information Technology, the $88-million Centre for Cellular and Biomolecular Research, and the $75-million Leslie L. Dan Pharmacy Building. There were also several other smaller projects in the capital plan for the St. George Campus.

Ms Brown directed members' attention to her report on the control environment for capital projects, with controls beginning when a division or department identified the need for new space and continuing until the division or department moved into the space. Ms Brown outlined some of the highlights of the report. The over-riding driver of the capital program was the Governing Council Policy on Capital Planning and Capital Projects. The Planning aspects of the capital program were overseen by Professor Venter, the Vice-Provost, Space and Facilities Planning, who (among other things) ensured that recommendations about capital projects reflected the University's academic priorities. Those priorities were reflected in the University's Capital Plan. When individual capital projects were approved in principle by the Governing Council (on the recommendation of its Planning and Budget Committee and its Academic Board) then responsibility for the execution of the projects was assumed by Mr. Bisanti, the Chief Capital Projects Officer. The Financial Services Department remained significantly involved in the process, with responsibility for accounting for capital projects. Mr. Bisanti would proceed to the Business Board to request appropriations for design and site development work. Then, when the projects were designed and plans for each project were completed and tendered, they were taken to the Business Board for review and approval of their execution.

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

(a) Planning process: role of the academic divisions. In response to a question, Professor Venter said that the first step taken by a Principal or Dean who wished to forward a proposal for the construction of new space was a conversation with the Vice-President and Provost. If the Provost was satisfied that the project was necessary to advance the unit's academic plan, she would then discuss the matter with a group that included the Vice-President, Business Affairs, Professor Venter, Mr. Bisanti and others. With the concurrence of that group, the project would be placed on a project-planning path. It might also be assigned to a higher priority of planning with resources to be sought for the project. That would lead to the formation of a project planning committee, which would include officers, faculty members and students from the division as well as appropriate central officers. Notice of the formation, composition and terms of reference of the Project Planning Committee would be submitted to the Planning and Budget Committee. The Project Planning Committee would produce a report, proposing the site for the project, its space plan, its sources of funding, and its estimated cost - an initial costing derived in consultation with Mr. Bisanti's Capital Projects group. The project planning report would then

5. Capital Projects: Control Environment (Cont'd)

be submitted through the Planning and Budget Committee and Academic Board for Governing Council approval. Project Planning Committees were assisted by an internal planning group headed by the Director of Campus and Facilities Planning. That group worked with the Capital Projects Department and, when appropriate, retained external consultants.

(b) Campus Master Plans. Professor Venter said that all three campuses had space-use plans, which identified sites available for building and the size of the buildings that could be erected on those sites. With sites disappearing with the erection of new buildings, it was becoming clear that it would be appropriate to revisit those campus master plans to reestablish priorities for the remaining sites that would be consistent with academic needs. Mr. Bisanti added that the master plan for the St. George Campus was arrived at in negotiations with City of Toronto planners and was incorporated into the zoning by-law for the Campus's part of the City plan. In more recent years, it had become necessary to make special applications to the City's Committee of Adjustment to erect buildings that did not conform to the plan; such applications had been necessary for the Leslie L. Dan Pharmacy Building project and the Centre for Cellular and Biomolecular Research building project, both on the north side of College Street near University Avenue. Mr. Chee observed that the need to make special application had reflected rapidly changing realities and the changing visions and priorities of new Principals and Deans. He observed that there might be need for more restraint in the University's future requests for changes to the master plans. They had in at least one case, that of the Woodsworth College Residence, led to disputes with nearby landowners and to delays and substantial additional cost, amounting to some $800,000 in that case.

(c) Control environment and auditing of capital projects. A member asked how capital projected were audited. Was there a segregation of duties with respect to executing capital projects and also with respect to executing and auditing them?

Ms Brown and Mr. Britt replied that there were two kinds of audits performed with respect to capital projects. The first type was the audit of capital funding for projects funded in part by the Government of Ontario, most recently through its SuperBuild program. Those audits were undertaken by Ernst & Young, which set the scope of the audit, the sampling plan and the materiality requirements. The actual auditing of the sample of transactions was completed by the Internal Audit Department. The auditing tested the propriety of spending for the purpose for which funding had been approved. All of the major projects, including the Bahen Centre for Information Technology, the Centre for Cellular and Biomolecular Research, and the Leslie L. Dan Pharmacy Building were funded in part by SuperBuild and were therefore subject to the capital-funding audits, as were many smaller projects. Professor Venter estimated that about 70% of the projects on the current capital plan received some support from the Province and were therefore subject to the capital-funding audits. In response to another member's question, Mr. Bowman said that there was not a value-for-money component to these audits. Rather, the audits inspected paid invoices for completed work to ensure that the funding for the projects was used for the approved purposes.

