UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 57 OF THE AUDIT COMMITTEE

June 21st, 2000

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, June 21st, 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
Dr. Marlene Puffer
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 Wanda M. Dorosz
Mr. Roger P. Parkinson
Ms Penny Somerville

In Attendance:

Mr. Keith B. Bowman, Ernst & Young*
Ms Diana Brouwer, Ernst & Young*
Ms Sheila Brown, Controller and Director of Financial Services**
Professor Jack Gorrie, Provost's Special Advisor on Information Technology***
Mr. Donald W. Lindsey, President and Chief Executive Officer, University of Toronto Asset Management Corporation****
Mr. Pierre Piché, Associate Controller**
Ms Deborah E. Simon-Edwards, Executive Assistant to the Chief Financial Officer**

* Absented themselves for the consideration of item 3.
** Absented themselves for the consideration of item 8.
*** In attendance for item 4.
**** In attendance for item 2.

ITEMS 2 AND 3 ARE RECOMMENDED TO THE BUSINESS BOARD FOR ITS RECOMMENDATION TO THE GOVERNING COUNCIL

1. Report of the Previous Meeting

Report Number 56 (May 24th, 2000) was approved.

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000

The Chair noted that the audited financial statements were before the Committee for recommendation to the Business Board, whence to the Governing Council. The five-page "Financial Highlights" (contained in the Financial Report), and the Supplementary Financial Report were for information only. The Audit Committee's responsibility was an important one, with the Governing Council and the Business Board relying on the Committee for a careful review of the financial statements. This point was made clear in the Statement of Administrative Responsibility on page 6 of the Financial Report, in the penultimate paragraph, which described the Audit Committee and its responsibility. "Governing Council carries out its responsibility for review of the financial statements and this annual report principally through the Business Board and its Audit Committee. The majority of the members of the Audit Committee are not officers or employees of the University. The Audit Committee meets regularly with the administration, as well as the internal auditors and the external auditors, to discuss the results of audit examinations and financial reporting matters, and to satisfy itself that each party is properly discharging its responsibilities. The auditors have full access to the Audit Committee with and without the presence of the administration."

Mr. White reiterated the importance of the work of the Audit Committee in reviewing the financial statements. The Business Board relied a great deal on the Committee's careful review. The year end had been a good one. First, the work of preparing the statements had proceeded very well. Ms Brown and Mr. Piché led an experienced team in the Financial Services Office. The Financial Information System was now in its fifth year of operation, and the 2000 year end was the first completely without technical problems. Second, the audit had been a clean one. The external auditors had advised that they would not be issuing a memorandum of recommendations arising from the audit. While they had made a number of observations during the course of the audit, such as a concern about computer backup, and while they would convey those concerns to the administration, none of those observations currently appeared to be of sufficient weight to merit a management letter to the Committee. The working relationship between the auditors and the University's staff had been a good one, with staff making every effort to provide the auditors with information in a timely manner. Third, the numbers showed that the University was in a strong financial position. Fourth, the information provided in the financial statements and related documents was very good - improved over the previous year. The 1999-2000 statements were the third ones in the new format. The "Financial Highlights" section had been improved over the previous year. Mr. White thanked the Chair for a number of valuable suggestions, and invited suggestions from members for further improvements.

With respect to the financial results for the year, Mr. White observed that the operating fund results were very close to those contained in the budget, and they were better than those predicted in the financial forecast presented to the Business Board in March.

2. <u>Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000</u> (Cont'd)

Ms Brown presented the highlights of the financial statements package and responded to numerous questions.

- **Sources of funds**. On page 1 of the "Financial Highlights," a pie chart displayed the sources of "funds" received by the University. This represented a change from the previous year, when the pie chart displayed the sources of "revenues" as defined by generally accepted accounting principles (GAAP). Total funds received included donations added directly to the endowment and grants received but not spent by the end of the fiscal year. It was valuable to display all funds received in order to recognize the outcome of efforts to obtain funds from all sources and for all purposes. Of the \$1.4-billion of funds received, \$1.1-billion was recognized as revenue in the financial statements.

