UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

# REPORT NUMBER 94 OF THE AUDIT COMMITTEE

**June 16, 2010**

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, June 16, 2010 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)
Professor Ramy Elitzur
Mr. J. Mark Gardhouse
Ms Shirley Hoy
Mr. Joseph Mapa
Mr. W. John Switzer

Ms Catherine J. Riggall, Vice-President, Business Affairs*
Ms Sheila Brown, Chief Financial Officer*
Mr. Louis R. Charpentier, Secretary of the Governing Council*

Mr. Neil Dobbs, Secretary*

In Attendance:

Ms Stephanie Cheung, Ernst & Young**
Mr. Eric G. Fleming, Director, Risk Management and Insurance***
Mr. Daniel Ottini, Audit Manager, Internal Audit Department*
Mr. Pierre G. Piché, Controller and Director of Financial Services*
Ms Mae-Yu Tan, Assistant Secretary of the Governing Council*
Ms Martha J. Tory, Ernst & Young**
Mr. Weeman Wong, Ernst & Young**

* Absented themselves for item 5(c).
** Absented themselves for item 6.
*** In attendance items 1 - 4.

ITEMS 5 AND 6 CONTAIN RECOMMENDATIONS TO THE BUSINESS BOARD FOR GOVERNING COUNCIL APPROVAL. ALL OTHER ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR INFORMATION.

## 1. Awards to University of Toronto Administrators

### Canadian Association of University Business Officers: Outstanding Contribution Award

Ms Riggall said that the Canadian Association of University Business Officers (CAUBO) made up to three awards annually to its members who had made outstanding contributions to higher education in Canada. The awards recognized administrators who had made particular contributions to the advancement of knowledge or good practice in a particular administrative

**1. Awards to University of Toronto Administrators** (Cont'd)

**Canadian Association of University Business Officers: Outstanding Contribution Award** (Cont'd)

field or who had been exemplary volunteers in the work of CAUBO or other professional associations. Two of the three awards in 2010 had been made to the Committee's assessors: Chief Financial Officer Sheila Brown and Director of Internal Audit Mark Britt. The Chair and members offered their congratulations to Ms Brown and Mr. Britt.

**Y.W.C.A. Agnes Amelia Blizzard Award for Voluntary Leadership**

The Chair announced that Vice-President, Business Affairs Catherine Riggall had received the Agnes Amelia Blizzard[*] Award for voluntary leadership at the Y.W.C.A. The Chair and members congratulated Ms Riggall.

**2. Report of the Previous Meeting**

Report Number 93 (May 12, 2010) was approved.

**3. Business Arising from the Report of the Previous Meeting**

The Chair recalled that the Committee had instructed the Secretary to arrange an additional meeting early in the fall to enable it to continue its *in camera* discussion and to give further consideration to the Committee's role and its agenda, the role of the internal auditor, and the risk assessment. That meeting had been scheduled for Wednesday, September 15, 2010. In response to Ms Riggall's question, the Vice-Chair said that it was intended that the entire meeting would be used to continue the Committee's *in camera* discussion, and therefore the Committee's assessors, apart from the Director of Internal Audit, would not be required to attend.

**4. Risk Management and Insurance: Annual Report, 2009-10**

Mr. Fleming said that the 2009-10 annual report was once again a good-news report. The University's experience under its key policies had remained positive. In spite of some general anxiety about the tightening of the insurance market, the University had been able to renew its polices with excellent rates and good coverage. Members would recall that the University had in 2009 extended the terms of its policies to April 30 so that the renewal and coverage dates would correspond with the University's fiscal year. The University's favourable experience with its current renewals reflected its good claims record. The University had achieved savings of about $750,000 per year by changing its insurance policies to the commercial market from the Canadian Universities Reciprocal Insurance Exchange (CURIE), and it had avoided levies and premium

[*] Agnes Amelia Blizzard (1850 – 1899) was an internationally recognized stage and screen actor who established the first Y.W.C.A. in Canada in St. John, New Brunswick in 1870.

increases of more than 30% arising from the poor claims experience of a number of other universities. The University

**4. Risk Management and Insurance: Annual Report, 2009-10** (Cont'd)

had retained all of the insurers for its property coverage (including Royal and Sun Alliance, GCAN, Aviva, ACE INA, Intact, Temple, CAN and others) and had retained the Chartis Insurance Company for its general liability and errors and omissions liability policies. The insurers would clearly have preferred to have increased their premiums, but the University had been able to avoid increases by having alternative suppliers available.

Mr. Fleming said that the University's property insurance was continued with a limit of $500-million per occurrence, with a deductible of $250,000 per loss. For the general liability, the errors and omissions, and the vehicle fleet policies, the total stacked limit was $35-million per occurrence (with the primary policy covering the first $5-million, an excess liability policy covering the next $20-million, and an umbrella liability policy covering the final $10-million). Renewals had been smooth for the University's other policies: the crime/fidelity policy, the boiler and machinery policy, and the personal professional property policy. The good renewals had been the outcome of a favourable claims record on all of those policies, including the boiler and machinery policy, which had in some previous years involved a number of claims. In summary, Mr. Fleming was pleased with the outcome of the program over the year. He had been grateful for the work of the University's insurance brokers, HKMB Hub International Ltd. and its professional staff.

Mr. Fleming reported that claims paid from the internal self-insurance reserve had remained approximately consistent with previous years. Those claims covered losses incurred by University divisions or departments between (a) the $2,500 "responsibility" amount the division or department was responsible for, and (b) the $250,000 deductible amount on the property insurance policy. The reserve had, however, declined in value primarily because of the cessation of dividends from CURIE several years previously and the absence of other revenues going into the reserve, apart from investment returns. To rebuild the reserve to an adequate level, it had been granted a one-time cash infusion of $400,000 and further base-budget support of $400,000 per year until it reaches at least $2.5-million.