5. Capital Projects: Control Environment (Cont'd)

The second type of auditing was the usual program of internal auditing. Mr. Britt recalled that the Capital Projects group had been subject to substantial departmental audits over the past three years, where the focus had been examining the group's business processes. More recently, and continuing into the present, the focus was on contract administration. Audit reports were provided both to Mr. Bisanti and Mr. Chee. Ms Brown added that this additional audit work had been requested by the administration to ensure proper accountability.

In response to the question concerning segregation of duties, Mr. Chee said that the project accounting staff were part of the Financial Services group reporting to Ms Brown rather than the Capital Projects group reporting to Mr. Bisanti. Mr. Bisanti was accountable for completing projects on time and on budget, meeting the requirements of the project planning report.
Mr. Bisanti noted that a third party was also involved. The University's Procurement Department participated in the process for pre-qualifying contractors to bid on University contracts and also participated in the process of opening and evaluating tenders.

(d) Cost controls. Mr. Chee observed that Mr. Bisanti benchmarked the costs of capital projects against the costs of those in the external community. One of his focuses for the year would be to perform attribution analyses where costs depart from the benchmark costs. One factor had become clear: laboratory buildings were expensive to build, and the specific needs of individual faculty researchers added a layer of additional cost, resulting in a premium cost per net assignable square metre compared to commercial buildings. Incurring this additional cost was important and justifiable, but it did mean that it was especially important, with respect to other costs, that buildings be erected as cost effectively as possible. The attribution analysis to be completed would include the cost of special design features. Additional costs frequently arose out of aesthetic concerns, for example the wish for more pleasing but more costly finishes for building surfaces. Projects were reviewed on several occasions: by the academic unit for which the building was being erected and which often had to pay a part of the cost; by the Planning and Budget Committee; and by the Business Board. The question was at which stage of the review should cost discipline be applied. He noted that some very expensive projects were still being undertaken. The project that involved adding two floors to the Rotman School of Management, for example, would cost about $800 per square foot rather than the usual $200 per square foot.

Mr. Bisanti noted other factors causing higher costs for projects. First, because buildings on the St. George Campus were most often on "infill" sites, shoehorned between other buildings, there was no construction staging space, leading to increased costs for moving equipment and materials. This had been reflected in the cost of the New College Residence and would be a factor in the cost of the Centre for Cellular and Biomolecular Research and the new University College Residence. For construction on the Mississauga and Scarborough Campuses, there was usually room for construction staging, leading to lower costs. Second, the construction market was very volatile. At the present time, construction work was in high demand. Because of the double cohort, all universities and colleges were engaged in building programs. After 2003, Mr. Bisanti expected pressures to ease somewhat, with other post-secondary institutions winding down their construction programs and the Pearson airport expansion being completed. There was little office construction currently underway. Mr. Bisanti hoped that the University would be able to take advantage of a softer market in future years.

5. Capital Projects: Control Environment (Cont'd)

Mr. Chee noted that one factor that had added substantial costs in the past was the use of construction management for some projects in order to place building completion of a fast track. Construction had been begun before all design work was completed. This tended to invite discretionary scope changes (see below). In the University environment, it had proven much more economical to proceed to construction when a general contractor could be engaged to take on the full, and fully designed, project and to assume the risks involved in bringing the project in at the contract price.

Mr. Bisanti stressed that the University was now following a highly risk-averse process, with design being completed before construction was begun and with projects being completed by general contractors for a fixed, lump sum.

(e) Scope changes. In response to a question, Mr. Bisanti said that there were two types of scope changes. The first was discretionary changes and arose from changes in the original plans, for example changes to add new facilities. The University sought to keep such changes to a minimum. The second type was unforeseen changes, for example the need to perform additional work that arose because of problems that emerged during excavation. Mr. Chee concurred that it was important to manage expectations in order to keep discretionary scope changes to a minimum. Doing so would mean allowing changes to meet important and sensible emerging needs but not allowing changes simply to cover all interests.