  Ms Brown displayed an alternative pie chart that compared the proportion of funds received in each category in 1999-2000 with the proportion in the previous year. For example, government grants for general operations had formed 32.7% of funds received in 1998-99 but only 26.4% in 1999-2000. Student fees had represented 22.5% of funds received in 1998-99 and 20.3% of funds received in 1999-2000. A number of members expressed the view that using the chart containing the comparative information would be helpful to the readers of the financial statements.

  Mr. White noted that the comparative information was valuable, but it could also be misleading. A number of large changes had taken place in funding sources in 1999-2000. Grants for capital infrastructure had increased from 1.0% of funds received to 6.5%. Investment income on endowments had increased from 2.9% to 10.2%. Those two large increases had the effect of reducing the proportion of all other funding sources. For example, student fees had increased substantially, with the revenue from that source increasing from \$238-million to \$275-million. Yet, the proportion of funding received from student fees had declined from 22.5% to 20.3%. Some readers of the *Financial Report* might well find that proportional decline difficult to understand.

  Members thought that the comparative figures would still be preferable. It was very useful to see the changes over time in the sources of finding received. Indeed, it would be useful to have a chart showing the amounts of funding received in the various categories over a number of years. The pie chart in the "Financial Highlights" document was backed up by full information in the *Financial Report*. The pie chart could be improved by showing the year-over-year change in the total funds received. That would show, for example, that while student fees represented a smaller proportional slice, it was a smaller slice of a larger pie. The Chair concluded that the Committee generally would favour the use of the comparative figures in the pie chart but not insist on it.

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000 (Cont'd)

- **Statement of Operations and Changes in Deficit**. The deficit on the year's operations had been $1.5-million, bringing the cumulative deficit to $11.7-million. That was in line with the University's financial plan.

- **Transfers**. Transfers for the year had been $69.5-million. They included mainly: (a) the transfer of donations (net of campaign expenses) to endowments, and (b) the transfer of income earned on internally designated endowments back into the endowment funds for capital preservation. The latter transfer had amounted to $50.6-million, reflecting the good investment return earned on the endowment. This amount included interest, dividends, and both realized and unrealized capital gains.

- **Investment income from endowments**. Total investment income on endowments, both those so designated by benefactors and those internally designated by the University, had amounted to $137.5-million, a sharp increase from $30.5-million in 1998-99, when the Canadian securities markets had provided poor returns. Of the $137.5-million of investment income on endowments, $92.4-million had been set aside for capital preservation and $45.1-million available for spending. The $92.4-million set aside for capital preservation consisted of two elements. The $50.6-million earned on internally designated endowments was recognized as revenue, according to GAAP rules. The remaining $41.8-million, earned on donor-designated endowments, was not recorded as revenue but was accounted for as a direct addition to the capital of the endowments.

  Ms Brown noted that the total amount paid out from the endowment to support University operations had doubled over the past four years, since 1996-97. That payout had been increasing over the years, notwithstanding the poor investment returns in 1998-99, when the payout prevented any money's being set aside for capital preservation and in fact required a draw on funds set aside in prior years for capital preservation. That draw was made up, and then some, by the 14% return on the endowment in 1999-2000. This illustrated the success of the University's Policy for the Preservation of the Capital of Endowment Funds, which (a) required the long-term preservation of the value of endowment capital against erosion by inflation, and (b) also provided for a long-term, smooth, increasing amount for spending. Most endowments were invested in the Consolidated Investment Pool, with individual endowment funds holding units in the Pool. The objective was to have a payout of 5% of the average unit value of the Pool smoothed over the past four years. The outcome had been an increase from a payout of $6.42 per unit in 1998 to $8.32 per unit in 2000. The higher total payout was a function of both the higher payout per unit and the larger number of units. The total market value of the endowment funds had increased by over 60% since 1997, the outcome of good investment returns, the capital preservation policy and successful fundraising.

2. <u>Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000</u> (Cont'd)

- **Student fees and student aid**. Revenue from student fees was $275-million, an increase of over 40% since 1997. Expenses for scholarships, fellowships and bursaries was $56-million, an increase of 136% since 1997. Spending on student financial support had increased consistently as a proportion of fee revenue over the past four years. This demonstrated the operation of the guarantee contained in the University's Policy on Student Financial Support, which provided that "no student offered admission to a program at the University of Toronto should be unable to enter or complete the program due to lack of financial means."