Mr. Fleming noted that all coverage would remain in effect during the G20 summit meetings. The Risk Management and Insurance Department was undertaking a number of steps to manage risks during those meetings, when protest demonstrations were anticipated. Those steps included a video survey of the campus to be used if it were to become necessary to make any claim.

Mr. Fleming responded to members' questions.

**(a) Insurance for construction projects**. Mr. Fleming said that the cost of insurance for construction projects was included as part of the total project cost and was capitalized in the University's accounts.

**(b) Decline in property insurance premiums in 2008**. Mr. Fleming said that the decline in the premium for the University's property insurance beginning in 2008 was partly the outcome of a

**4. Risk Management and Insurance: Annual Report, 2009-10** (Cont'd)

substantial reduction in the valuation of the University's library holdings made in that year. Those holdings had inadvertently been valued too highly in previous years.

**(c) Limits for liability insurance and errors and omissions insurance**. A member asked the basis of the $35-million limit to claims on the University's general liability insurance and its errors and omissions insurance coverage. Was the limit based on any industry benchmark? Was the limit similar to that at universities of comparable size in the United States? Mr. Fleming replied that the limits to liability insurance policies taken out by U.S. institutions would typically be substantially higher, perhaps $100-million, reflecting a higher U.S. risk environment characterized by much more litigation. The University of Toronto purchased insurance to a limit that it deemed prudent, based on the cost of moving to the next higher limit and based on its claims experience. The University had never made a claim greater than $1-million under its liability policies.

**(d) Possibility of premium savings through increasing deductibles**. Noting the University's very good claims record, a member asked whether it would be worth considering increasing the policy deductibles in order to obtain reduced premiums. Mr. Fleming said that it would be well worthwhile considering that option when the self-insurance reserve is built back up to a high enough level to deal with higher potential needs.

**5. Audited Financial Statements for the Year Ended April 30, 2010**

The Chair noted that the audited financial statements were before the Committee for recommendation to the Business Board (from there to the Governing Council). The remainder of the *Financial Report* – the "Highlights" and the "Supplementary Report by Fund" – were for information.

Ms Brown said that it was remarkable that the University produced financial statements for a fiscal year ended April 30 in time for their consideration by the Audit Committee in the middle of June. Achieving that timetable was not easy, and it was particularly difficult to do so year after year. It was possible only by virtue of a great deal of hard work by the external auditors, the internal auditors, and by Mr. Piché and his colleagues, who worked day and night to get the job done. She thanked all concerned.

**(a) Highlights of the Financial Statements**

Mr. Piché presented the highlights of the financial statements.

- **Financial statement coverage**. The financial statements included the financial position and results of all operations under the jurisdiction of the Governing Council. That included controlled, separately incorporated 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

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

(St. Michael's, Trinity and Victoria) which were separate corporate entities. Nor did they include the research conducted by University of Toronto faculty members and administered at the affiliated hospitals.

- **Significant accounting concepts**. Mr. Piché noted that some of the accounting concepts used by the University were different from those used in the business sector. The University did follow the accrual method of accounting. Therefore, the amount recorded as revenue was not the same as funds received, and the amount recorded as expense was not the same as funds spent. Expendable grants and donations that were not restricted as to their use were recorded as revenue and flowed through the statement of operations. However, restricted grants and restricted expendable donations were recorded as revenue only when they were spent for their specified purpose. Any unspent restricted grants and restricted expendable donations were recorded on the balance sheet not only as cash but also as liabilities: deferred contributions or deferred capital contributions.

  Donations to the endowment were not recorded as revenue on the statement of operations. Rather they were added directly to the endowments, a component of the net assets recorded on the balance sheet. Similarly, investment earnings on donations to the endowment were not recorded as revenue. Rather, such earnings were added to the endowments on the balance sheet and recorded on the statement of changes in net assets.

  The University did record amortization of capital projects, and it did record the cost of employee future benefits earned in a given year in accordance with the recently initiated accounting rules on that topic.

- **Significant accounting concepts: internal accounting**. For internal purposes, the University recorded its financial transactions using fund accounting. There were four funds: (a) the operating fund for teaching, research and administrative activities supported mainly by government operating grants, student fees and the sales of supplies and services; (b) the ancillary operations fund for the residences, food and beverage services, parking, Hart House, Real Estate and the University of Toronto Press; (c) the restricted funds for donations, including endowments and research grants; and (d) the capital fund for capital projects, except those for the ancillary operations. That fund accounting was not displayed in the audited financial statements, but it was presented in the Supplementary Report in the second half of the Financial Report.

- **Key drivers of financial performance and their interdependence.** Key drivers of financial performance included: growth in student enrolment, growth in research activity, growth in salaries and benefits, growth in space, donations, growth in endowments, and investment earnings. Those factors were interdependent. For example, growth in student enrolment would bring about an increase in revenue. But, it would also require an increase in the number of faculty members to teach the additional students, and it would

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

therefore cause an increase in expense. Both students and faculty would require accommodation, which would bring about an increase in spending on capital construction. That would lead to an increase in assets. However, because the University would likely lack full funding for the new facilities, it would also require borrowing, resulting in an increase in liabilities.

- **Financial results compared to forecast**. Each year, early in the calendar year, the administration presented to the Business Board a forecast of the financial results for the fiscal year ending April 30. For 2009-10, the forecasted net income for the year was a loss of $25.2-million. In fact, there had been a positive net income of $45.4-million. There were several major variances. First, it was always difficult to forecast spending by the University's divisions, and the estimate made of such spending was always a conservative one. For 2009-10, the divisions had under-spent their budgets by $31.7-million. Second, the University had received, late in the fiscal year, $25.3-million of additional grant funding from the Government of Ontario for both graduate students and undergraduate accessibility. Third, there had been $7.2-million that had not been borrowed by the divisions from the Academic Deficit Finance Fund – the special fund established to enable the divisions to meet expenses that would under usual circumstances have been funded by a payout from the endowment. That payout had not been made for 2009-10 owing to the highly negative investment result posted by the endowment fund in the previous year. Finally, there had been several smaller variances including a reduced cost for utilities, a decrease in the cost of employee benefits and a decreased cost for legal fees. As noted, the outcome had been a positive net income for the year of $45.4-million rather than the projected loss of $25.2-million.