(f) University resources to deliver the capital program. In response to a question, Mr. Bisanti said that he had a staff of 55 to carry out the capital program, including the real estate group of four people, who managed (among other things) acquisitions and dispositions of properties. The overall group included 24 staff members, including architects and engineers, who designed and oversaw smaller projects, primarily upgrades to current facilities. Larger projects were overseen by project managers, with some outsourcing where necessary.

(g) Deferred maintenance. A member observed that it would require about thirty years of funding at the current rate to deal with just the current amount of deferred maintenance. How did the University prioritize needed maintenance work against new construction? Mr. Chee agreed that this was a substantial issue which was only now receiving attention and increased funding. However, that increased funding would still only allow the University to tread water. He noted that one improvement was requiring divisions to undertake responsibility to pay the operating costs of all of their new facilities. Previously, the academic divisions were regarded as neither tenants nor owners of the facilities they occupied. They paid neither rent nor anything like a property tax. That made it very difficult for the University to maintain the divisions' infrastructure. The divisions also did not pay the costs of the utilities they used. With some divisions now taking out loans to pay a part of the cost of new facilities, a transition was taking place whereby the divisions were becoming more like owners. This transition was, however, far from complete.

5. Capital Projects: Control Environment (Cont'd)

(h) Need for new facilities. Professor Venter said that the Council of Ontario Universities (C.O.U.) had prepared space standards in terms of the amount of space per student or faculty member required by post-secondary institutions. The University would take those standards into account in assessing the need for additional space. Notwithstanding the large amount of construction that had been undertaken, the amount of space available on the St. George Campus still fell short of the C.O.U. standards. The amount of space on the Mississauga and Scarborough campuses fell very far short of those standards.

6. Capital Projects: Financial Report

Ms Brown presented the first financial report to the Audit Committee on capital projects. The report was in two parts: (a) a copy of the Report on the Capital Plan for Buildings and Projects in Excess of $2-Million and Other Requirements, which report was tabled regularly at meetings of the Business Board, and (b) a report comparing the actual costs incurred for the projects to the costs projected in the Capital Plan. The latter report had been derived from the financial information that was maintained on each project. Each project was tracked carefully. In many cases, the funding for a project was provided by multiple sources including the Province's SuperBuild program, the Government of Canada's infrastructure funding, donations, pledges of future donations, funds provided by the University, and funds provided by the division, often borrowed internally to be repaid over many years. In other cases, the funding was from a single source. In all cases, the revenue to support the project was tracked carefully. In addition, the expenses incurred for each project were tracked carefully, both "hard" and "soft" costs, and the costs were projected forward in order to derive a forecast of the cost of the project to be compared with the authorized cost.

Ms Brown pointed out that the current capital plan included $298-million of completed projects, $371-million of projects currently under construction or properties being acquired, and $127-million of projects at the pre-tender or tender stage, for a total of $796-million. In addition, section 3 of the report contained a number of other projects in the formative stage; those projects represented aspirations that often could be achieved only if full external funding could be secured.

Mr. Chee added that the $796-million of projects contained in the first section of the report would exhaust the University's borrowing capacity. That presented a conundrum because some of the projects/property acquisitions in section 3 did have to be undertaken / paid for. For example, enrolment at the University of Toronto at Scarborough had expanded, and it was therefore essential to complete the upgrades to its science laboratories. The Medical Arts Building had been purchased and funding had to be found to replace the bridge financing. Of the $796-million group of projects, some funding would be generated over time. The divisions would be making payments on the internal loans ("mortgages") they had assumed to secure financing for their projects. For example, the Faculty of Arts and Science and the Faculty of Applied Science and Engineering were making payments for their share of the cost of the Bahen Centre for Information Technology. Residences and the parking service ancillary would generate revenue over time to repay the cost of their new structures. In addition, it was anticipated that future donations would cover a part of the cost of some new buildings. Mr. Chee and Ms Brown added that the University

6. Capital Projects: Financial Report (Cont'd)

had been very conservative with respect to future donations in its financial planning for the capital program. Where donations or firm pledges were not in hand, it was assumed that the amount would have to be borrowed. Indeed, it was recognized that bridge financing would have to be provided to cover costs while pledges were realized for projects that were going forward, and the value of the pledges had to be reduced to their estimated present value. Professor Venter added that the projects given priority A1A had sole priority for very active fundraising efforts. Other academic divisions were not permitted to solicit donations for their projects from prospective supporters for the A1A projects. Mr. Chee said that the Vice-President and Chief Advancement Officer was closely involved in decisions about priorities for capital projects, along with the Vice-President and Provost, Mr. Chee, Professor Venter and Mr. Bisanti. The objective was to ensure that decisions about priorities included a reasonable assessment of fundraising prospects. All that having been said, Mr. Chee was concerned that the University was running out of means for its capital program as it had reached the edge of its borrowing capacity.