  In response to a member's question, Ms Brown said that the $56-million represented the University's own spending; it did not include the Ontario Student Assistance Program.

- **Donations** received over the year had again exceeded $100-million. Total donations of $102.2-million included $49.5-million that was recorded as revenue and $52.7-million that was added directly to endowment capital. Donations in 1999-2000 had actually declined from $113.8-million in the previous year, but 1998-99 had been an exceptional year, including the deadline for the double-matching of donations under the Ontario Student Opportunities Trust Fund program. The Campaign had been achieving extraordinary success over the past four years, with total receipts of $386.1-million. In response to a question, Ms Brown said that the current Campaign target was $575-million, and the Campaign was scheduled to continue for a further two years. Campaign efforts were being maintained at a high level and had enjoyed astonishing success even in the few weeks since the fiscal year end. Mr. White added that Dr. Jon S. Dellandrea had recently agreed to stay on as Vice-President and Chief Development Officer for at least a further eight years, and he planned to maintain the momentum of the Campaign.

- **Government and other grants and contracts received for restricted purposes**. Restricted grants and contracts had grown steadily over the past three years, reaching $296.1-million in 1999-2000. The most dramatic aspect of the increase for 1999-2000 had been the $95.8-million of support for capital infrastructure from such sources as the Ontario SuperBuild Growth Fund. This was an increase of $74.5-million from the capital infrastructure support provided in 1998-99. This money would support the building of the Bahen Centre for Information Technology, the planned Health Sciences Complex and other projects. Grants and contracts for research projects had also increased dramatically, by $54.7-million, to a total of $200.3-million. Sources of support included the new Canada Foundation for Innovation and the Ontario Research and Development Challenge Fund. Of the $296.1-million of restricted funding received during 1999-2000, $127.5-million was recorded as revenue and the remaining $168.6-million was recorded as deferred revenue for future spending on research projects and capital infrastructure. That had a significant effect on the balance sheet. The obligation to use this money for the restricted purposes for which it had been provided had to be recorded as a liability as at the 1999-2000 year end, resulting in an increase in the total liability for deferred

2. **Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000** (Cont'd)

contributions from $157-million to $207.3-million and to the increase in the liability for deferred capital contributions from $200-million to $318.4-million. In response to a question, Ms Brown said that these liabilities included only externally designated grants; they did not include matching funding provided by the University at its own discretion.

- **Ontario Government operating grant**. The operating grant had remained relatively flat over the past several years, increasing by a total of 3.5% over the past four years. With the increase in other sources of funds, government operating grants were representing a declining proportion of the University's revenue and of its total funds received.

- **Expenses**. Year-to-year changes in each of the categories of expense had been much smaller than the changes within categories of income. Salaries and benefits remained the largest category of expense. It had declined from 58.1% of spending in 1998-99 to 57.8% in 1999-2000. Significantly more had been spent on student aid and on research projects, the latter category mirroring the increased research support.

- **Balance sheet: net assets** as of April 30th had increased from $1.361-billion in 1999 to $1.548-billion in 2000. The largest component of the net assets was represented by the endowed funds, amounting to $1.171-billion as of April 30th, 2000. Funds committed for specific purposes amounted to $226-million, including $76-million of departmental trust funds, $74-million set aside and invested in the special fund to match the University's obligation under the Supplemental Retirement Arrangement, and $29-million of unexpended operating funds (see below). The investment in capital assets amounted to $162-million, including buildings, equipment and library books, all recorded at cost and excluding accumulated amortization.

- **Balance sheet: liabilities** had increased by 41% since 1999, largely as the result of the need to record deferred contributions and deferred capital contributions, representing government grants and donations received for specific purposes where the funds had not yet been spent to achieve those purposes. (See "Government and other grants and contracts received for restricted purposes," above.)

