UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 98 OF THE AUDIT COMMITTEE

May 10, 2011

To the Business Board,
University of Toronto.

Your Committee reports that it met on Tuesday, May 10, 2011 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
Ms Penny Somerville
Mr. Chris Thatcher
Ms Catherine J. Riggall, Vice-President, Business Affairs
Mr. Mark Britt, Director, Internal Audit
Ms Sheila Brown, Chief Financial Officer
Mr. Louis R. Charpentier, Secretary of the Governing Council

Mr. Neil Dobbs, Secretary

Regrets:

Mr. Joseph Mapa
Mr. J. Mark Gardhouse
Mr. W. John Switzer

In Attendance:

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

ALL ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR INFORMATION.

1. Report of the Previous Meeting

The Chair noted that in addition to the usual report, which was a public document, members had received confidential notes on the *in camera* portion of the meeting, dealing with the discussion of specific matters in the risk assessment. Report Number 97 (March 21, 2011) was approved.

2. Audited Financial Statements for the Year Ended April 30, 2011: Draft Notes

Mr. Piché observed that the material provided included a draft of the independent auditors' report because that report would change significantly from the previous year. He said that the notes to the financial statements for 2010-11 would contain only one new element:

2. Audited Financial Statements for the Year Ended April 30, 2011: Draft Notes (Cont'd)

note 2(n) on future accounting policy changes. The Canadian Institute of Chartered Accountants *Handbook*, Part II, set out new accounting standards for not-for-profit organizations that would affect the University's financial statements for the 2012-13 fiscal year. The University was currently evaluating the impact of those standards.

Mr. Piché reported that, in connection with the new rules, the University was considering the option of valuing the University's land and buildings at their fair value as at the opening of the comparative year, that is as at May 1, 2011. The University had not yet made a decision, but it was giving consideration to adopting this option for its land. To keep this option open, it was arranging to have its land appraised by an independent valuator. It would not record the 2011 value of its buildings because it would be required to amortize that value over the years. The benefit of reporting the 2011 fair value of University land would be to increase the University's net assets, which might well be viewed favourably by the rating agencies with respect to their rating of University debenture issues. That would in turn reduce the cost of borrowing.

In response to questions, Ms Riggall, Ms Brown, and Mr. Piché said that the May 1, 2011 valuation of the land would continue to be used on the statements for subsequent years. The land would not be re-valued from year to year. The value of the land would be regarded in the same manner as a cost. The appraisers would establish the value of the land by using comparisons to similar properties that had been sold in the area, stripping away the imputed value of the buildings on the land. The value of the land was affected by zoning restrictions. Most of the land on the St. George Campus was zoned for institutional use. Some of the frontage on Bloor Street West was zoned for commercial/residential use, which allowed for institutional use. Substantial proportions of the land of the Mississauga and Scarborough campuses were restricted for reasons of conservation, and buildings could not be erected on that land. It was true that the rating agencies were aware of the value of the University's land and that their awareness should affect their ratings. However, they did not know the specific value of the land. A substantial advantage of recording the 2011 value of land would be that it would move the University closer to having all of its assets and liabilities recorded on the balance sheet – something that would be particularly important as the University would be required over the next few years to record on its balance sheet its full liability for employee future benefits. On the other hand, there was concern that recording the fair value of its land would make the University appear to be unrealistically well-off in light of the fact that it required its land resources to carry out its mission. A decision would be made by the University's administration and included in the 2011-12 financial statements brought forward for approval through the Audit Committee and the Business Board to the Governing Council. In the course of discussion, a member observed that in the current Note 6 the value of the land was recorded at its cost of $72.2-million, which was likely well below its market value. Whatever value was used in the financial statements would have to be written down in the unlikely event of any impairment of its value.

Mr. Piché responded to questions about other aspects of the notes. With respect to the first paragraph of note 5, Investments, significant amounts invested in pooled funds, hedge funds

2. Audited Financial Statements for the Year Ended April 30, 2011: Draft Notes (Cont'd)

and derivative investment contracts had always been reclassified into other asset-mix categories (e.g. equities, bonds) based on the intention of those investments. With respect to note 16, Ontario Student Opportunity Trust Fund, the funds were recorded separately as Phase 1 and Phase 2 in accordance with the matching funding programs provided in two separate phases by the Government of Ontario. Doing so minimized the amount of auditing required for those funds.