- **Revenues and expenses**. Revenues for 2009-10 had been $2,210.9-million and expenses had been $2,165.5-million, for a net income of $45.4-million. The largest element in the growth of revenue over the past ten years had been caused by an increase of 44.5% in student enrolment, which increased the University's revenue both from tuition fees and government grants.

  For 2009-10, a major difference in revenue had been the change in investment income. For 2008-09, the University had incurred a loss of $125.3-million, whereas for 2009-10, investment income had been $124.9-million. It was interesting to note that 2009-10 had marked the first year in which the University's revenue from student fees of $701.3-million had exceeded that from government grants, which had been $674.8-million. In response to a question, Ms Brown and Mr. Piché said that the University had expected that fee revenue would come to exceed that from government grants, and that expectation had been built into the budget for 2010-11. However, the actual tipping point had been reached in 2009-10 – one year earlier than expected. In response to another question, Ms Riggall said that the Government of Ontario had announced the continuation of its tuition-fee framework for a further two years. It was anticipated that in Ontario, and

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

elsewhere in Canada, student fees would continue to form a greater part of university revenue than government grants. Governments were paying a relatively smaller share, and expecting students to pay relatively greater share, of the costs of their educations.

- **Revenues: Government and other grants and contracts for restricted purposes**. In 2009-10, the University had received grants, primarily from the Federal and Ontario Government infrastructure funding programs, for capital projects amounting to $99.7-million. The large projects that had received funding were the Instructional Centres on the Scarborough and Mississauga campuses and the Mining Building renovation on the St. George campus.

- **Revenues: Donations**. In 2009-10 the University had received (a) donations of $19.5-million to its endowed funds, and (b) grants of $4.2-million earmarked for endowments. Total donations received had amounted to $77.2 million. That represented a significant decline from the $131.5-million donated the previous year. However, pledges of future donations to the University, its federated universities and other affiliated institutions (including the teaching hospitals) had increased from $106.3-million in 2008-09 to $120.0-million in 2009-10. In response to a member's question, Ms Brown said that there was some correlation, albeit not a perfect one, between the level of donations and pledges and the returns provided by the securities markets. In response to another question, Ms Riggall said that the Vice-President, Advancement had reported that there were a number of possible significant donations in the works, leading to optimism about the level of donations in the 2010-11 fiscal year.

- **Expenses**. Expenses showed trends similar to revenues, reflecting the growth in student enrolment and in the amount of funded research. The largest category of expense was salaries and benefits. Benefits expense had grown considerably from $240.4-million in 2008-09 to $311.6-million in 2009-10. The growth included an increase of $73-million in pension expense booked to the financial statements in 2009-10. The pension plan deficit, as shown in the financial statements, had grown from $784-million as at April 30, 2009 to $1,226.9-million as at April 30, 2010. Much of that increase was the result of the change in the discount rate for pension benefit costs from 7.75%. to 6.0%. That change had resulted in an increase in the benefit obligation of $675-million.

  The increase in salary expense from $565.9-million in 2000-01 to 1,007.9-million in 2009-10 reflected the 34% increase in the employee complement over those years as well as the increase in the level of salaries resulting from the University's various collective agreements with its Faculty Association and its unions.

  Spending on scholarships, fellowships and bursaries had declined somewhat from $144.6-million in 2008-9 to $132.1-million in 2009-10. That decline had been the result of the need to miss a payout from the endowment funds for 2009-10; endowment income

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

represented a significant source of funding for student awards. The University had, however, ensured that all need-based awards were maintained from other sources of funding. A member observed that spending on scholarships, fellowships and bursaries amounted to 10% of spending on salaries and benefits – a proportion that he thought to be a very good one relative to most other universities.

- **Net assets**. The University's net assets as at April 30, 2010 were $1.8-billion. That was derived from total assets of $4.292-billion less liabilities and deferred contributions. The total assets had grown almost back to the peak level of $4.305-billion they had reached as at April 30, 2008. The largest component, nearly 80%, of the net assets was the endowment funds, amounting to $1.437-billion as at April 30, 2010. Internally restricted net assets amounted to $136.4-million.

  The internally restricted net assets included $438.9-million of various reserves, including divisional reserves carried forward, expendable departmental trust funds, funds set aside for alterations and renovations, research overhead funds to be distributed in the coming year, and other funds. Under the new budget model the reserve funds were very important to the divisions, which now had to handle changes in their revenue and costs. Offsetting those funds was a $302.5-million deficit in the assets set aside or to be set aside for employee future benefits.

  In response to a member's question, Mr. Piché (referring to note 14 on page 41) said that the deficit for employee future benefits included deficits of $161.0-million for the pension plans and $293.5-million for other employee future benefits. Those deficits were offset by $127.2-million set aside for the supplemental retirement arrangement and $24.8-million set aside for the pension plan reserve. The negative numbers represented unfunded liabilities for the pension plan and for the employee future benefits earned by employees up to the 2009-10 year.

- **Changes in net assets**. Net assets had grown by $182.9-million over the year. The largest element in that growth was the $106.7-million gain in the value of the externally restricted endowments arising from the 14.7% investment return for 2009-10 – a return that was very welcome given the large loss the previous year. Other changes were the net income for the year of $45.4-million, externally restricted donations to the endowments of $19.5-million, externally restricted grants from the Province of Ontario of $4.2-million and an unrealized gain on swap contracts of $7.1-million.