- **Funds committed for specific purposes: unexpended operating funds**. Among the funds committed for specific purposes were the unexpended operating funds, amounting to $28.7-million. The details of those funds were provided in Supplementary Schedule 3. In some cases, divisions had not expended all of their appropriations from 1999-2000. In all cases, a plan was in place showing the purposes for which those funds were to be used, including such things as large equipment purchases, start-up costs for new faculty appointees, payment of replacements for faculty members who would be on research leave, and meeting the costs of one-time-only budget reductions imposed on all divisions to control the accumulated operating fund deficit. In some other cases, divisions had incurred deficits. The largest of those was the planned $10.8-million planned deficit for the costs of the fundraising Campaign. That deficit would be repaid by investment

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000 (Cont'd)

earnings on donations, held back from their designated use for a period of four months, and from a small levy on the investment earnings on all endowment funds. Academic divisions carrying deficits included the University of Toronto at Scarborough ($4-million), the School of Continuing Studies ($1-million), the Rotman School of Management ($711,000), and the Faculty of Dentistry ($582,000). In all cases, the Vice-President and Provost required plans for the elimination of the deficits.

- **Cumulative deficit**. The University's net assets were reduced by the amount of the accumulated deficit, which was $11.7-million as at April 30th, 2000.

- **Endowment funds**. The largest portion of the endowment funds, amounting to 42.5%, was dedicated to funding student aid. A further 22% was dedicated to funding endowed chairs and professorships. 17.5% supported research endeavours. 15% supported academic programs. An amount of $27.5-million represented uncommitted endowed funds available to match future donations. This amount had been declining significantly over the past four years as uncommitted endowment funds had been used for matching funds to attract donations. In response to a member's question, Ms Brown said that the various participating endowments had units in the Consolidated Investment Pool. The payout for each unit was 5% of the average market value of the units over the past four years.

- **Operating fund results**. Considering only the operating fund (i.e. setting aside the results of the capital fund, the ancillary operations fund, and the restricted funds, including the endowment funds and the funds for research grants and contracts), the University had completed the 1999-2000 year with an operating deficit of $251,000, compared to a budgeted surplus of $300,000. That represented an outcome that was very close to budget in an operating fund with revenues of $725-million. The result brought the cumulative deficit in the operating fund to $5.3-million, well within the limit of 1.5% of operating revenue established by Governing Council policy. The maximum deficit permitted under that policy would be $10.1-million.

- **Revision to the notes**. Ms Brown recalled that the Committee had, at its previous meeting, reviewed the draft notes to the financial statements. In response to a member's question, note 10(c), which dealt with unexpended operating funds, had been reworded.

- **Financial Highlights: deferred maintenance and renewal**. Ms Brown drew members' attention to page 5 of the "Financial Highlights," which dealt with deferred maintenance and renewal. The University of Toronto was participating with other Ontario universities in a study to develop a consistent definition of deferred maintenance that would be applied across all Ontario universities.

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000 (Cont'd)

The Chair thanked Ms Brown for her excellent presentation. A member expressed particular praise for the charts and graphs which clearly showed the trends that were developing over the past four years.

Among the matters that arose in discussion were the following.

(a) Investments. A member asked whether the new University of Toronto Asset Management Corporation (UTAM) planned to change the asset mix and therefore the risk profile of the endowment funds. Mr. Lindsey noted that the University itself, rather than UTAM, would have to specify its risk tolerance and therefore the desirable risk/return trade-off. In Mr. Lindsey's view, the best definition of risk was uncertainty of return. For the endowment funds to provide the resources needed by the University to support its operations, it was important not only to achieve a very good investment return but also to avoid a situation whereby returns were, say, 14% last year and only 2% in the forthcoming year. The best means of combining the two objectives was a portfolio that stressed equity investments, which should over the long term provide a return of between 10% and 12% per year, and also to diversify the equity portfolio broadly to keep volatility to the lowest level possible. For example, in the 1998-99 fiscal year, the investment return provided by the endowment funds had been poor owing primarily to the poor performance of the Canadian equity market, notwithstanding good returns in the U.S. market. For the 1999-2000 year, however, the situation had been largely the reverse, with the Canadian market providing a return of about 20% and the broader U.S. market almost flat. This led to the strategy of spreading investments among as many markets as possible in order to ensure that the endowment fund would always capture the areas of good return and, in so doing, reduce the uncertainty of the stream of investment returns. UTAM would likely pursue this diversification strategy in two ways. First, Mr. Lindsey would propose the adoption of a North-American benchmark rather than individual Canadian and U.S. benchmarks. That should enable portfolio managers to work in a broader and more diversified investment environment rather than adopting a narrow national focus. Second, UTAM would continue and extend the University's investments outside of North America, which might well outperform North American investments over the next five to ten years. Performance would be measured against appropriate, broad benchmarks and against the returns provided by a universe of comparable funds. In short, Mr. Lindsey proposed accepting the risk of the overall, world-wide equity markets and seeking to reduce the volatility of returns by diversifying equity investments broadly. In addition, the endowment fund should hold some bonds as a deflation hedge and as a back-up during downturns in the equity markets.

