UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 88 OF THE AUDIT COMMITTEE

June 18, 2008

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, June 18, 2008 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 (Vice-Chair)
Ms Dominique Barker
Mr. Paul E. Lindblad
Mr. Gerald A. Lokash
Mr. Robert S. Weiss

Ms Catherine J. Riggall, Vice-President, Business Affairs
Mr. Mark L. Britt, Director, Internal Audit Department*
Ms Sheila Brown, Chief Financial Officer
Mr. Louis R. Charpentier, Secretary of the Governing Council

Mr. Neil Dobbs, Secretary

Regrets:

Mr. Joseph Mapa

In Attendance:

Mr. Pierre G. Piché, Controller and Director of Financial Services
Ms Martha J. Tory, Ernst & Young

ITEMS 2 AND 3 WERE RECOMMENDED TO THE BUSINESS BOARD FOR APPROVAL. ALL OTHER ITEMS ARE REPORTED FOR INFORMATION.

1. Report of the Previous Meeting

Report Number 87 (May 28, 2008) was amended. On page 1, the starting time of the meeting was 4:00 p.m. On page 4, item 3, “Risk Assessment, 2008,” discussion point (b), the third sentence was amended to read, “It would be very useful for the Committee to understand which key risks and related controls the Internal Audit Department had not examined.” Report Number 87, as amended, was approved.

2. Audited Financial Statements for the Year ended April 30, 2008

(a) Financial Report: Presentation

Ms Brown reported that the audit of the financial statements was now complete and the external auditors' report was unqualified. She noted that the preparation of the financial statements so soon after the April 30 completion of the fiscal year required a great deal of hard work and many late nights, and she thanked Mr. Piché, Ms Tory, Mr. Britt and all of the members of their teams for their work.

Mr. Piché presented the highlights of the financial statements.

- **Components of the financial statements**. The financial statements included all of the organizations under the jurisdiction of the Governing Council. That included the separately incorporated but controlled ancillary operations with their own boards of directors: the University of Toronto Press Inc. and the University of Toronto Asset Management Corporation. The statements did not include the federated universities (St. Michael's, Trinity and Victoria) which were separate corporations not controlled by the University of Toronto. Finally, the statements did not include the funding for research by University faculty and students that was administered by the affiliated teaching hospitals.

- **Key components of net assets**. The University's net assets or capital represented the total of its assets minus the total of its liabilities. The $2.2-billion of net assets included four elements.

  The first and largest element was the University's endowment funds. Endowments could not be expended; only the investment earnings on the endowments could be spent. The endowments included: (i) the total amount of endowed donations, plus (ii) the investment earnings that had been reinvested to maintain the capital value of the endowments against erosion by inflation and to provide a buffer for years of poor investment returns. The sum was recorded at its fair market value.

  In response to a question, Mr. Piché said that the University of Toronto endowment did not include the endowment funds of the three federated universities, which owned and managed their own endowments and used the earnings to support their own operations.

  The second element of the University's net assets was its investment in capital assets. That represented the amount of internally generated funds spent on capital projects. That amount was reduced over time by the amortization (or depreciation) of those assets.

  The third component of the University's net assets was internally restricted funds: retained earnings committed by the University to be spent for specific purposes in the future. Those funds included: (a) unspent monies allocated to, or earned by, the divisions, and (b) the money set aside and invested to meet the University's obligations under the Supplemental Retirement Arrangement.

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

The final component was the University's unrestricted deficit or unrestricted retained earnings, more commonly known as its cumulative deficit or surplus.

- **Significant accounting concepts: recognition of revenue**. Mr. Piché stressed that the University used accrual accounting. Revenue was not the same thing as funds received and expense was not the same thing as funds spent. Revenues included both funds that had no restriction as to their use and funds where the use was restricted by the external provider of the funds: governments, research granting agencies or donors.