A member asked about the status of the $127-million of approved projects that were still at the tender of pre-tender stage. Was the University committed to moving forward with them? Mr. Bisanti replied that the projects at the pre-tender stage were being designed. All of those approved projects were in queue and moving forward.

Ms Orange said that the Business Board was becoming more educated with respect to the University's financial ratios and was aware that the University was running out of room to maneuver as its reached the edge of its borrowing capacity. In considering future proposals for capital projects, the Board would no doubt ask questions about borrowing capacity and the effect of further debt on the University's credit rating.

The Chair drew members' attention to the second financial report, that on Projected Costs, Revenues and Borrowing Compared to Plan as at October 30, 2003. He asked Mr. Bisanti if he had concerns about any projects running over budget. Mr. Bisanti replied that his Department was vigilant about reviewing schedules with contractors to ensure that projects came in on time. If there were problems, the Department worked with contractors to obtain completion on schedule. The Department also worked diligently to ensure that projects came in on budget. The University tried to work with only the more reputable and stable contractors and to ensure that they were selective in their choice of sub-contractors. While there were always issues to be dealt with, there were no unusual ones.

The Chair proposed an addition to the financial report that compared costs, revenue and borrowing to plan: the addition of a column to show the approximate percent of project completion.

7. Internal Audit Department: Semi-Annual Report

Mr. Britt presented the Internal Audit Department's activity report for the first six months of the 2003-04 fiscal year.

- **Departmental audits**. The Department had issued seven final reports on departmental audits, along with four draft reports. Pursuant to the internal audit plan, a further nine departmental audits were in progress. The budget units were identified in Schedule 1 to Mr. Britt's report.

- **Continuous audits**. Reports had been issued on two quarterly continuous audits, which tested selected types of transactions in all budget units. A further continuous audit was in progress.

- **Special Reviews**. One final report and one draft report had been issued on special reviews. A further special review was in progress.

- **Follow-up reviews**. Four follow-up reviews were in progress.

In addition, 550 audit hours had been devoted to assisting Ernst & Young with the external audit of the 2002-03 financial statements and other audits including: the capital spending audits, the enrolment audit, and the triennial audit of the Ontario Student Assistance Program and of bursary assistance provided with the participation of provincial funding. Information systems reviews included the assessment of the functionality of the new electronic procurement system (the SAP Enterprise Buyer Professional module) as well as the enhancements to the control features of the student records system (the Repository of Student Information or ROSI). Finally, the Department provided internal auditing services to the University of Toronto Asset Management Corporation (UTAM) on a cost-recovery basis. This work was carried out by a senior auditor who worked 60% of full-time on the assignment. In addition, Department staff, working in conjunction with client services staff from the Administrative Management Systems (A.M.S.) group was developing an Internal Audit Department web site. The site would serve as a resource to the University by providing links to policies and procedures and information about internal controls. The site would also include the risk self-assessment for divisions that would enable the divisions to evaluate elements of risk in their management and would enable the Internal Audit Department to prepare its risk-based annual audit plan. Mr. Britt anticipated that the site would be in operation by the end of the year. Finally, Department management had made presentations to groups of business officers/administrative assistants and new academic administrators about effective financial management, internal controls and fraud awareness and prevention.

Mr. Britt reported on the staffing of his Department. The work of the Department had been affected by the absence of two staff members on sick leave. One had returned and the other had resigned and been replaced as of December 1. The Department had carried on with the aid of two contract staff: one Senior Auditor and one Audit/Administrative Assistant. However, a delay in the return of the staff member from sick leave had meant operating below the usual complement for a period of time.