A member asked whether the endowment fund would be invested in a manner that stressed long-term holdings or whether there would be active trading. Mr. Lindsey replied that it would be important to diversify not only geographically but also according to investment style. It would be important to have portfolio managers with a growth style of investing and a value style as well as appropriate diversification geographically and across industrial sectors. Having done that, however, it would be wise to ensure that there not be too much activity in the management of the Pool. For example, making shifts in asset mix would mean incurring substantial transaction costs. Moreover, it was necessary to have the right timing both for the shift from the

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000 (Cont'd)

normal asset mix and then back again, for example from the usual level of stocks to more bonds, and then back to the usual level of stocks. Therefore, Mr. Lindsey took the view that it was best to have the right long-term asset allocation and to stick to it.

The Chair noted that a conservative asset allocation that avoided risk could well lead to returns that were inferior to those of the overall market. Presumably asset allocation had to be determined by the desired long-term return. Mr. Lindsey noted that the University Funds Investment Policy specified that the normal asset mix for the Consolidated Investment Pool was 70% equities and 30% fixed-income investments. That asset mix established the basic risk profile desired by the University, although the policy also left some flexibility. UTAM would, within the policy's constraints, seek the best possible risk-adjusted return. It would seek out the best possible equity investments, while using fixed-income instruments to control volatility. In so doing, UTAM would not take on unreasonable risk; for example, it would not make all investments in the technology sector. It was appropriate to surrender some potential return in order to control volatility. By and large, it would be fitting to seek at least an average return, but with less volatility, hence avoiding the roller-coaster ride that could cause real problems for the University and its divisions in their financial planning. The key to controlling volatility was to sacrifice some potential upside to control the downside.

The Chair asked whether UTAM's compensation policy would reward not only high returns but also risk avoidance. Mr. Lindsey replied in the affirmative. Performance would be measured against broad market indices. That would discourage taking on a great deal of risk by departing radically from the benchmark, but it would encourage reasonable decisions that could add some significant value above the index return.

A member asked whether the Asset Management Corporation would serve as a manager of managers or whether it would manage some part of the University's portfolios internally. Mr. Lindsey replied that at this time, UTAM would serve as a manager of managers. After UTAM had a year or two to build up its staff, it might well undertake in-house bond management. That would allow some cost saving and it would enable UTAM to customize bond investments to meet the University's cash-flow needs. Having a bond manager on staff would also provide UTAM with a valuable resource - an individual with up-to-the minute awareness of market developments. Mr. Lindsey did not foresee in-house management of equities; its asset base was too small to allow active management of equity portfolios.

In response to a question, Mr. Lindsey said that the University's use of derivative financial instruments was a very prudent one. The derivative investments provided cost-effective exposure to broad market indices such as the Standard and Poor's 500 Index of large U.S. corporations or the Morgan Stanley Europe / Far East / Australasia (EAFE) Index. The investments were cost-effective because they were index investments, not requiring the payment of substantial fees to portfolio managers to select stocks actively. The investments were prudent because there was no leverage - no use of the derivative instruments to take bets on the markets without having underlying cash. The full notional value of the derivative instruments - stock-

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000 (Cont'd)

index futures contracts - was invested in safe and liquid money-market instruments. If the value of the indices should decline, moneys would be taken from the money-market investments to meet the resulting obligation to pay the counterparty of the futures contract.