  When the University received unrestricted grants and expendable donations, they were recorded as revenues when received. When it received restricted grants, and restricted but expendable donations, the amounts were recorded as revenue only when spent. When restricted grants and restricted expendable donations were received, they were recorded as cash on the balance sheet, but they were also recorded as liabilities: either deferred contributions or deferred capital contributions, reflecting the requirement that the University spend the money for the specified purpose.

  Donations to the endowments were not recorded as revenue. They did not flow through the income statement but were recorded on the balance sheet as direct additions to the endowment. Similarly, where investment earnings on externally restricted endowment funds were not spent but were reinvested to maintain the real value of the endowments, the investment earnings were not recorded as revenue. They were added directly to the endowment funds on the balance sheet. When endowment funds had been internally restricted – that is, when funds had been committed to endowments by decision of the University – the investment earnings on those funds were recorded as revenue. When a portion of that revenue was reinvested to maintain the value of the endowment against erosion by inflation, it was transferred to the endowment, and the sum of those transfers was recorded on the statement of change in net assets.

- **Significant accounting concepts: recognition of expense.** Expenses included two large non-cash items. The first was the amortization of capital projects. The second was the recording of an amount for the post-retirement benefits earned by employees for their service during the year in accordance with the rules on accounting for employee future benefits.

- **Significant accounting concepts: fund accounting**. Internally, the University recorded its financial transactions in four fund groups. The objective was to highlight the activities within each group. The information on the four fund groups was included in the Supplementary Report. The first fund group was the restricted funds, which included expendable donations, endowment funds and research grants. The capital fund included

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

all capital projects, except those for ancillary operations. The ancillary operations group included accounting for the residences, food and beverage services, parking, Hart House, the faculty housing operation, and also the University of Toronto Press and the residual operations of the University of Toronto Innovations Foundation. The operating fund, which took in the University's teaching and administrative activities, was supported mainly by Government operating grants, student fees, and the sale of supplies and services.

- **Key drivers of financial performance and their interdependence**. The University's financial position was driven by the growth in student enrolment, the growth in research activity, higher salaries and benefit costs, the growth in space, the receipt of donations, growth in the value of endowments, and the amount of investment earnings. All had an impact on the outcome of the year's financial operations and on the University's financial position.

  The growth factors that drove financial performance were interdependent. For example, the growth in student enrolment did increase revenues, but it also required an increase in expenses for additional faculty. It also required additional facilities which would have an impact both on expense and on the total of the University's assets and liabilities since the increase in facilities would probably also require an increase in debt to finance their construction. Donations could be restricted or unrestricted. Donations to the endowments would have an impact on the University's net assets. Similarly, investment returns would have an impact on revenues and net assets.

- **Financial results for the year: assets, net assets and liabilities**. In the years 2002 – 2007, there had been a steady growth in assets and net assets because of (a) a growth in the value of the University's endowments, and (b) a substantial amount of construction. For 2008, there had been relatively little change in net assets, which had held steady at about $2.17-billion. There had been one element of growth in assets as the result of continued construction activity. That had, however, been offset by a decline in the value of the endowments, leading to the amount of assets remaining relatively unchanged. There had also been little change in liabilities as the University had taken on no new debt for its capital program.

- **Components and changes in net assets in 2007-08**. The largest element of net assets was the endowment funds, valued at $1.75-billion at April 30, 2008. Internally restricted assets, primarily divisional funds and the fund to support the Supplemental Retirement Arrangement, had amounted to $280-million. The University's investment in capital assets, minus depreciation, amounted to $372-million, reflecting continuing construction activity. From the sum of those assets was subtracted the cumulative deficit, which amounted to $232-million.

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

There had been very little change in net assets: a decrease of $2.2-million. Net assets had been increased by the year's net income of $50.6-million. There had been a decline in the value of the externally restricted endowments, amounting to $86.1-million. On the other hand, there had been externally restricted donations to the endowment of $36.4-million and externally restricted grants to the endowments amounting to $14.2-million. Finally, there had been two smaller negative items, including a $5.5-million unrealized loss on the swap contracts used to maintain the same effective interest rate on older floating rate loans for capital projects.

