



TO: Members of the Audit Committee

SPONSOR: George Myhal, Chair, Audit Committee

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Revised by Audit Committee March 21, 2011

AGENDA ITEM **4**

ITEM IDENTIFICATION:

Audit Committee Terms of Reference: Proposed Revisions

JURISDICTIONAL INFORMATION:

Section 5.1.6 of the Audit Committee Terms of Reference state that the Committee “reviews, from time to time as required by regulatory changes and as the Committee deems appropriate, and at least every five years, these terms of reference, and makes recommendations to the Business Board for any appropriate amendments.” The Business Board in turn makes a recommendation to the Governing Council.

In addition, the Implementation Committee of the Governing Council Task Force on Governance is at work, and that process encourages review of Committee terms of reference.

PREVIOUS ACTION TAKEN

On June 29, 2006, the Governing Council approved revised Audit Committee terms of reference, arising from an extensive review by the Committee.

On October 28, 2010, the Governing Council approved a revision to the Terms of Reference specifying that the Audit Committee would make its recommendation concerning the financial statements of the Pension Plan to the new Pension Committee.

At its meetings of December 8, 2009 and December 8, 2010, the Committee reviewed its terms of reference, and members made a number of suggestions for changes.

At its special meeting of September 15, 2010, the Committee agreed that it should give increased emphasis to governance oversight of risk management, devoting the whole of one meeting to the annual report on risk assessment and perhaps proposing a change in the Committee’s name to emphasize the risk-management oversight function.

Audit Committee Terms of Reference: Proposed Revisions

HIGHLIGHTS:

- **Risk Management.** To implement the Committee’s decision to increase the emphasis on its role in oversight of risk management, it is proposed to change the name of the Committee to the “Audit and Risk Committee.”

In the section dealing with the composition of the Committee, it is proposed to specify that members are appointed “on the basis of their expertise in financial matters *and/or risk management* . . . [emphasized words added].”

The Committee’s role with respect to risk management is stated in section 5.1.5 of the current terms of reference.

Reviews an annual management report on significant business, financial and regulatory risks and monitors the University’s processes for identifying and controlling those risks. In carrying out this responsibility, the Committee focuses primarily on the adequacy of key controls over, and mitigations of, those vital risks considered to be, currently or in the future, more significant and likely to occur, meets with management and the internal or external auditors to come to a fuller understanding and better assessment of management’s response to controlling important risk situations, and reports any concerns to the University’s senior officer reporting to the President responsible for financial matters, to the President, or to the Business Board, as appropriate.

That provision does not appear to require strengthening.

Section 5.2, setting out the responsibility of the administration, states that it is “directly responsible for the University’s risk-management and financial reporting processes, including . . .” It is proposed to add a new “including” sub-section dealing with risk management:

- (ii) the preparation of an annual report on the key risks facing the University, including controls, procedures and other actions taken to mitigate known risks, and procedures and other actions to enhance the organization’s ability to respond to unexpected events;

Audit Committee Terms of Reference: Proposed Revisions

- **External auditors' independence.** Section 4 of the current terms of reference, outlining the Committee's function, states that the Committee "ensures the [external] auditors' independence in their relationships with the administration." In the 2010 review of the terms of reference, a member observed that while the Committee received reports from the external auditors, including their assurance of their independence, the accountability for their remaining independent was that of the auditors.

It is therefore proposed that the final sentence of Section 4 of the Terms of Reference, Function, be amended to read as follows (with the emphasized words added):

The Committee monitors the competence with which external and internal audits are carried out; ensures that the auditors' recommendations are given due consideration; and *receives reports on* the auditors' independence in their relationships with the administration.

The words "receives reports on" would replace the word "ensures."

- **Financial reporting – Reports on outstanding legal actions against the University.** Section 5.1.1(c) of the current terms of reference sets out the Committee's responsibilities in connection with financial reporting. The current section states that the Committee

Reviews, in connection with the review of the 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 the financial statements, as well as . . . to monitor possible risk exposures.

During the 2010 review, a member expressed concern that the adjective "substantial" might give the impression that there was a relatively high threshold for the actions that were to be disclosed to the Committee and reviewed. It is therefore proposed that a specific threshold for inclusion of legal actions in the report be stated, and that section 5.1.1(c) be amended to read as follows (with emphasized words added):

Reviews, in connection with the review of the University's audited financial statements, an annual report on outstanding legal actions against the University *in amounts in excess of \$500,000* in order to monitor contingent liabilities that should be disclosed in *the* financial statements, as well as . . . to monitor possible risk exposures.

Audit Committee Terms of Reference: Proposed Revisions

- **Internal Auditor.** Section 5.1.3(b) states that the Committee “reviews the internal auditor’s plan and procedures.” The Committee concluded that it should not be seen as responsible to review of the internal auditor’s procedures. The internal audit plan provided a good view of the general processes carried out, for example the system of continuous auditing. It is therefore proposed that the words “and procedures” be removed from this section of the terms of reference.
- **Financial controls and control environment.** Section 5.1.4 (Financial Controls and Control Environment), part (a), states that the Committee:

Periodically reviews management reports on control systems and the control environment. Assesses, on the basis of the interim and annual reports from the internal auditor, the annual management letter from the external auditors and other relevant reports the effectiveness of the University’s control systems.

In the 2009 review of the terms of reference, a member proposed revision of the terms of reference to make it clear that the Audit Committee reviewed reports on the effectiveness of controls, but it did not itself make an independent assessment of them. It is therefore proposed that section 5.1.4(a) be revised to read as follows:

Periodically reviews management reports on control systems and the control environment, including the interim and annual reports from the internal auditor, the annual management letter from the external auditors and other relevant reports that evaluate the effectiveness of the University’s control systems.

- **Responsibility of the administration – Preparation of financial statements.** Section 5.2 of the current terms of reference states that the administration is directly responsible for “the University’s risk-management and financial reporting processes, including” In the 2010 review, a member said that this provision should make it clear that the administration is responsible not only for the financial reporting process but also the outcome of the process, i.e. the actual financial statements.

It is proposed that this section be amended to read as follows:

The administration is directly responsible for the University’s financial reporting process, preparation of its financial statements, and its risk management process.

Audit Committee Terms of Reference: Proposed Revisions

- **Editorial change.** The terms of reference would use the proposed full name of the Committee – the Audit and Risk Committee – only once, and would state in section 1.1 that all further references would simply be to “the Committee.”

FINANCIAL AND/OR PLANNING IMPLICATIONS: N/A

RECOMMENDATION:

Be it Recommended to the Business Board

THAT the proposed amended terms of reference of the Audit Committee, a copy of which is attached hereto, be approved.

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