UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 79 OF THE AUDIT COMMITTEE

November 23, 2005

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, November 23, 2005 at 4:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Mr. George Myhal (In the Chair)
Ms Dominique Barker
Ms Paulette L. Kennedy
Mr. Paul E. Lindblad
Mr. David Oxtoby
Mr. Roger P. Parkinson
Professor Gordon Richardson
Mr. Christopher Sparks
Mr. Mark Weisdorf

Non-voting Assessors:

Ms Catherine J. Riggall, Vice-President, Business Affairs
Ms Sheila Brown, Chief Financial Officer
Mr. Mark L. Britt, Director, Internal Audit Department

Secretariat:
Mr. Andrew Drummond
Ms Cristina Oke (Secretary)

Regrets:
Mr. Gerald A. Lokash
Mr. Richard Nunn
Mr. Robert Weiss

In Attendance:

Mr. Pierre Piché, Controller
Ms Martha Tory, Ernst & Young

ALL ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR INFORMATION.

1. Report of the Previous Meeting: Report Number 78 – October 26, 2005

It was noted that Mr. Weiss had been in attendance at the meeting. Report Number 78 of the meeting of October 26, 2005 was approved as corrected.

2. Business Arising

(a) Report Number 75, November 24, 2004, item 7 - External Auditors' Engagement Letter, Audit Plan and Audit Fees

Ms Brown advised members that a policy on the use of the external auditors for other assignments was being drafted. She reminded members that the external auditor was required to follow rules and guidelines that set out standards of professional behaviour. The policy would be framed around those requirements. Ms Tory added that the

2. Business Arising (Cont'd)

(b) Report Number 75, November 24, 2004, item 7 - External Auditors' Engagement Letter, Audit Plan and Audit Fees (Cont'd)

external auditors also had internal standards of professional behaviour that were, in some cases, more rigorous than those set out by bodies such as the Canadian Institute of Chartered Accountants (CICA).

Ms Brown noted that the Audit Committee received a report each year of all the work done by the external auditors for the University. A member asked how the fees for additional work were determined. Ms Brown replied that the fee for each assignment was determined on a case by case basis.

The Chair asked whether the proposed policy would require that the Audit Committee be notified of each additional assignment agreed to by the external auditors. Ms Brown undertook to bring a draft policy to the next meeting of the Committee.

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

Ms Tory presented the external auditors' engagement letter, plan and fees. She noted that the objective of the audit was to obtain reasonable – not absolute- assurance that the financial statements were free from material misstatement. The internal accounting procedures and systems of internal controls would be considered to the extent necessary to determine the auditing procedures. The work of the auditors did not provide assurance on the internal control structure, nor did the audit procedures necessarily cover all control systems upon which management might be relying. However, a management letter would be issued providing any recommendations regarding opportunities for improvement to internal controls, based on observations made during the course of the audit.

Ms Tory explained that, consistent with past years, controls would be identified and tested in connection with the audit of donations, payroll and other disbursements. For other balances, audit procedures such as confirmations and analytical review would be used to obtain audit assurance.

A member asked whether the proposed fees changed during the audit. Mr. Piché replied that the external auditors were held to the proposed fee. Ms Tory added that a separate bill would be shown for special circumstances.

The Committee reviewed the timetable for the audit. Between January and March, the external auditors would update their understanding of the University's systems, develop the overall audit plan, evaluate internal control at the entity level, including fraud controls, perform combined (inherent and control) risk assessments, and develop a customized audit approach. In May and June, the audit procedures would be performed, the review of final audited financial statements would be completed, the results of the audit would be discussed with senior management, and the results would be reported to the Audit Committee.

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

Ms Tory informed members that materiality for the University had been determined to be an amount greater than $15 million, which represented approximately 0.9% of the proposed total revenues in fiscal 2006 of $1.6 billion. Hewitt Associates LLC, the University's actuaries, provided the actuarial estimates that were required to account for employee future benefits cost.

Ms Tory noted that it was now a requirement that investments be reported at market value. The University was already doing that. A significant development in the current fiscal year was the debt offering made by the University in the fall of 2005.

It was noted that the reference to the Innovations Foundation in paragraph 14 of Appendix A on page 9 should be removed.

A member asked if the fees proposed in Appendix B were all audit-related, and if the private placement was an audit fee. Ms Brown replied in the affirmative.

The member asked if non-audit fees could be identified. Ms Brown replied that opportunities to recover tax matters arose periodically. Issues that might arise could be related to a SAP upgrade, the debenture offering, parking garage financing, and arrangements with the University of Toronto Schools.

A member commented that the Committee would receive a report of non-audit assignments at the end of the year, and that the expense of those assignments was a small portion of the amount of tax that was recovered.

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, 2006, as outlined in the report from Ernst & Young dated November 1, 2005.

4. Capital Projects Financial Report

The Chair reminded members that, in the light of the size of, and risks associated with, the University's capital program, this report was presented each fall and each spring.