- **Financial results compared to forecast**. In the financial forecast presented to the Business Board early in February, it had been predicted that the University's revenue for 2009-10 would be $2.140-billion. Because of the unanticipated grants received from the Government of Ontario, actual revenue had been 3.3% greater at $2.211-billion. Actual expense had been very close to the forecasted amount, leading to the net income of

5. **Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

$45-million. Net assets, as noted, had grown to $1.8-billion, which was 4.2% more than the forecasted amount. In the operating fund alone, the forecasted deficit had been $42.6-million. Owing in large part to the end-of-year Government of Ontario grants, the actual operating-fund deficit was only $2.1-million.

- **Endowment funds**. The University's total endowments amounted to $1.437-billion. The largest portion of the endowments, amounting to $614.1-million, was devoted to student aid. The second largest component, $437.4-million, was in support of Endowed Chairs and Professorships. Other endowments supported particular academic programs and areas of research.

  To protect the endowed funds against the effects of inflation, their actual value, as at April 30, 2010, should have been $316-million above their original or book value. In fact, their actual value was only $124.5-million above their book value. That represented a substantial improvement over the previous year, when investment losses had weighed heavily on the endowments. While the endowments as a whole were now above their book value, some individual endowments, funded when the securities markets were at their high point, remained under their book value. The endowments were, however, on a positive track to recover their value protected against inflation.

  Mr. Piché displayed a graph comparing the cumulative preservation of capital to cumulative effect of inflation at fiscal years' end from 2001 to 2010. Until 2009, in all years except one (2003), the value of the endowment capital had been preserved against the effects of inflation with a substantial cushion. The major investment loss in 2008-09 had, however, used up all of the inflation protection and had reduced the real (after inflation) value of the endowment to a point well below its inflation-adjusted value. While the good investment returns in 2009-10 had gone some way to reducing the gap, a substantial gap of $191.5-million remained.

- **Capital investment in infrastructure**. The University had invested $210.1-million in its infrastructure for 2009-10, an amount similar to those in recent years. The 2009-10 investments were the result of funding from the Federal and Provincial Governments through the Knowledge Infrastructure Program, intended to assist the post-secondary institutions in building their infrastructure and to promote the recovery of the economy from the recent recession.

- **Borrowing**. The University's borrowing strategy defined the maximum permissible external borrowing capacity as 40% of net assets averaged over the previous five years. In addition, the University was permitted to arrange $200-million of borrowing from an internal source: the University's operating monies, which were invested through the Expendable Funds Investment Pool. For 2010-11, the maximum external borrowing capacity would be $771.5-million, representing 29.2% of the 2009-10 net assets. The

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Business Board had granted approval for the borrowing of a further $200-million. If that capacity were to be used, actual external borrowing would increase to 37.7% of capacity – very close to the limit.

- **Notes to the financial statements**. Mr. Piché recalled that the Committee had at its previous meeting considered draft notes to the financial statements. Only one change had been made since that meeting: the addition of part (e) to note 24 on Contingencies. The note concerned the University's negotiation of a new job evaluation system with one of its unions representing administrative staff. The negotiation was considering what, if any, salary increase would be required to be paid to union members for the University to comply with the *Ontario Pay Equity Act*. It was not possible to estimate the liability, if any, for any increase in salary expense that might arise from that negotiation.

Numerous matters arose in questions and discussions. Among them were the following.

**(i) Marginal financial effect of enrolment growth**. A member asked about the financial effect of increasing enrolment: specifically the net revenue and cost per student. Did the University benefit financially from enrolment increases or did they come at a net cost? Another member observed that it would be very helpful to have this information on particular units. While the Business Board was made aware of the large items of spending such as salary and benefits and capital expenditures, it did not have information on the financial efficiency and effectiveness of the various units. A member observed that the cost of adding an additional student could be quite low in a program where instruction was provided primarily through large lecture sections. On the other hand, the cost could be quite high in a program such as Dentistry, where a great deal of instruction consisted of individually supervised practical work. Ms Riggall and Ms Brown concurred that both expenses and revenues varied a great deal, depending on the Faculty concerned. While Faculties might have completed analyses of marginal cost compared to marginal revenue, such analysis was not available centrally. As the new budget model developed and as overall costs were better allocated to each division, the University would be able to produce much better information on costs. With respect to revenue, the Government of Ontario not only determined the operating grant provided per student but it also regulated the tuition fees that could be charged for each program. Apart from a few self-funded programs, which did not receive government operating funds, the University and its Faculties could not determine their own pricing. The self-funded programs tended to have quite high fees and were often aimed at students whose employers would pay fees for professionally valuable training. It was the general intention of the Government that its funding for most programs, combined with tuition fees, would correspond with the costs of those programs. However, the most recent study used to determine the public funding per student had been completed many years ago, probably in the 1960s, and it was now quite out of date. In the new budget model, a small percent of the revenue generated by each Faculty was placed into a "University Fund," which was then assigned by the University to various programs. One purpose of the University Fund was to rectify inappropriate funding levels for particular programs, as well as to allow the University to set its own academic

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

priorities and to fund them, rather than having resources wholly allocated in accordance with the Province's funding system.

**(ii) Cash flows**. A member observed that having a positive cash flow was an essential life-line for the institution. Referring to the Statement of Cash Flows, he noted that the University had a positive cash flow leading to the holding of cash and equivalents of $66.8-million at the end of the 2008-09 year. That amount had increased to $133.1-million at the end of the 2009-10 year. Mr. Piché confirmed that that was the case, notwithstanding the use of $210.1-million to purchase capital assets and also the use of $137.0-million for net purchases of investments.