- **Endowments**. There had been steady growth in the total endowment from 2003 to 2007. Of the total amount of $1.75-billion, the largest element, amounting to $768-million, supported student aid. That was followed by the $554-million of endowed funds that supported chairs and professorships. As noted, the value of the endowments had declined slightly in 2007-08.

- **Revenues and expenses**. Revenues had grown steadily over the past several years as the result of the increase in the University's enrolment and in its research activity. For 2007-08, both revenues and expenses had amounted to approximately $1.95-billion, with a net income of $50.6-million.

- **Revenues by category**. Government grants had declined slightly for 2007-08 to $639-million. The decline had been in some part an effect of the special $40-million grant from the Ontario Government at the end of the previous year, but not repeated for 2007-08, to relieve university cost pressures. Revenue from student fees had increased to $584-million as a result of the increase in enrolment and in student-fee prices. Investment income (from funds other than the externally restricted endowments) had declined to $70-million because of poorer market returns.

  In response to a question, Mr. Piché said that the Government had announced a special grant at the end of the 2007-08 year for maintenance. The University of Toronto had received $25.6-million to assist in dealing with its deferred maintenance.

- **Funding for restricted purposes**. As noted, a special Government of Ontario grant of $25.6-million had been received to fund deferred maintenance and capital renewal projects. In addition, the University spent $21.4-million over the capital grant received for graduate expansion of $1.5-million and this amount was set up as a receivable in 2007-08. Government and other funding for research had declined from $423-million

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

in 2006-07 to $372-million in 2007-08. That had been a manifestation of special grants made in the previous year: $30.2-million from the Ministry of Research and Innovation and $15.9-million to support the Centre for Structural Genomics.

Notwithstanding the decline in the most recent year, there had been a steady secular increase in the amount of research funding, reflecting the success of University of Toronto researchers in obtaining a disproportionate share of research funding.

In response to a question, Ms Riggall said that the primary source of support for the University's research activities remained government agencies rather than private-sector corporate support.

- **Donations**. In 2007-08, the University had received donations, not including donations pledged but not yet fulfilled, of $92.6-million, a relatively stable result although down somewhat from the $105.7-million received the previous year. One interesting feature was the shift over the past four years from donations to the endowment to expendable donations. Expendable donations were very valuable to the University to assist it in addressing immediate cost pressures and in funding capital projects. Mr. Piché commented that the results of fundraising efforts had been very significant over the past few years, even though no formal fundraising campaign had been in place. Even more impressive was the total amount of donations pledged in 2007-08, which had grown from $163.6-million to $183-million. That included amounts pledged both to the University and to the federated universities and other affiliated institutions. Donations to the federated universities and other affiliated institutions were not reflected in this University's financial statements. But because the University and its affiliated institutions cooperated in their fundraising, the report on combined pledges was, however, a very useful reflection of the success of that effort. Ms Brown noted that the very large amount pledged in 2001 had included the major donation arising from the wind-up of the McLaughlin Foundation. Setting aside that atypical year, there had been a strong trend to increasing pledges, often multi-year pledges, of donations to support the University.

  In response to questions, Ms Brown said that the amount of donations fulfilling earlier pledges was reported in the annual report of the Vice-President and Chief Advancement Officer to the Business Board, which reconciled the amount donated and pledged to the amount of donations reported in the financial statements. The exceptional growth in the amount pledged in recent years had been the outcome of a number of extraordinarily large pledges, including a number leading to the naming of particular units of the University in honour of the benefactor.

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

The Chair noted that the previous and the current Vice-Presidents responsible for advancement had reported that the large pledges and donations were often the outcome of years of work and incubation.

In answer to a question, Ms Riggall said that the new legislation, which permitted the donation of marketable securities without triggering capital gains tax, had been of help. While it had not generated a major increase in overall donations, marketable securities were forming a larger portion of donations.