Ms Brown reviewed the variance report on the Capital Plan, noting that a column on the initial approved cost had been added in response to members' requests. She reminded members that the Vice-President, Business Affairs had the authority to approve increases of up to 10% of the original cost, to a maximum of $2 million. Increases greater than that amount had to be resubmitted to the Planning and Budget Committee and proceed through the Academic Board to the Governing Council.

Ms Brown explained that the intent was to complete capital projects on time and on budget. However, circumstances sometimes changed once work on the project had begun. She highlighted three major capital projects and explained why it had been

4. Capital Projects Financial Report (Cont'd)

necessary to increase the original budget for each of these projects. She noted that there had been lengthy debate about the increased project budgets at the relevant Boards and Committees.

The original budget for the Terrence Donnelly Centre for Cellular and Biomolecular Research (CCBR) had been approved for $85.10 million. A donation from Dr. Donnelly had resulted in a change in scope for the project, and an increased budget of $96.6 million had been approved.

The original budget for renovations to 155 College Street had been approved for $24.14 million. Exploratory design work had revealed the need for additional upgrades to the mechanical and electrical infrastructure, and the budget increased to $28 million.

The University College residence project had an original budget of $22 million. The tenders received for the project were all greater than had been estimated, and the budget increased to $28 million.

A member commented that the report reflected an impressive accomplishment by the University. Ms Riggall stated that the University of Toronto was the largest developer in Toronto, and that the skills of the groups involved in project management had increased over the past few years.

A member asked how the University determined whether high quality work had been done. Ms Riggall replied that each capital project remained open for a year after the building had opened to make sure that all the required work had been successfully completed.

A member asked how priorities for capital projects were established. Ms Riggall replied that academic priorities drove capital project decisions. Each project had to meet a 9 point set of criteria. [1]

5. Internal Audit Department: Semi-Annual Report

The Chair reminded members that this item was for information. No Committee action was required, but the Committee should make known any concerns, tender any advice, or request any follow-up report(s) if appropriate.

[1] The nine criteria by which all capital projects are assessed are:

1. Mission Objectives of the University, 2. Policy Objectives & Legislative Requirements,
3. Provincial Space Standards, 4. Strengthening Scholarship,
5. Providing Academic Leadership, 6. Student Experience,
7. Economic Consistency, 8. Resources,
9. Deferred Maintenance.

5. Internal Audit Department: Semi-Annual Report for the Six Months Ended October 30, 2005 (Cont'd)

Mr. Britt presented the highlights of his semi-annual report.

- **University auditing activities**.

The Department had, as at October 31, completed nine reviews, of which seven were departmental audits, one was a continuous audit, and one was a follow-up review. There were fifteen reviews in progress, of which nine were departmental audits, one was a continuous audit, one was a special review and four were follow-up reviews. Actual audit hours were 4,050 from a staff complement of 7.2 FTE, compared to the plan of 4,550 hours from a staff complement of 8.0 FTE. The variance was due to the departure of a Senior Auditor in June, as well as utilization of vacation credits during the summer. To date, recruitment efforts had been unsuccessful.

Approximately 500 hours of assistance had been provided to assist the external auditors with the year-end audit of the University's financial statements, the enrolment audit, and Ministry-funded review of capital spending projects.

- **UTAM auditing**.

The Department had provided internal audit services to the University of Toronto Asset Management Corporation (UTAM) on a cost-recovery basis. That work had been carried out by a dedicated 65% full-time-equivalent senior auditor, and had been planned and completed under Mr. Britt's supervision. The total audit hours provided to UTAM had been 425 hours.

- **Other departmental activities.**

Mr. Britt reported that Department management had made presentations to groups of business officers/administrative assistants and academic administrators about effective financial management, internal controls and fraud awareness and prevention. Management had participated as members of committees involved with developing checklists for ensuring compliance with the Policy on Contracts and Execution of Documents, revising the University's taxation manual, and developing the University's new budget model, as well as the IT Technical Operations Committee.

- **Administrative accountability reporting**.

Mr. Britt reported that there had been a low rate of non-completion with administrative accountability reporting. Of the 87 reports required to be completed in the departments reviewed, nine or 10% were not completed, of which two were required from faculty and seven from administrative staff.

5. Internal Audit Department: Semi-Annual Report for the Six Months Ended October 30, 2005 (Cont'd)

Risk Based Audit Report

Mr. Britt noted that the Internal Audit Department used a risk-based audit approach to evaluate critical business processes and internal-control systems within the unit being audited. The approach used risk-identification and assessment tools and procedures based on the Business Risk Model Definitions. The assessment included testing the effectiveness of local unit as well as centralized systems of internal control that managed the identified risk in order to determine the significance of any residual risk. Residual risk indicative of significant internal control deficiencies that could impact the attainment of the unit's or University's objectives were reported to unit management and University's senior management.