Mr. Piché said that the Controller's Office prepared three-month forecasts of cash-flows, which were updated daily. Any excess cash not required at once but likely to be required in the next three months was deposited in a cash-in-action (enhanced money market) account. Any excess cash not likely to be required for a period of three months or longer was invested by the University of Toronto Asset Management Corporation (UTAM) in the Expendable Funds Investment Pool. Those arrangements had been operating successfully over many years, and the forecasting had proven to be quite accurate.

The member who had raised the matter asked that future years' presentations of the financial statements include commentary on the cash flows, which were very important. Mr. Piché undertook to provide such information.

Ms Brown referred members to Note 5 on Investments, specifically to the table on page 36, which showed the monies in the Expendable Funds Investment Pool. Those monies amounted to $893.5-million as at the end of the year. While not all of that Pool was invested in cash or equivalents, all of the investments were quite liquid and could readily be made available for cash-flow needs.

**(iii) Inter-fund transfers.** In response to a member's question, Mr. Piché explained some of the major inter-fund transfers and other items which led to a change in the unrestricted deficit for the year. Those transfers and items were listed on Schedule 2 of the "Supplementary Report by Fund," on page 52 of the *Financial Report*. First, payments were made from the Operating Fund to support certain ancillary operations that were running deficits. The line showing the net transfer between funds showed $4.8-million transferred into the Ancillary Operations Fund, as part of the $11.3-million of net transfers from the Operating Fund. For example, when the Woodsworth College Residence building on the southeast corner of St. George and Bloor was built, Woodsworth College had no previous residence buildings which were earning an income to support the new residence. It was therefore agreed that the residence would receive an annual subsidy of $1.2-million per year for the first eight years. Second, a net amount of $2.3-million was transferred from the Operating Fund to the Restricted Funds in order to meet the requirement to maintain certain restricted funds at a given level. Third, a transfer of $52.6-million from the Operating Fund to the Capital Fund was required to amortize certain capital assets. Fourth, the line called "change in investment in capital assets" showed a reduction of $15.8-million in the

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value of capital assets in the Ancillary Operations Fund and a reduction of $13.6-million in the value of capital assets in the Capital Fund. That reflected the amortization of the capital assets, indicating the year-over-year change in the stated value of the internally funded capital projects.

**(iv) Pension expense**. In response to a question, referring to Note 4, "Employee benefit plans," and specifically to the table on the middle of page 34, Mr. Piché said that the pension-plan deficit for accounting purposes as at April 30, 2010 was $1.267-billion. The impact of that deficit would be to increase the pension expense for 2010-11 to about $211-million.

**(b) External Auditors' Report on Audit Results**

Ms Tory observed that the level of preparedness for the audit of the financial statements had been outstanding. The material prepared for the auditors had been of very high quality, enabling focus on matters of real importance rather than on details. She complimented Mr. Piché and his colleagues on their exceptional work.

Ms Tory commented on the items of audit emphasis that had been discussed with management. In only one case had the discussion led to an audit difference. Management had recorded as a receivable a prospective $3.5-million grant from the Ministry of Health and Long-Term Care. While management had indicated that it had received verbal assurances for the Ministry that the grant could be paid and while it was confident that it would be, there was no documentation to support that conclusion. That had led the auditors to record their view that the amount was an overstatement of revenue.

Ms Tory commented briefly on the other items of audit emphasis that had been discussed with management.

- **Decision to make no provision for the possibility of a retroactive across-the-board salary increase for faculty and professional librarians**. The Faculty Association, as a group engaging in collective bargaining, was officially exempt from the Province of Ontario's pay-restraint legislation. However, the Government required employers to make every effort to negotiate for no across-the-board salary increase for all employees over two years. The matter for 2009-10 and 2010-11 was currently in the hands of an arbitrator. The University had awarded merit increases but had taken the position that there should be no across-the-Board salary increase (a) in the light of the Government's direction, and (b) in view of the fact that there had been no inflation, or even negative inflation, over much of the period in question. The 2009-10 financial statements therefore contained no accrual for additional salary costs for the year. The cost to the University for the year of an across-the-board salary increase of 1% was estimated to be $3.5-million, which was not a material amount from the point of view of the audit. The auditors had concluded that management's estimate of potential

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liability was at the low end of a reasonable range and that there was a reasonable basis to conclude that no further amount would be payable. Ms Riggall noted that the outcome of the arbitration would likely be the first test of the Government's hortatory position under the legislation. It would therefore be watching the outcome with great interest, and it would be in a position to take the outcome into account with respect to future funding decisions.

- **Pay equity negotiation with a union**. The University was in the process of negotiation with one of the unions representing its administrative staff concerning a new job evaluation system. The union's position would require the University's payment of a significant amount for 2009-10 to comply with the Ontario *Pay Equity Act*. Management's view was that the University had made all appropriate payments under the *Act*. Management had added note 24(e) to the financial statements to disclose this contingent liability. That note had stated that it was impossible to estimate what liability, if any, might exist as at April 30, 2010 with respect to the matter. The auditors had agreed that the note disclosure was appropriate.

- **Externally restricted grants, especially research grants**. The University recorded the unspent parts of externally restricted grants as liabilities – deferred contributions – (as well as cash) until the monies received were spent. It did so because the University had an obligation to spend the monies for the purposes of the grant. Sometimes, sponsors required the University to send invoices to recover spending on the funded projects. In those cases, monies were spent before the grant funding was received. In such cases, there were debit balances in particular accounts. The auditors believed that such debit balances should be recorded as receivables rather than as deferred contributions. However, the amount was not regarded as material. In addition, there was concern that a provision should be recorded for those cases in which the full grants could prove not to be collectable, and in which the debit balance would not be eliminated. The recently appointed Executive Director of the Research Oversight and Compliance Office had looked carefully into the matter and had made a provision in the 2009-10 statements for $4.5-million for uncollectible amounts. The auditors had agreed that the amount of the provision was within a reasonable range. Ms Tory noted that the situation was similar to that experienced in other institutions with large grant-funded research programs.