- **Preservation of capital**. The University had, since the market declines in 2001-03, been building up a cushion to protect the endowment for future years of poor investment returns. It had done so by reinvesting a portion of the good investment returns from 2004 – 2007, which had exceeded the amounts required for the payout and to compensate for inflation. The value of the endowment at the end of the previous year, April 30, 2007, had been $1.82-billion. That had included a cushion of $416.6-million above the amount required for the payout and for inflation protection. Given that the amount needed for the payout for 2007-08 was $62.1-million, some leaders in the academic divisions thought that the cushion would be sufficient to assure the payout for several years. In fact, however, for 2007-08, there was need to set aside $27.6-million to compensate for inflation, to use $62.1-million for the payout, and to recognize an investment loss of $39.8-million. In addition there was $16.6-million of net transfers from the endowment, primarily to the University of Toronto Schools, which had become independent. Adding back $50.6-million of donations and grants to the endowed funds, the cushion was reduced to $287.1-million. It was, however, important to note that the payout from the endowment had been increased since 2003, with increases to compensate for inflation, and the principal of the endowment had been maintained against the effect of inflation.

- **Expenses**. Expenses had been increasing steadily over the years, reflecting both the growth in the number of students and in the amount of research activity. Total expenses had increased from $1.8-billion in 2006-07 to $1.9-billion in 2007-08. The largest component of expense was salaries and benefits, which had increased from $1.062-billion in 2006-07 to $1.127-billion in 2007-08. The increase in expense for salaries and benefits over the year reflected both the increase in the number of employees required for the larger enrolment and also the effect of negotiated increases. The amount required for benefits had actually declined from $210-million in 2006-07 to $208-million in 2007-08, reflecting a slight reduction in pension expense.

- **Capital investment in infrastructure**. Capital spending on infrastructure had peaked in 2004, with $329.2-million of additions to capital assets. Additions for the 2007-08 year

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

had amounted to $214.3-million. The additions reflected the University's construction program, which provided the space for student enrolment growth and increasing research activity.

- **External borrowing**. The University's maximum external borrowing capacity, defined in policy as 40% of net assets averaged over five years, had become $748-million. In addition to external borrowing, the University could authorize internal borrowing for capital projects of up to $200-million from its Expendable Funds Investment Pool, meaning a maximum borrowing capacity of $948-million. Actual external borrowing of $556.3-million amounted to 25.6% of net assets. That proportion had remained unchanged from the previous year; while there had been little change in net assets for 2007-08, the five-year averaging rule meant that the lower net assets from 2002-03 had been dropped from the calculation. The growth in borrowing over time reflected the growth in the University's capital construction program.

  In response to a question, Ms Brown and Mr. Piché said that the external borrowing, made through bullet debentures, was not repayable until each debenture matured. However, cash for their eventual repayment was being accumulated. Divisions responsible for capital projects that were funded by borrowing were required to sign internal loan agreements, assuming responsibility for the loans for their projects. Each division was then required to make blended principal and interest payments on its loan at a fixed rate of interest, which was based on the market rate at the time of the loan. A part of the payments was used to pay the interest on the bullet debentures and the various costs. The remaining amount was retained in the Long-Term Borrowing Pool and invested. That remaining amount, plus investment earnings, would be used to repay the principal of the debentures when they became due. The amount set aside for principal repayment was accounted for in the financial statements as a part of the University's investments.

- **Financial results compared to forecast**. Mr. Piché compared the financial results for 2007-08 with the forecast that had been provided to the Business Board on February 4, 2008. The operating fund deficit for the year had increased by $20.3-million, compared to the projected increase of $18.3-million. The primary reason had been that investment earnings had been lower than forecast.

  Net assets for April 30, 2008 had been $2.174-billion, compared to a forecast net assets of $2.224-billion. The primary reason again had been investment returns below the forecasted returns. The market value of the endowment had, for example, declined by $89.7-million.