(b) Effect of the new arrangement for investment management on the financial statements. In response to a member's question, Ms Brown said that the assets being managed by UTAM would continue to be University assets and the earnings from those investments would continue to be recorded in the University's accounts and reflected in the financial statements in the same way as before. UTAM itself was a separate corporation, wholly controlled by the University, with its own budget and financial statements. As a wholly controlled corporation, its operations and financial position would be consolidated into the University's financial statements. There should be no material difference, from the point of view of the financial statements, from the situation up until April 30th, 2000, when investment management was overseen by University staff.

(c) Deferred maintenance and renewal. A member noted the statement in the "Financial Highlights" that "the University's deferred maintenance and capital renewal requirements are currently estimated at $210 million." Did the University's participation in the Ontario study of deferred maintenance indicate its view that the $210-million was too high? Ms Brown replied that the projects on the deferred maintenance and capital renewal list covered a broad range of need. Those projects included, for example, chillers that were past their maximum suggested life that should be replaced as soon as possible to avoid system breakdowns. However, the list also included the replacement of worn carpets that presented no safety hazard. Some of the items on the list might be regarded not as deferred maintenance but rather as items of regular renewal. The objective of the Ontario-wide study was to develop rigorous definitions in order to ensure consistency of reporting among the universities. That would serve as the basis for dialogue with the Government of Ontario with respect to funding for clearly understood deferred-maintenance needs.

In response to a question, Ms Brown said that the University had made good progress during 1999-2000. A Government facilities renewal grant was supplemented by $6.5-million of University spending to provide a total investment of $14.5-million. The University currently estimated that it would require $15-million per year in order to deal with its deferred maintenance needs.

The Chair expressed some concern with the wording of this section of the "Financial Highlights." On the one hand, the University provided an estimate of $210-million for deferred maintenance and capital renewal, a number consistent with previous years. On the other hand, the document stated that "we believe that the deferred maintenance component is significantly less." The section then stated that the need over the next four years was forecasted to be $15-million per year. While it was understandable that there would be a differentiation between needed deferred-maintenance work and other work that was merely desirable, the Chair did stress the importance of disclosure of any contingent liability represented by deferred maintenance.

2. Audited Financial Statements and Supplementary Financial Report for the Year ended April 30th, 2000 (Cont'd)

Mr. White noted that the detailed annual report on deferred maintenance had been presented to the Business Board at its meeting of May 1st, 2000. Although the agenda of that meeting had been a very crowded one and had left little time for discussion, members had raised no questions about the annual report.

The Chair agreed that responsibility for maintenance resided with the Business Board, but urged that the wording of the financial report be clear to give comfort to readers that there was no contingent liability involving deferred maintenance that had not been disclosed. Mr. White said that the University would be in a better position to provide a firm estimate of the cost of needed deferred maintenance work when the province-wide study was complete. The administration had felt discomfort with the $210-million figure, which discomfort had led to the University's participation in the province-wide study. Mr. White anticipated that when a firm definition of deferred maintenance had been agreed, the figure for the University of Toronto would be significantly less than $210-million.

A member suggested redrafting of the first two sentences, which stated the current estimate and then called it into question. It might be better to tie the two sentences together.

(d) Pension funds. A member suggested that the section on the pension funds be separated into two paragraphs, one dealing with the position of the basic pension funds, and the second dealing with the supplemental retirement arrangement. Mr. White agreed to do so.

On the recommendation of the Chief Financial Officer,

YOUR COMMITTEE RECOMMENDS

THAT the University of Toronto audited financial statements for the fiscal year ended April 30th, 2000 be approved.

The Chair said that it was remarkable that April 30th financial statements were prepared and the audit completed well before the end of June, particularly in so complex an institution. He congratulated Mr. White, Ms Brown, Mr. Piché, Mr. Britt, Mr. Bowman, Ms Brouwer and all of the members of their teams.