- **Income statement presentation of transactions on a gross basis**. Generally accepted accounting principles currently required that transactions in which an organization acts as a principal rather than as an agent be recorded on a gross basis – with income and expense recorded separately – rather than on a net basis. For example, investment income had previously been reported after fees. Now, the University was required to report full investment income before fees and to report

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

investment-management fees separately. The auditors had concluded that the University's implementation of the new presentation was appropriate.

- **Interest-rate swap contracts**. The University had entered into interest-rate swap contracts that had the effect of converting two variable-interest-rate loans to fixed rates. The University had during 2009-10 repaid those loans but had retained the swap contracts in order avoid the very large fee required to buy out the contracts. As a result, the swap contracts could no longer be regarded as hedges, and changes in the value of the contracts throughout their lives had to be recorded as investment income or as a reduction in investment income for the current year. The $6.3-million reduction in the value of the contracts had been appropriately recognized as a reduction in investment income in the 2009-10 year.

- **Pension plan**. In line with the reduced interest rate on high quality corporate bonds, the University had reduced the rate it used to discount its accrued benefit obligations in the pension plan from 7.75% to 6%. The result had been a substantial increase in the accrued benefit obligation. The auditors had agreed that the new assumption was a reasonable one. Ms Tory noted that the resulting increase in the accrued benefit obligation was, fortunately, accompanied by an increase in the value of the assets. In the previous year, an increase in the discount rate had reduced the accrued benefit obligation in a year in which the value of the assets had also declined.

- **Legal matters**. The auditors had reviewed a wide range of documentation and were satisfied that the financial statements included appropriate disclosures about potential liability arising from litigation at various stages.

- **Adoption of accounting standards for not-for-profit organizations: cash flow statements**. The auditors concurred with the revised separate presentation of investing and financing activities in the statement of cash flows.

- **Investments**. The auditors had reviewed various documentation and were satisfied with the investment values recorded for non-publicly traded alternative investments.

- **Restricted research grants**. The external auditors had completed a number of audits of individual research grants in compliance with the requirements of the funding agencies. The auditors had noted problems arising from the inability of staff in Research Services in some instances to answer questions about the appropriateness of expenses. During the year, the Vice-President, Research had appointed an Executive Director of the Research Oversight and Compliance Office with appropriate professional accounting qualifications and seniority. The outcome had been a very significant improvement. The Director was, however, still facing a challenging situation with respect to (a) the size of her staff, and (b) access to information beyond

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

that entered into the financial information system. Information on the financial information system was sometimes insufficient to enable a judgement about the compliance of spending with the conditions of research grants.

Substantial discussion developed concerning oversight and compliance with the conditions of research grants. In response to a member's question, Ms Tory said that a broad range of solutions was possible. One possibility might be a knowledgeable individual looking at the nature of the grant, being aware of the typical terms of a grant and asking whether the reported spending of the grant monies made sense. At the other extreme, the oversight / compliance officer might almost complete an audit of the grant. The ideal would probably be somewhere between the two extremes, with an examination of the grant spending based on a risk-based approach – perhaps focusing most on unusual allocations such as (for example) those for frequent travel.

A member expressed concern about the need to make a provision for $4.5-million of research grants that might not be paid. Ms Tory and Ms Riggall replied that the problem arose from a number of situations. In some cases, the principal investigator who held a research grant spent money in anticipation of further support from the grant or from other grants. In other cases, the research was supported by a gift in kind, where the value of the gift proved to be less than anticipated. The Vice-President, Research was aware of the problem and supported the efforts of the Executive Director, Research Oversight and Compliance, to deal with the problem.

Ms Brown stressed the importance of the educational work of the Executive Director of Research Oversight and Compliance. The number of research grants awarded to the University's faculty was very large, and in each case the principal investigator who had won the grant was responsible for it. That individual was required to authorize all spending and was required to communicate with the granting agency. It was therefore very important that principal investigators and departmental business officers be made knowledgeable about the financial aspects of their duties. In response to a question, Ms Riggall said that the training now being provided was very good and was very being very well received by leaders of the academic divisions, principal investigators and business officers. They were well aware of the complexity of meeting the requirements of the granting agencies and wished to do as good a job as possible in meeting those requirements.

In response to a member's question about progress in the area, Ms Brown said that there was a clear need for more oversight by knowledgeable staff. The Executive Director of Research Oversight and Compliance did not have a sufficient number of staff with appropriate financial qualifications to carry out the necessary oversight. The Vice-President, Research would seek an additional budget appropriation to enable the appointment of additional, highly qualified staff, but this clear priority would have to compete with others to be funded.

**5. Audited Financial Statements for the Year Ended April 30, 2010** (Cont'd)

A member asked whether the Internal Audit Department could make compliance with the conditions of research grants a priority issue. Ms Brown replied that while departmental audits did look at the administration of research grants, she did not think that those audits would be a sufficient response to the problems that had arisen. Rather, there was need for an approach focused on the administration of research grants by specialists in the area.

A member noted that faculty members who received grants were required to sign annual accountability reports as part of their activity reports. Those statements made clear the personal responsibility of individual faculty members for their research grants and appeared to stress their individual liability in the event that spending from the grants did not meet the research-granting agency's policy. Ms Brown agreed that such verifications were very important, and the administration of most research grants was very good. The Canada Foundation for Innovation, for example, considered the University of Toronto to be one of the better universities in the country in terms of its compliance with the conditions of research grants. However, there were thousands of grants; while many were very well administered, some were not and the addition of oversight would be of real importance. Ms Brown stressed that the appointment of the Executive Director, who was a compliance expert, had made a very great difference.