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

- **Financial Report**. Mr. Piché was invited to comment on any new features of the Financial Report. He noted the revised commentary on the endowment funds on page 18, which explained (i) the operation of the policy on the preservation of the capital of those funds, and (ii) the determination of the payout rate in a manner that would provide for a cushion for years of poor investment returns. The commentary on the Expendable Funds Investment Pool, on pages 20-1, had also been revised to remove the comparison of investment returns on that conservatively managed Pool to a market benchmark and to stress instead the comparison of the Pool's return to its meeting the University's objectives.

  Among the matters that arose in discussion were the following.

(i) Accounting for research grants where spending was required before the costs were reimbursed. A member noted that management and the external auditors had differed on appropriate accounting where a research granting agency required that the University spend money for some or all of a research project and then submit a bill for reimbursement. Because the University recognized revenue only when it was spent, this created an accounting problem. The University had chosen to recognize revenue in its accounts before its actual receipt to match the costs incurred. The external auditors had stated their preference that the amount be set up as a receivable. In response to a member's question, Mr. Piché said that in all cases, the provider of the research grant was a government or other major institution that invariably paid the costs when the bill was submitted by the University. Ms Tory agreed that that was the case. Given that the amount, $15-million, was not material, the auditors were willing to accept the accounting. They would, however, continue to monitor the matter, in particular the payment of bills submitted for research costs already incurred.

(ii) Hedging program. A member asked about the losses the University would have incurred in the absence of its program to hedge the value of its investments against declines in the value of foreign currencies compared to the Canadian dollar. Mr. Brown replied that the information was not included in the University's financial statements. Any comment, if the matter was deemed to be significant, would be included in the annual report of the University of Toronto Asset Management Corporation.

(iii) Increase in net income. In the course of discussion, it was noted that net income had increased by $41.6-million from the amount forecasted to the Business Board in February, mainly owing to under-spending by the divisions. Ms Brown said that the increase was in significant part an outcome of the new budget model. Divisions had for many years been permitted to carry forward unspent appropriations. That was a real benefit in that it avoided suboptimal end-of-year spending simply in order to spend down budgets rather than to lose the amounts. In addition, carry-forward funds were often accumulated in one year to deal with one-time only costs

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

anticipated in the next year. That concept had now been extended in the new budget model. Divisions were exposed to year-to-year fluctuations in the revenue they generated and they were responsible for finding funds to pay the costs of annual increases in salaries and benefit costs. Divisions therefore had to consider those factors and they often used carry-forward funds to set aside prudent reserves to deal with the revenue fluctuations and increased compensation costs. From the point of view of the Chief Financial Officer, that change was highly beneficial. Ms Riggall noted that, in effect, divisions had their own retained earnings.

(iv) Service ancillary operating results: student residences. Ms Riggall responded to a member's questions about the results of the residence operations. The plan for ancillary operations that had borrowed to finance construction or renovation was to break even on an annual basis in five years and on a cumulative basis in eight years. The Chestnut Street Residence was doing well. It was generating the operating earnings anticipated in its financial plan. The residence had rented all of its beds for the next year. It had added fifty beds by converting unused common-room space into bedrooms. Its conference, parking and food services were doing well. The residence was not currently generating sufficient revenue to pay its mortgage loan fully at this time, but it was anticipated that it would do so shortly, pursuant to its financial plan. The New College Residence operation was not faring as well. It had failed for a few years to implement the full fee increases projected in its plan, submitted in connection with the proposal for a new residence building. As a consequence of the operation's accumulated deficit, it had been required to assess a 20% fee increase for 2008-09. It would clearly have been easier and more appropriate to implement the 7% annual fee increases contained in the original plan.

A member asked how the prices for residence rooms compared to the costs students might incur in renting accommodation off campus. Ms Riggall replied that there was no clear answer to the question because rates varied considerably. Residence rates were highest in the Chestnut Street residence, a converted hotel building somewhat off the campus. It had filled its rooms. Residence accommodation in the new Woodsworth College Residence was closest to that students might obtain by renting an apartment. Woodsworth students in residence had rooms in a shared unit, each with its own kitchen and bathroom. The rate charged to all students in a unit compared well to the price of renting a comparable apartment in the area of Bloor and St. George. Moreover, life in student residence buildings included certain services and social supports (such as those offered by residence Deans and Dons) that were not available in other accommodation. The largest risk to the financial health of the residence operations was the risk of a substantial decline in the rental housing market, which would lead to the availability of lower cost alternatives for students.