7. Internal Audit Department: Semi-Annual Report

Mr. Britt reported his key findings. In each of its departmental audits, the internal auditors tested for completion of administrative accountability reports. During the first six months of 2003-04, 30.9% (46/149) of the required Administrative Accountability reports were not completed in the departments reviewed. Of the reports not completed, 32 were required from faculty and 14 were required from administrative staff. The rate of non-completion represented a significant increase from the same period in the prior year when the non-completion rate was 8.5%. The large increase in the non-compliance rate arose from the audit of a single academic unit located in one of the teaching hospitals, where 30 of 32 faculty and two of fourteen staff members had not completed the reports. The matter had been dealt with by the Chair of the Department and the Dean, and Mr. Britt anticipated that the problem would not recur. The fourteen reports not completed by administrative staff members were from three departments comprising one central administration function (8), one Faculty central administration area (4), and one academic department. In all cases, there was a misunderstanding of the need to complete the reports by staff members who did not have spending authority but nonetheless had financial responsibilities.

With respect to other audit findings, the internal audit recommendations dealt primarily with the need to improve existing controls and the need for improved compliance with policies, procedures and laws at the divisional level. The internal auditors had received full co-operation, and the department heads of the units audited had either already implemented or had agreed to implement the recommendations included in the audit reports.

A member asked what additional procedures were followed if internal audits identified areas of risk. Mr. Britt replied that risk most often arose in budget units that were too small for appropriate division of financial responsibilities, leaving an individual staff member with the sole responsibility for cash handling, procurement and payroll transactions, giving that individual the opportunity to misappropriate resources. In such cases, the internal auditors stressed the special importance of the unit heads' actively looking after their financial administrative duties, in particular diligently reviewing the financial reports produced by the central financial information system to ensure that there were no inappropriate actions.

8. Administrative Accountability Reports: Annual Report on the Program, 2002-03

Ms Brown presented the annual report on the program requiring administrative accountability reports from each faculty and staff member with financial or administrative responsibility. The report before the Committee included a copy of the accountability report from the President, indicating that he had, among other things, received and reviewed administrative accountability reports from all of the Vice-Presidents and other officers who reported directly to him. The reports of those officers would have indicated their receipt and review of reports from the officers reporting to them and so on down the line.

A member observed that a review of the accountability reports provided to the Vice-President and Provost indicated three negative responses out of a possible 387 responses.

8. Administrative Accountability Reports: Annual Report on the Program, 2002-03 (Cont'd)

He asked about those negative responses. Mr. Piché replied that in all cases one or more administrative accountability reports had not been received on time by the Principal, Dean or other officer reporting to the Provost.

9. External Auditors' Engagement Letter, Audit Plan and Audit Fees

Ms Brouwer outlined the key elements in Ernst & Young's engagement letter, its external audit approach and its audit fee proposal. The material provided by the firm represented a high-level planning document, outlining the terms and scope of the external audit. The principal objective of the external audit was to provide reasonable assurance of the fairness of the financial statements as a whole. Upon completion of the audit, the external auditors would advise the Committee of any issues or concerns that had arisen. The audit approach and engagement letter were largely consistent with those from the previous year. The fees for all auditing work to be completed for the University and its ancillary operations were shown, with the proposed fee for the main University audit remaining unchanged at $110,000.

Ms Brouwer continued that the external audit approach was risk-based, with work focusing on higher risk areas. The audit would look at the internal control environment and identify and test controls to ensure that the audit could rely on them. Among the areas for testing would be donations, payroll and other disbursements. Confirmations and analytic review would be used to obtain assurance with respect to such other matters as government funding. The audit of investments would concentrate on confirmations and reconciliation of manager reports to trustee reports, as well as verifications of the valuation of private equity investments.
Ms Brouwer referred members to the timetable for external audit activities, shown on page 4 of the report. Those activities had already begun and would continue to the end of June. The determination of materiality was an important factor. An item would be considered material if its impact might reasonably be expected to affect the decisions of readers of the financial statements. For most non-profit entities, the level of materiality is somewhere between 0.5% and 2% of revenues. For this audit, an amount greater than $15-million, or 1.2% of 2003 revenues, would be considered material, with smaller items considered material where appropriate, i.e. where they were sensitive or not of a routine nature. The audit would rely on Hewitt Associates LLC to provide actuarial estimates related to employee future benefit costs. Finally, the external auditors would work closely with the University's internal auditors.

In planning the audit, the external auditors reviewed significant developments within the University and outside the University that might affect the University's environment. The key factors reviewed were the following: the University's year-end financial position from April 30, 2003, uncertainties concerning Government funding, the plan for a new $200-million debenture issue to finance capital projects, and the new Ontario Student Opportunities Trust Fund program that would match up to $114-million in endowment donations for need-based student aid.