Ms Tory drew the Committee's attention to the "Required Communications" contained in the *Audit Results* Report. She then directed the Committee's attention to the letter on page 12 of that Report, which assured the Committee of the external auditors' independence. She asked members to raise any areas of risk that they thought had not been addressed in the auditors' communications and to inform her of their knowledge of any actual or suspected act of fraud. Members confirmed that they were aware of no such matters.

**(c) External Auditors: Private Meeting**

THE COMMITTEE MOVED IN CAMERA.

Members of the administration, the Secretariat and the internal auditors absented themselves. Ms Tory was invited 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."

THE COMMITTEE ENDED ITS IN CAMERA SESSION.

The Chair reported that no matters had arisen in the *in camera* session that would require attention at a higher level.

## 5. Audited Financial Statements for the Year Ended April 30, 2010 (Cont'd)

### (d) Legal Claims

The Chair said 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 one new claim had arisen during the year, which was highlighted in the report by underscoring.

A member enquired about a class action suit filed by individuals whose salaries were deemed not to be subject to tax withholding. Mr. Piché replied that the individuals, who were not deemed to be University employees, had been paid according to a number of different arrangements. Tax had not been withheld and the individuals were deemed to be responsible to pay their own taxes. They were challenging the University's not withholding the tax from their compensation.

### (e) Committee Recommendation

On the recommendation of the Vice-President, Business Affairs and of the Chief Financial Officer,

YOUR COMMITTEE RECOMMENDS

THAT the University of Toronto audited financial statements for the fiscal year ended April 30, 2010 be approved.

On behalf of the Committee, the Chair congratulated Ms Brown and Mr. Piché and members of their staff on their very well done job in preparing the annual financial statements. A member observed that the *Financial Report* was one of the most comprehensive he had seen. It was a real model of transparency, and those responsible for its preparation were to be congratulated.

## 6. External Auditors: Appointment for 2010 – 11

Ms Brown said that the administration recommended the re-appointment of Ernst & Young as the external auditors of the University and its pension plans. The firm had a high level of expertise in the audits of post-secondary institutions, and the University was very fortunate to have a firm and a partner with so thorough an understanding of accounting issues for universities. The University did a periodic, major review of professional services as well as a more routine annual review. The periodic review included consultation with other client groups within the University, which review had to date revealed a very high level of satisfaction with the audit service provided. The auditors would complete not only the audit of the University's overall



financial statements but also of the financial statements of the pension plans, Hart House and the University of Toronto Asset Management Corporation. Ms Brown had no hesitation whatever in recommending the reappointment.

The following matters arose in discussion.

**(a) Length of service of the auditors**. In response to a member's question, Ms Brown said that Ernst & Young, and its predecessor firm in Canada – Clarkson Gordon – had been the University's auditors for many, many years. To ensure the independence of the auditors, the firm had periodically changed the partner in charge of the audit. Ms Tory, who was an expert in the not-for-profit sector, had been the partner in charge for the past five years. In response to another question, Ms Brown said that there was no legislated limit in Canada on the length of service of an audit firm or partner in charge of an audit. Such a limit was in place in the United States, but it did not apply to not-for-profit organizations. In the U.S., the National Association of College and University Business Officers (NACUBO) had considered the matter. It had recognized that post-secondary institutions had highly specialized accounting, and that only a limited number of audit firms had specialists capable of providing excellent audit services to those institutions. The Association did not, therefore, recommend the mandatory rotation of audit firms. Rather it recommended the periodic rotation of the audit partner. In Ms Brown's view, the key factors to be considered in appointing auditors were the level of their independence and their expert knowledge. The University had been very well served by Ernst & Young, who had arranged quite appropriately for the periodic change of the partner in charge.

**(b) Cost of audit services**. In response to a member's question, Ms Brown and Mr. Piché said that the University compared the price charged by its external auditors with those charged to other universities as appearing in an annual survey conducted by the Council of Ontario Universities (C.O.U.). That comparison showed that the cost of audit services paid by the University of Toronto was competitive. In comparing the price charged for audit services, it was necessary to take into account a number of factors. At the University of Toronto, for example, the Internal Audit Department devoted 700 hours to assisting the external auditors – something that reduced the cost of the audit. Other factors to be considered were the size and complexity of the institution, the experience of its financial-administration staff, and the preparedness of the records required for the audit.

**(c) Suggestion for periodically inviting tenders for audit services**. Two members urged that the University invite tenders from major firms knowledgeable in university affairs every seven years or so. That would be an appropriate process even if the outcome was the re-appointment of the same firm. The tendering process might well be useful in controlling the cost of the audit, but the process would be even more important as a means of providing assurance of accountability and of the independence of the auditors. Ms Brown assured members that the current external auditors were highly independent.

**6. External Auditors: Appointment for 2010 – 11** (Cont'd)

On the recommendation of the Vice-President, Business Affairs and 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, 2011; 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, 2011.

**7. Report of the Administration**

**(a) Investment Management**

The Chair said that it had been noted, in the Committee's *in camera* discussion, that there was underway a major change concerning the management of University and pension-plan investments. The Chair invited Ms Riggall to comment.