(v) Derivative financial instruments. In response to a member's question, Ms Brown said that derivative financial instruments were recorded at their fair market value. They included interest-rate swap contracts used as hedges. They also included derivative instruments used for

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(a) Financial Report: Presentation (Cont'd)

investment purposes including forward contracts used to hedge exposure to fluctuations in the value of foreign currencies and futures contracts used to emulate the returns on various securities indices.

(b) External Auditors' Report on Audit Results

The Committee reviewed the external auditors' "Audit Results" report.

(c) External Auditors: Private Meeting

Members of the administration, the Secretariat and the internal auditors absented themselves.

THE COMMITTEE MOVED IN CAMERA.

The Committee held its regular private meeting with the external auditor. The meeting was intended to enable the external auditor to advise [as provided in the Committee's terms of reference] of "any problems encountered by the auditors, any restrictions on their work, the co-operation received in the performance of their duties by the administration and the Internal Audit Department, and any matters requiring discussion arising from the auditors' findings," and to respond to members' questions.

THE COMMITTEE CONCLUDED ITS *IN CAMERA* SESSION.

Members of the administration, the internal auditor and the Secretariat rejoined the meeting.

The Chair said that the Committee had had a lively discussion, much of which had dealt with the Committee's interplay with the internal auditor. No doubt, the matter would be discussed further during the annual report of the Director of Internal Audit.

(d) Legal Claims

It was noted that the Committee's terms of reference charged it to review "in connection with the review of the University's audited financial statements, an annual report on substantial outstanding legal actions against the University in order to monitor contingent liabilities that should be disclosed in financial statements, as well as . . . to monitor possible risk exposures."

Mr. Piché said that the new items in the report were underscored. The report was somewhat briefer than that in previous years because a number of items were no longer required for inclusion on the list. He noted that two claims listed on the final page of the report had been dismissed after the end of the University's fiscal year.

2. Audited Financial Statements for the Year ended April 30, 2008 (Cont'd)

(d) Legal Claims (Cont'd)

Questions arose with respect to two matters.

(i) Insurance coverage. A member commended inclusion in the report of information about insurance coverage. That coverage would deal with a part or all of the costs of some of the legal actions, if they were to succeed. He noted that insurance coverage would not deal with other matters. Had there been any change in the University's insurance coverage with respect to these matters? Was the absence of insurance coverage the outcome of a lack of its availability or had a decision been made that the cost of such coverage would not be worthwhile? Ms Riggall and Ms Brown replied that insurance coverage would have been very difficult or impossible to obtain in many cases, for example for breach of contract. In other cases, the Director of Risk Management and Insurance had determined that insurance was not appropriate in given areas.

(ii) Evaluation of legal claims. A member asked about the evaluation of the legal claims included in the report. Mr. Piché said that the evaluations had been based on legal consultations.

(e) Recommendation

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 30, 2008 be approved.

3. External Auditors: Appointment for 2008 – 09

Ms Tory absented herself for the consideration of this item.

Ms Brown recommended the re-appointment of Ernst & Young as external auditors for the University. Ms Brown and her colleagues had a very positive view of the conduct of the audit in 2008. The audit team was especially good and thorough. The auditors had worked very long hours to complete their work in a timely manner. Moreover, they had worked very hard to understand the context and intention of the transactions they reviewed.

Ms Brown recalled that the University periodically completed a formal review of the external auditors, speaking with various stakeholders on campus. Such a review was not required for the current year, but it would be carried out in the not-too-distant future. Members would recall that in 2005 the partner in charge of the audit had changed. A regular process of reviews and a regular change of the partner in charge were consistent with the guidance concerning the appointment of external auditors provided by the National Association of College

3. External Auditors: Appointment for 2008 – 09 (Cont'd)

and University Business Officers (NACUBO) in the United States. That organization had reviewed the process for such appointments in 2002-03 in response to the recommendations contained in the Sarbanes Oxley Act.