Mr. Bowman drew members' attention to the external auditors' engagement letter, which was a new version. Among the changes were a stress on the external auditors' responsibilities to

9. External Auditors' Engagement Letter, Audit Plan and Audit Fees (Cont'd)

communicate stated information to the Audit Committee, a clear enunciation of management's responsibilities, some housekeeping in the statement of "Standard Terms and Conditions," and a statement concerning Ernst & Young's operation as a limited liability partnership.

In response to a question, Mr. Chee said that the external auditors had discussed the audit fees with management. Fees for the audits of the ancillary operations had been discussed with the management and audit committees of each operation.

Among the other matters that arose in response to questions were the following. Two audits were required for the University of Toronto Asset Management Corporation because separate, mid-year audited financial statements had been required by UTAM in connection with its application for registration with the Ontario Securities Commission. The consultations in connection with the purchase of the then Colony Hotel were primarily concerned with the Goods and Services Tax and would not affect the financial statements. The fee for consultations on recovery of the Goods and Services Tax on the construction of the Bahen Centre for Information Technology represented a small fraction of the savings realized. In addition to the audits of capital funding performed with respect to projects partly funded by the Province, the external auditors completed further work. The auditors sampled transactions to ensure their propriety.

The Chair drew members' attention to the survey of audit fees charged to Ontario Universities, 1999-2000 to 2001-02. Ms Brown said that publication of the survey was one of the services provided by the Council of Ontario Universities. She urged caution in making comparisons. For example, while a member had noted that audit fees were lower at the University of Toronto than at a smaller Ontario university, that university did not have an internal audit department.

In response to a member's question, Mr. Bowman said that the audit fees and the terms of the audit engagement would enable the external auditors to complete their work satisfactorily.

On motion duly made and seconded, it was RESOLVED

> THAT the Audit Committee accept the external auditors' engagement letter, audit plan and audit fees for the year ended April 30, 2004, as outlined in the report from Ernst & Young dated November 26, 2003.

10. Report of the Administration

(a) Leadership at UTAM

The Chair invited Mr. Chee to report with respect to leadership at the University of Toronto Asset Management Corporation (UTAM). Mr. Chee said that the UTAM Board, at its meeting of November 12, 2003, had made it clear to the President of the University its wish that there be a full-time Chief Executive Officer sooner rather than later. The matter was now in the President's hands, and he had undertaken to resolve the matter early in the new calendar year.

10. Report of the Administration (Cont'd)

(a) Leadership at UTAM (Cont'd)

A member asked whether there was a conflict of roles in Mr. Chee's both serving as interim C.E.O. of UTAM, making investment decisions as asset manager, and serving as Vice-

President, Business Affairs of the University – the chief financial officer of the client of the asset manager. Ms Brown replied that that temporary situation did not differ from the situation at most universities where responsibility for asset management was carried out in-house by a treasurer who reported to the vice-president responsible for business affairs. Indeed, that had been the situation at the University of Toronto prior to the formation of UTAM.

The Chair noted that the situation had been in abeyance for some months. He asked whether the funds were fully invested in the care of external managers. Mr. Chee replied that the funds were fully invested by external managers and (for some fixed-income funds) by UTAM staff. Investment performance during the interim period had been satisfactory.

Mr. Chee, Ms Brown and Mr. Britt stated that they knew of no other matters that should be drawn to the attention of the Committee at this time.

11. Dates of Next Meetings

The Chair reminded members that the next regular meeting of the Committee was scheduled for Wednesday, May 19, 2004 at 4:00 p.m. He commented on the long interval between the November and May meetings, noting that this was one manifestation of the University's not producing regular interim financial reports. At the May meeting, the Committee was scheduled, among other things:

- to consider the draft notes to the financial statements;
- to receive the annual, general risk assessment profile;
- to review the annual report on insurance and risk-management related to insurance; and
- to review the annual report of the Internal Auditor for 2003-04, review the Internal Audit Plan for 2004-05, and hold the annual private meeting with the Internal Auditor;
- to review the audited financial statements for the University of Toronto Asset Management Corporation for the year ended December 31, 2003; and
- to receive a financial report on capital projects.

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11. Dates of Next Meetings (Cont'd)

Members were also asked to set aside a "reserve date" for a possible meeting on March 3, 2004, in the event that any business were to arise requiring the Committee's attention.

The meeting adjourned at 6:15 p.m.

Secretary	Chair

December 18, 2003

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