Ms Riggall reported that the President of the University had received the report of his Advisory Committee on Investment Policies, Structures, Strategy and Execution, which had been chaired by the Honourable Henry N. R. Jackman, Chancellor-Emeritus of the University. The University was currently acting to implement the recommendations of that Committee. There would be significant changes to the governance of the University of Toronto Asset Management Corporation (UTAM). A new interim Board of Directors had been appointed beginning in March, 2010 and it had held two meetings. Its membership, apart from *ex officio* members, consisted primarily of members of the Business Board. That interim Board had approved amendments to the UTAM By-Law Number 1 which had reduced the size of the Board from thirteen to five members. The new, smaller Board would focus its attention on the governance of UTAM. It would carry out its operations without committees. (Previous Committees had been an Executive Committee, an Audit and Compliance Committee, a Compensation Committee and a Private Markets Committee.) The membership of the Board would consist solely of University employees: the President of the University; the Vice-President, Business Affairs; the Chief Financial Officer; the President and Chief Executive Officer of UTAM; and a nominee of the Faculty Association (UTFA). Provision for the UTFA representative had arisen from an arbitration proceeding concerning the management of the pension plan. The key aspects of the By-Law changes would be recommended for approval by the Business Board at its meeting on June 17. The Business Board would also be asked to approved a revised Delegation of Authority from the University to UTAM. UTAM would cease to have delegated authority to determine the asset mix for the major funds. The arbitration proceeding had stipulated the formation of a new Pension Committee of the Governing Council. When that new Committee, which would include employee representatives, was established and in operation, it would approve the asset mix for

**7. Report of the Administration** (Cont'd)

**(a) Investment Management** (Cont'd)

the Pension Fund. The President of the University would approve the asset mix for the Long-Term Capital Appreciation Pool (the L.T.CAP) which included almost all of the University's endowment funds, the funds set aside to meet the University's commitments under the Supplemental Retirement Arrangement, and the Long-term Borrowing Pool containing the funds being set aside to repay the University's capital-project debentures when they became due. The L.T.CAP asset mix would be determined by the President and his administration, acting with the benefit of the advice of a new Investment Advisory Committee, consisting of independent external experts. The Business Board was also being asked to recommend to the Governing Council amendments to its own terms of reference in the light of the proposed new arrangements. Further amendments to the Business Board terms of reference, and amendments to the Audit Committee terms of reference, would be required in connection with the establishment of the planned Pension Committee. The proposal to establish that Committee was not ready at the moment to come forward; there were some difficulties in securing the agreement of all parties to its membership and terms of reference.

In response to a member's question, Ms Riggall said that the asset mix of the pension plan and the L.T.CAP might well change, driven by changes to the return targets and risk tolerances for those funds. The return targets and risk tolerances were currently under review by the University's administration.

**(b) Proposed Pension Committee**

In response to member's questions, Ms Riggall said that the proposed Pension Committee would include representatives of the Faculty Association and of the largest unions representing the administrative staff. It would also be important that there be a representative of the non-union administrative staff. For any Governing Council committee to have the authority to make decisions on behalf of the Council, the *University of Toronto Act* required that a majority of the Committee's members be members of the Governing Council. A member cautioned that for the proposed Committee to be effective, it was important that it not be too large.

**(c) Pension Plan Funding**

Ms Riggall recalled that as at the most recent actuarial valuation, the University's pension plan included a substantial actuarial deficit and a solvency deficit. Following the severe declines in the equity markets in 2008-09, other Ontario universities faced the same problem. The Council of Ontario Universities and the Council of Senior Administrative Officers of the Universities of Ontario were seeking an exemption from the usual requirement that plan sponsors be required to make additional contributions to the pension plan to eliminate the solvency deficit within five years. The solvency deficit had been a highly exceptional position arising from a highly unusual market deterioration. However, Government authorities had not to date

**7. Report of the Administration** (Cont'd)

**(c) Pension Plan Funding** (Cont'd)

been supportive of this request, proposing instead that the level of employee and employer contributions be increased. While an increase in contributions might well be desirable, any increase in employee contributions had to arise from negotiations, and obtaining the agreement of employee associations and unions would be very difficult, especially at a time when employees were affected by compensation-restraint legislation. In response to a member's question,
Ms Riggall said that employee contributions at the University of Toronto were at the norm for universities with defined-benefit pension plans. They were probably under the norm for public-sector pension plans, but the pension benefits were also less than those for public-sector employees.

**(d) Other Matters**

Ms Riggall, Ms Brown, and Mr. Charpentier said that there were no other items that should be drawn to the attention of the Committee at this time.

**8. Borrowing Capacity and Status of the Long-Term Borrowing Pool to April 30, 2010**

Ms Brown said that in recent years the University's external borrowing program had been carried out by the issue of long-term debentures with terms of thirty to forty years. The debentures were not secured against any University property, and there was no requirement that the University accumulate a sinking fund to repay them. The only requirement was that the University make twice-annual interest payments and then repay the debentures when they become due. For reason of internal prudence and discipline, however, the University had initiated a sinking fund, the Long Term Borrowing Pool. Internal borrowers were required to make blended principal and interest payments. Those payments were placed in the Long-Term Borrowing Pool, which was used to make interest payments on the debentures, to pay other expenses such as credit-rating costs, and to accumulate monies for repayment of the debentures. The series "A" debenture had been issued in the amount of $160-million and was due on July 18, 2031. The series "B" debenture had been issued in the amount of $200-million for repayment in December 15, 2043. The series "C" debenture, in the amount of $75-million was repayable in November 2045. The series "D" debenture, in the amount of $75-million, was repayable in December 2046. The balance in the Long-Term Borrowing Pool as at April 30, 2010 was $67.5-million. That balance was invested in the Long-Term Capital Appreciation Pool, which had suffered a substantial loss in 2008-09 but had earned a very good return in 2009-10.

**9. Date of Next Meeting**

The Chair reminded members that the Committee's first meeting for 2010-11 was scheduled for Wednesday, September 15, 2010 at 4:00 p.m.. That meeting would continue the *in camera* discussion begun by the Committee on May 12, 2010. The Vice-Chair invited members

**9. Date of Next Meeting (Cont'd)**

to be in touch with her with topics they would like to have included in the discussion. The first meeting to conduct regular business was scheduled for Wednesday, December 8, 2010. The complete meeting schedule for the year would be distributed to members over the summer.

The meeting adjourned at 6:05 p.m.

Secretary

Chair

August 24, 2010

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