A member noted that the Committee received a report in the fall on fees other than audit fees earned by the external auditors during the previous year. As a matter of due diligence in connection with the appointment of external auditors, he asked if there had been material change in the amount of fees charged by the external audit firm for work other than auditing. Ms Brown replied that there had been no material difference.

On the recommendation of the Chief Financial Officer,

YOUR COMMITTEE RECOMMENDS

(a) THAT Ernst & Young LLP be re-appointed as external auditors of the University of Toronto for the fiscal year ending April 30, 2009; and

(b) THAT Ernst & Young LLP be re-appointed as external auditors of the University of Toronto pension plans for the fiscal year ending June 30, 2009.

4. Internal Audit: Annual Report, 2007-08

Mr. Britt presented the annual report of the Internal Audit Department for 2007-08.

- **Productivity**. The Department had provided 8,700 hours of auditing. That represented a 17.3% improvement over the previous year, although it still did not meet the Department's plan. Overall, the Department's complement was eight full-time-equivalent staff, as projected in the year's plan. At one time, during the transition to an external provider of internal audit services to the University of Toronto Asset Management Corporation (UTAM), the auditor who had been engaged to perform internal audits at UTAM had worked on reviews in the University. Her work partly offset the time loss caused by the earlier-than-planned maternity leaves of two other staff. The increase in the Department's productivity had led to the completion of 42 reviews, with another seventeen in progress and five draft reports outstanding. The productivity increase had been partly attributable to: (i) the realignment of the Department to add one audit supervisor, and (ii) the investment in an automated audit management system, called Teammate. That system had provided substantial efficiencies to the Department's operations, especially at the review and report-issuing stages. The Department had completed four special reviews – three requested by management and one the result of the discovery of a misappropriation. Mr. Britt noted that the misappropriation had not been material or significant from a dollar standpoint.

4. **Internal Audit: Annual Report, 2007-08** (Cont'd)

- **Observations and conclusions**. Mr. Britt reported that the audit results did not indicate an unreasonable level of financial or operational risk in the University or in the individual divisions and departments. He cautioned that his conclusion could extend only to those areas included in the Department's audits for the year. Caution in interpreting the results was particularly necessary in the light of the decentralization of financial management in the University. The reviews indicated a somewhat increased level of all four types of risk that had been identified in the risk profile document brought to the previous meeting of the Committee: financial risk, information / information-technology risk, legal and contractual risk, and research risk. The Report outlined, for each category of risk, the controls or mitigating factors intended to limit risk, the indicators of risk identified in the audits, and the University divisions or departments involved where the risks had been found. The findings indicated certain areas of non-compliance with policies and procedures and poor functioning of controls which had resulted, in some cases, in the lack of proper safeguarding of assets.

- **Consulting and advisory services**. The Department not only conducted audits but also, as specified in the Internal Audit Policy, provided consulting and advisory services. Non-audit hours included a substantial amount of time dedicated to the evaluation and deployment of the new automated audit-management software. The Department had also developed an audit ranking system to specify the outcome of the overall assessment of controls (as strong, adequate, or needing improvement) and the corresponding extent of residual risk (as low, low/moderate, or moderate/high). That ranking system had been adopted about half way through year, and it would facilitate benchmarking and reporting back to Committee on an exception basis where there was a need for improvement.

- **Departmental audits**. Schedule 1 of the Report listed areas where audits had been completed, where audits had been prepared, and where draft reports were in progress. Mr. Britt reported that in three of the fifteen divisions/departments where audits had been completed, a "Needs Improvement" rating had been assigned.

- **Follow-up audits**. A major effort had been made to complete outstanding follow-up audits, which were an important component of the process. They enabled the Department to provide assurance that the changes agreed at an earlier stage of the process had indeed been implemented. The Department's new Teammate system enabled it to work with the department interactively to monitor the implementation of changes through a web interface.