3. External Auditors: Appointment for 2000 - 01

Mr. White recommended the re-appointment of Ernst & Young as the University's external auditors. The firm had recently arranged for a change in the partner responsible for the audit, providing renewal and a fresh approach. Mr. White believed that so long as an external audit firm continued to provide good service at a good price, and so long as it maintained a good relationship with the administration but continued to challenge it, it was appropriate to continue with the existing firm. He assured the Committee that the extent and nature of Ernst & Young's

3. <u>External Auditors: Appointment for 2000 - 01</u> (Cont'd)

consulting assignments would in no way compromise their independence as external auditors. In response to a member's question, Mr. White said that the fees paid to Ernst & Young for the audit exceeded the fees paid for consulting assignments by a wide margin. In fact, the firm had performed few additional services for the University during the past year. Consistent with usual practice, the administration would provide a report on audit fees in the fall. That report would include a detailed schedule of consulting assignments as well as data on the audit fees paid by all Ontario universities.

On the recommendation of the Chief Financial Officer,

YOUR COMMITTEE RECOMMENDS

(a) THAT Ernst & Young be re-appointed as external auditors of the University of Toronto for the fiscal year ending April 30th, 2001;

(b) THAT Ernst & Young be re-appointed as external auditors of the University of Toronto pension fund for the fiscal year ending June 30th, 2001;

(b) THAT Ernst & Young be re-appointed as external auditors of the Employees Pension Plan for the Ontario Institute for Studies in Education for the fiscal year ending June 30th, 2001; and

(c) THAT the members of the University of Toronto Innovations Foundation be requested to appoint Ernst & Young as the external auditors of the Foundation for the fiscal year ending April 30th, 2001 at a remuneration to be fixed by the Directors of the Foundation.

4. <u>Business Arising from the Report of the Previous Meeting: Computer Virus Preparedness</u>

The Chair recalled that at the previous meeting, Professor Gorrie had provided a final written report on year-2000 preparedness. At that meeting, the Committee recorded its commendation of Professor Gorrie for his excellent work in leading the University's successful changeover of its systems to the new millennium and helping to make it a non-event. Also at that meeting, a member had asked whether Professor Gorrie was leading a comparable assault on the problem of computer viruses.

Professor Gorrie said that he was not leading a comparable assault. There was no uniform, University-wide effort with respect to computer viruses. Rather, the task was

4. <u>Business Arising from the Report of the Previous Meeting: Computer Virus Preparedness</u> (Cont'd)

distributed in an *ad hoc* fashion across the University. Support was available from a small security group consisting of staff from the Computing and Network Services Department, the Department of Administrative Management Systems and some end users. That group provided instruction concerning anti-virus software and distributed information concerning such problems as opening attachments from unknown senders of e-mail messages. While the University's problems with viruses were no worse than those faced by others, there clearly were problems.

Professor Gorrie said that malicious software was being written with the intention of causing harm to systems. In one recent development, the propagator of a virus had used e-mail address books to spread the virus. A next stage might well be distribution of viruses in the form of ostensible responses to the user's e-mail messages in an effort to reassure users and to motivate them to open the harmful attachments. Commercial software was available to combat those efforts, but it was useful only if the software was updated frequently, even daily, and virus checks were run frequently, even daily. There was, unfortunately, no ready way to filter incoming information centrally to remove viruses. Even sophisticated computer companies like Microsoft had suffered virus damage.

Professor Gorrie nonetheless agreed with the Committee's apparent view that more could and should be done. He noted that the Report of the Provostial Task Force on Academic Computing and New Media, chaired by Principal Paul Thompson of the University of Toronto at Scarborough, had recommended a greater effort to educate users on security issues generally.

In response to questions, Professor Gorrie said that there was no University-wide "firewall," comparable to the first line of defense in a number of companies. The reason was that firewalls blocked non-standard information, but by its nature, members of the University sought and exchanged information far and wide. There were, however, firewalls protecting the Repository of Student Information, and Administrative Management Systems and some departments. The informal security group did complete scans of the computing environment, looking for potential security breeches and advising corrective action. Indeed, even that limited activity had caused some unfriendly responses from users who decried what they saw as central interference. Some companies engaged staff to conduct on-going virus searches. That was, however, very labour intensive and expensive, and it would not be the right solution for the University. The more appropriate solution appeared to be encouragement of the regular use and updating of anti-virus software.