The following conditions that resulted in increased residual risk had been identified:

- lack of business resumption/disaster recovery plans for space management operations and a student residence;
- non-compliance with income taxation requirements for payments to individuals;
- lack of effective control over revenue collection and cash handling activities,
- lack of compliance with authorization protocols for payments, contracts and expense reimbursement claims, and, in several cases,
- lack of segregation of incompatible duties.

Mr. Britt concluded his report by stating that the heads of the units audited had either already implemented or had agreed to consider and where possible implement the recommendations included in the audit reports.

A member asked why department heads would not implement recommendations. Mr. Britt replied that department heads had the discretion to accept Internal Audit recommendations and to implement action plans accordingly or to reject the recommendations thereby accepting the risk in question. In those few cases where recommendations were not implemented, the decisions was often affected by resource considerations. For example, the department head might give higher priority to hiring a faculty member needed for an academic program rather than increasing administrative staff to improve financial management.

A member asked how well cash was handled at the University. Mr. Britt replied that the University had a better procedural framework for handling cash than many other institutions. Ms Brown added that most cash transactions were handled by the centre. These transactions included tuition fees and research grants.

A member noted that the budget for the Internal Audit department had been under pressure a few years ago, and asked whether recruitment efforts were hampered by the salary that was being offered. Mr. Britt replied that the University's Human Resources department was surveying salaries in private sector and public accounting firms. The

5. Internal Audit Department: Semi-Annual Report for the Six Months Ended October 30, 2005 (Cont'd)

appropriate resources could be assembled if the right person was found. Unfortunately, the number of qualified candidates for the position had decreased.

A member asked whether the disappearance of electronic equipment was still a matter of concern. Mr. Britt replied that it was not a matter of concern.

A member asked whether the improvement in the completion of accountability reports was a matter of luck. Another member noted that one Dean would not provide progress-through-the-ranks (PTR) increase to faculty who did not complete accountability reports.

A member asked whether deferred-maintenance risk should be included with other identified risks. Mr. Britt replied that deferred-maintenance risk was addressed at the institutional level, rather than at the level of internal audit. Ms Riggall added that, in May 2005, the provincial government had provided the University with $25 million to fund deferred-maintenance projects.

A member asked about the relationship between the risk factors defined in the Internal Audit Report and the Risk Profile prepared by the Chief Financial Officer. Mr. Britt replied that Internal Audit took the Risk Profile and determined which parts of the profile applied to units being audited. Ms Brown noted that broad-based risks were added to the departmental risk profiles to create the University's overall Risk Profile.

6. Reports of the Administration

a) Freedom of Information and Personal Privacy Act (FIPPA)

Ms Riggall reported that the Freedom of Information and Personal Privacy Act (FIPPA) had received third reading. The University would be subject to the provisions of the Act on June 12, 2006. It would have to set up a process to be able to reply to requests made under the Act within 28 days of receiving the request.

Ms Riggall noted that some exemptions would be allowed under the Act, including information about donors, research, and personnel. The Act had implications for access to personal information stored in archival collections.

A member asked whether any financial support would be available for the implementation of FIPPA. Ms Riggall replied that no financial support would be provided to institutions.

b) University Debenture

Ms Brown reminded members that, in June 2004, the Business Board had approved borrowing of $150 million for capital projects. On November 16, 2005, the University had issued a 40-year debenture for $75 million with an interest rate of 4.937%. A

6. Reports of the Administration (Cont'd)

b) University Debenture (Cont'd)

member asked if the University would be borrowing the remaining $75 million. Ms Brown replied that allocations against the remaining amount had not yet been made. A member asked about the University's debt versus its credit capacity. Ms Brown replied that the internal borrowing capacity for loans from the University's Expendable Funds Investment Pool (EFIP) was $200 million, while the external borrowing capacity was 40 per cent of net assets smoothed over five years, which was approximately $587 million as at April 30, 2005. Ms Brown commented that the borrowing strategy would be reviewed in the next few months.

A member asked whether the University's access to debt markets was an anomaly. Ms Brown replied that a number of universities in the United States had credit ratings.

A member asked whether there was an internal sinking fund. Ms Brown replied that internal loans were amortized with combined principal and interest payments being made to the sinking fund that would be used to pay debt. The member asked how the University avoided a negative spread. Ms Brown replied that the thirty to forty year term of the debenture was matched to an average 18 year amortization for the internal loans. The loans were priced at market, with 100 basis points, or 1%, over the interest rate on Canadian government bonds for the same terms built into the loan payment.

A member asked whether the University could borrow funds to address issues of deferred maintenance and operating costs of its aging buildings. Ms Riggall replied that some approved projects had renovation and deferred maintenance components. However, academic priorities drove capital spending.

7. Dates of Next Meeting

(a) Wednesday, March 22, 2006 at 4:00 p.m.
(b) Wednesday, May 17, 2006 at 4:00 p.m.
(c) Wednesday, June 21, 2006 at 4:00 p.m.

8. Other Business

There were no items of other business.

The meeting adjourned at 5:40 p.m.

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Secretary Chair

March 13, 2006
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