- **Continuous auditing**. Appendix "B" provided a summary exceptions report of problems found in a University-wide sampling of four types of transactions: expense reimbursements, accountable advance settlements, purchasing card charges, and invoice payments. Of the sample of 480 transactions from across the University, 231 exceptions had been identified including 72 minor or housekeeping issues. However, the remaining 159 exceptions were considered significant, especially when they related to research funds and compliance requirements for documentation. In response to the Chair's

4. Internal Audit: Annual Report, 2007-08 (Cont'd)

question, Mr. Britt said that there had been no cases identified where assets had been misappropriated. The problems related to a failure to complete established procedures, to obtain required approvals, and so on.

- **Administrative accountability reporting**. In the units that had been subject to review in 2006-07, all 51 of the required accountability reports had been completed. The number of reports involved in 2007-08 had been significantly lower that the previous year because the previous year's data had included reports scheduled for submission that were still in draft stage. Such reports were not included in the data for the current Internal Audit Report.

Mr. Britt responded to questions, and the Committee engaged in a discussion of a number of matters that arose from the report.

5. Internal Audit: Audit Plan, 2008-09

The Committee received, for information, the Internal Audit Plan for 2008-09.

6. Borrowing Strategy: Annual Status Report to April 30, 2008

Ms Brown recalled that the Borrowing Strategy, originally approved in 2004, defined the maximum external borrowing capacity as 40% of the University's net income averaged over five years. As at April 30, 2008 that represented an external borrowing capacity of $748-million. In addition, the maximum internal borrowing capacity – loans from the University's Expendable Funds Investment Pool to capital projects – was defined as $200-million. As a consequence, total loans amounting to $948-million would be permissible within the maximum. As noted in the financial statements, total approved borrowing as at April 30, 2008 amounted to $757.2-million. External borrowing outstanding as at April 30 was $556.3-million.

Ms Brown pointed out that the Report before the Committee included information on the status of the Long-Term Borrowing Pool – the sinking fund used to accumulate and invest funds for the repayment of the bullet debentures that served as the instruments of the University's borrowing. That Pool had accumulated $52.8-million as at April 30, 2008. The Pool appeared to be in good condition and on track to fund the repayment of the first debenture when it came due in 2031.

7. Report of the Administration

Ms Riggall, Ms Brown, Mr. Charpentier and Mr. Britt stated that they knew of no matter not on the agenda that should be drawn to the attention of the Audit Committee at that time.

8. Date of Next Meeting

The Chair said that the Committee's first meeting for 2008-09 had been scheduled for Wednesday, December 3, 2008 at 4:00 p.m. The full meeting schedule would be distributed over the summer.

9. Chair's Remarks

The Chair thanked all members for their service over the past year. He thanked Mr. Piché and his colleagues for their exceptional efforts in providing the audited financial statements at a very early date. He expressed his special thanks and personal appreciation to two members who were completing lengthy terms of outstanding service to the Committee: Mr. Robert Weiss, the past-Chair, and Mr. Gerald Lokash had been "rocks of stability" for the Committee, and it would be very difficult to replace them. They had brought to the Committee a great deal of expertise and a great deal of knowledge about University. They had made valuable contributions to the work of the Committee and would be sorely missed.

10. Internal Auditor: Private Meeting

Members of the administration, the Secretariat and the external auditor absented themselves.

THE COMMITTEE MOVED IN CAMERA.

The Committee held its regular private meeting with the internal auditor. The meeting was intended to enable the internal auditor [as provided in the Committee's terms of reference] to report on "any problems encountered, any failure to provide appropriate information or any restrictions on internal audit work, the general co-operation received in the performance of internal audit duties, and any matters requiring discussion arising from the auditor's findings."

THE COMMITTEE CONCLUDED ITS *IN CAMERA* SESSION.

The meeting adjourned at 6:05 p.m.

Secretary   Chair

September 12, 2008

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