The Chair invited the internal and external auditors to comment. Mr. Britt said that as part of the regular departmental audits, Internal Audit staff reviewed local area networks. The use of anti-virus software was included in the questionnaires given to the units being audited. Internal audits did not include actual tests on individual computers. Mr. Bowman said that the external auditors had completed some extra work on the question of computer security and would follow up with the administration.

4. Business Arising from the Report of the Previous Meeting: Computer Virus Preparedness (Cont'd)

The Chair asked whether there was any central policy or any body with a formal mandate to promote the use of anti-virus software. If not, should there be such a policy and such a body? Professor Gorrie replied that there was no policy or mandate now in place. It would probably be useful to formalize responsibility in that way. The Chair noted that the Audit Committee had responsibility with respect to security of the University's assets. It was proposed by the Chair and AGREED that the Audit Committee express its support for the establishment of a policy concerning protection against computer viruses and the establishment of an appropriate mandate to ensure that such a policy was developed and implemented.

5. Report of the Administration

(a) Audit of Research Grants

Mr. White reported on the outcome of a recent audit of research grants by two of the federal granting councils: the Natural Sciences and Engineering Research Council and the Social Sciences and Humanities Research Council. Mr. White had arranged for the distribution of an informal report prepared by Ms Audrey Cheung, the Director of Research Grants and Manager of Research Accounting. The research councils' auditors had noted a number of specific problems, but they were not major ones. Mr. White was very encouraged by Ms Cheung's report of the auditors' highly positive oral comments at the wind-up meeting of the audit. This gave Mr. White additional confidence because the University's own internal audits had from time to time noted problems in the financial administration of research grants.

The Chair thanked Mr. White for his report. He said that the Committee should be aware of all such audits and should receive copies of the auditors' written reports.

(b) Other Matters

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

6. Tentative Date of Next Meeting

The Chair advised members that the interim date of the next meeting was Wednesday, October 4th, 2000. [Secretary's note: the meeting is now scheduled for Tuesday, October 17th, 2000.]

7. Other Business

Chair's Remarks

The Chair thanked each and every member of the Committee for their on-going diligence in contributing to the Committee's work. He also thanked Mr. White, Ms Brown, Mr. Piché, Mr. Bowman, Mr. Britt, and the staff of the Governing Council Secretariat for their efforts. He offered special thanks to two extraordinary members who were completing their service on the Committee.

- **Marlene Puffer**. Dr. Puffer had taken on a new voluntary commitment. She was heading up the Women in Capital Markets - a group that encouraged young women to take up careers in the financial services industry and to complete the academic work in mathematics and other fields necessary for such careers. With a demanding new job and two young children, Ms Puffer had decided that one major voluntary commitment would be her limit. She hoped that she would be able to resume her participation in the governance at the University of Toronto at some future time.

- **Ms Penny Somerville** had been a valued member of Audit Committee for seven years. She too was combining responsibility for a very senior job and a young family, and she had indicated that she would not be able to offer an eighth year. In addition to being an exemplary member of the Committee, Ms Somerville had played a key role in the working group that had advised Mr. White and his colleagues on the University's implementation of the new accounting rules for not-for-profit organizations and on the new format of the financial statements.

The Chair reported that Ms Wanda Dorosz, the Committee's Vice-Chair, had recently moved to New York City. She had not yet decided whether she would be able to carry on as a member of the Governing Council.

8. External Auditors: Private Meeting

The Chair said that the Committee held an annual private meeting with the external auditors, who were asked to advise, as provided in the Committee's terms of reference, "whether adequate cooperation has been received from management and whether management has exerted any undue pressure." The auditors were also asked to comment candidly on the probity and the competence of the University's senior financial officers and its Internal Audit Department, and to respond to members' questions.

THE COMMITTEE MOVED *IN CAMERA.*

The Committee completed its meeting with the external auditors.

8. <u>External Auditors: Private Meeting</u> (Cont'd)

THE COMMITTEE ENDED ITS *IN CAMERA* SESSION.

The Chair reported that there were no matters arising from the private meeting that would require action. The Committee had received positive feedback from the external auditors with respect to the administration's cooperation and readiness for the audit.

The meeting adjourned at 7:00 p.m.

Secretary

Chair

September 5th, 2000