The Chair said that the full statements, including numbers for 2010-11, would come before the Committee at its June 15th meeting, at which time the Committee would consider a motion for approval. Mr. Piché would, at that meeting, report specifically on any changes to the format or wording of the notes made between now and June 15. He urged members with any additional comments to be in touch with Mr. Piché as soon as possible.

3. Audit Committee Terms of Reference: Further Consideration

The Chair recalled that at its March meeting, the Committee had recommended to the Business Board revisions to its terms of reference. However, the Business Board had not endorsed those recommendations and forwarded them on the Governing Council. Rather, because of certain concerns, and because the matter was not one requiring urgent action, the Board had asked for further consideration of the proposal both by the Committee and by the Implementation Committee for the Task Force on Governance.

Ms Kennedy reported that two matters of concern had been raised at the Business Board. The first concerned the composition of the Committee. The terms of reference stated that the Committee would consist of "about eight independent voting members, who are normally not members of the teaching staff, administrative staff or students of the University." Notwithstanding that provision, "the voting membership may include a senior member of the teaching staff of the University with expertise in accounting." A Business Board member had expressed concern that a member of the teaching staff of the University would not be independent. In addition, the terms of reference stated that the Chair and Vice-Chair of the committee were "appointed annually by the Business Board." That meant that the teaching staff member could be made Chair or Vice-Chair. Ms Kennedy had sought to assure the Board that the teaching staff member with expertise in accounting had in fact always acted independently and had brought very valuable feedback to the Committee's discussions. Ms Kennedy suggested dealing with the concern by tightening the language of the terms of reference and clarifying that the Chair and Vice-Chair would be one of the independent members and not the member of the teaching staff. However, the provision for membership of a faculty expert had proven to be a very valuable one and should be retained.

Ms Kennedy reported that the other matter of concern had been risk management, in particular a concern that the terms of reference did not make it clear that there would be a

3. Audit Committee Terms of Reference: Further Consideration (Cont'd)

comprehensive review by a Governing Council committee of all aspects of risk management. In a full discussion of the matter, Ms Kennedy had sought to make it clear that the Committee did review a comprehensive report on risk and to advise that it was taking action to ensure that members had adequate information on all risks while not at the same time duplicating the work completed elsewhere. The Committee had asked that Mr. Switzer, as a member of the Implementation Committee for the Task Force on Governance, bring this matter to the attention of the Implementation Committee. The Committee should not, therefore, at this time recommended further change in its terms of reference concerning risk management.
Ms Kennedy thought it might be worthwhile to make the Business Board aware of the extent of the Committee's work in the area of risk management, to review with the Business Board its work on the annual risk-assessment report. Ms Kennedy also thought it appropriate to complete some limited redrafting of the terms of reference as they concerned risk management, and she would forward suggestions to the Chair and Ms Riggall.

Ms Riggall said that the discussion raised the question whether governance responsibility for risk management should remain in the terms of reference of the Audit Committee or should instead reside with the Business Board. While the predominant view appeared to be that the responsibility should remain that of the Audit Committee, the question was one that should be considered by the Implementation Committee for the Task Force on Governance. She proposed, therefore, that the Committee await the outcome of the discussions of the Implementation Committee before itself proceeding further.

Mr. Charpentier agreed that it would be the most prudent course of action to await the outcome of Implementation Committee discussions. He anticipated that the Implementation Committee would bring forward recommendations in the first cycle of governance meetings in the fall. While they might not contain specific recommendations concerning the terms of reference, they would at the least propose a timetable for review. One possibility that had been raised was that the Executive Committee of Governing Council assume some portion of responsibility for governance review of risk management. However, the division of responsibility among the Audit Committee, the Business Board and the Executive Committee would require careful consideration. The views of the Audit Committee, and the discussion in the Business Board, would be taken into account.

Ms Kennedy asked whether it would be appropriate for the Committee to proceed with the other, or housekeeping, aspects of its recommendations at this time. Ms Riggall and Mr. Charpentier advised that it would be preferable not to proceed further at this time. The Business Board agenda in June was always a very full one. In addition, the Implementation Committee might well recommend certain housekeeping changes for the Governing Council committees in general.

In the course of discussion, two members commended Ms Kennedy for her clear presentation of the Committee proposal to the Business Board and for her vigorous defense of it.

4. Risk Assessment: Focus Topics for 2011-12

The Chair recalled that at the previous meeting, the Committee had decided that in addition to its review of the overall risk-assessment profile, the Committee should, over the course of the year, give additional, focused attention to a small number of areas of risk. On the assumption that the Audit Committee would continue to be responsible for monitoring risk, Ms Riggall had proposed three areas.

Ms Riggall reported that she had discussed the matter with the University's senior executive group, and following those discussions, she proposed the three areas for more intensive review. The first was risk in the area of information technology. The Committee had noted, in its review of the overall risk-assessment profile, that there was currently no reporting on information-technology risk to any other committee of the Governing Council. That area was an important one also because there were a number of major information-technology projects underway including the new-generation student information system.

Ms Riggall proposed that a second area for closer examination be investment risk. The Committee had about three years previously received a presentation from the University of Toronto Asset Management Corporation (UTAM) on its investment-compliance assurance and risk-management arrangements. UTAM was, however, making a number of moves to establish a risk budget and to manage various risks more specifically, and it would be useful for the Committee to receive a report on those matters. A member observed that UTAM currently submitted semi-annual reports to the Business Board, and she asked whether its also reporting to the Audit Committee might represent duplication. Ms Riggall replied that the subject of reporting to the Audit Committee would deal specifically with risk management. The Business Board was more interested in investment returns.

Ms Riggall proposed that the third area for more intensive consideration could be student-crisis management. It was always a matter of great concern when an incident took place that caused harm to a student(s). The University had developed a very rigorous process to deal with potential or actual incidents, and it would be very useful for the Committee to have a more detailed understanding of that process. Ms Riggall noted that the University had made its process more formal and more rigorous following the tragic events at Virginia Tech.

Ms Riggall also noted that Mr. Britt had recently made an excellent presentation on fraud risk to the Risk Forum, and that presentation might well be of considerable interest to the Committee. She stressed that her suggestions were only that and that she would be pleased to arrange for consideration of other topics instead.

Ms Riggall said that the Committee's consideration of those matters, or others, would be most useful if the University officers responsible in the particular areas of risk were to be invited to make presentations and to answer questions. She therefore suggested that one area be considered at each of the Committee's first three meetings.

In response to the Chair's question, Mr. Britt and Mr. Charpentier agreed that the suggested topics would be very useful ones. The topic of information-technology risk would be a particularly important one given the absence of reporting to any other governance body. Ms Tory said that the

4. Risk Assessment: Focus Topics for 2011-12 (Cont'd)

areas were of considerable interest, and it was worthwhile that the Committee was moving to consider areas of risk (a) outside of the traditional financial areas, and (b) in areas where there could be a substantial impact arising from undesirable outcomes.

The Chair thanked Ms Riggall and concluded that the proposed topics would be appropriate ones.

5. Report of the Administration

Ms Riggall stated that she was aware of no other matters that should be drawn to the attention of the Audit Committee at this time.

6. Date of Next Meeting

The Chair reminded members that the final regular meeting of the academic year was scheduled for Wednesday, June 15 at 4:00 p.m. The major item of business would be the review of the audited financial statements. The Committee would also, among other things, receive the annual report on insurance and risk management and the annual report of the Internal Audit Department.

THE COMMITTEE MOVED *IN CAMERA.*

7. *In Camera* Meeting with the Internal Auditor

The administrative assessors other than Mr. Britt absented themselves. The Chair invited Mr. Britt to comment on any matters that should be drawn to the Committee's attention and to respond to questions.

In the course of discussion, it was agreed that Mr. Britt be asked to make his presentation on fraud risk to the Committee at a meeting in 2011-12. Another topic that might merit closer attention was compliance with the new Procurement Policy, adopted in response to the Ontario broader public sector guideline on compliance. The subject of investment risk management could, in view of UTAM's regular reports to the Business Board, be deferred if there was no time to fit it into the Committee's calendar of business for 2011-12.

THE COMMITTEE COMPLETED ITS *IN CAMERA* SESSION.

The meeting adjourned at 4:45 p.m.

Secretary | Chair

June 9, 2011

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