

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

**REPORT NUMBER 97 OF THE AUDIT COMMITTEE**

**March 21, 2011**

To the Business Board,  
University of Toronto.

Your Committee reports that it met on Monday, March 21, 2011 at 5:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Ms Paulette L. Kennedy (In the Chair)  
Professor Ramy Elitzur  
Mr. Joseph Mapa  
Mr. W. John Switzer  
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. J. Mark Gardhouse  
Mr. George E. Myhal

Ms Penny Somerville

In Attendance:

Ms Martha Tory, Ernst & Young  
Mr. Anwar Kazimi, Committee Secretary, Office of the Governing Council

ITEM 2 CONTAINS A RECOMMENDATION TO THE BUSINESS BOARD.  
ALL OTHER ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR  
INFORMATION.

**1. Report of the Previous Meeting**

Report Number 96 (December 8, 2010) was approved.

**2. Audit Committee Terms of Reference: Revisions**

The Chair said that the proposed revisions to the Committee's terms of reference arose from both the Committee's special meeting of September 15, 2010 and from its annual reviews of the terms of reference which had taken place in December 2009 and December 2010. The most substantial change concerned the Committee's wish to clarify its role in overseeing risk management. The name of the Committee would be changed to the Audit and Risk Committee.

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The Committee's role with respect to oversight of risk management was already set out in section 5.1.5. It was, however, proposed to state specifically the responsibility of the administration to prepare an annual report on key risks, the actions taken to mitigate them, and the provisions in place to respond to unexpected events. Other proposed changes were relatively minor in nature and were set out in the black-lined version of the terms of reference.

- It was proposed to revise section 4. The objective was to make it clear that, while the Committee received an annual report from the external auditors concerning their independence, the auditors themselves, and not the Committee, were responsible for maintaining that independence.
- Section 5.1.1(c) concerned the Committee's review of an annual report on outstanding legal actions against the University. That review took place in connection with the review of the audited financial statements. The revision would specify that all actions making claims in excess of \$500,000 would be included in the report. The current terms of reference simply spoke of "substantial" amounts.
- Section 5.1.2, on financial controls and the control environment, would be amended. The objective was to make it clear that the Committee reviewed reports on the effectiveness of controls. It did not itself make an assessment of their effectiveness.
- Section 5.2 would be amended to make it clear that the administration was responsible not only for the "financial reporting process" but also for the actual preparation of the financial statements.

Two additional amendments were proposed and agreed by the Committee.

- Section 5.1.3(b) currently stated that the Committee "reviews the internal auditor's annual audit plan and procedures." A member suggested that it would be over-stating the case to suggest that the Committee reviewed the internal audit procedures. Mr. Britt said that the intention of the provision was to require that the Committee review the nature of the work carried out, for example the programs of departmental audits and continuous audits. Those matters were, however, included in the annual audit plan, and the words "and procedures" were therefore redundant. It was agreed to recommend their removal.
- It was noted that the terms of reference sometimes referred to the Audit and Risk Committee (using the proposed new name). At other times, it simply referred to "the Committee." It was agreed that the Committee would be referred to in section 1.1 as "the Audit and Risk Committee ('the Committee')" and thereafter simply as "the Committee."

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On motion duly made, seconded and carried

**YOUR COMMITTEE RECOMMENDS**

THAT the proposed amended terms of reference of the Audit Committee, a copy of which is attached hereto as Appendix “A” be approved.

**3. Risk Assessment, 2011**

The Chair said that the Audit Committee terms of reference called upon the Committee to review “an annual management report on significant business, financial and regulatory risks and [to] monitor 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, [and] 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. . . .” The Committee was charged to report “any concerns to the University’s senior officer reporting to the President responsible for financial matters [that is, Catherine Riggall], to the President, or to the Business Board, as appropriate.” At its special meeting held in September, the Committee had concluded that it should devote more attention to risk management. It had therefore decided to schedule a full meeting to the review of the risk-assessment profile, using this meeting date, which had until now been a reserve date.

Ms Riggall said that the process for evaluating risk and the method for reporting on risk assessment had been matters of continuing debate. The administration wished to produce a useful risk-assessment profile that would not contain a burdensome amount of detail but that would still communicate what the administration saw as the crucial issues. She recalled that when the process had been initiated, the report had included a two page summary for each category of risk, evaluating as high, medium or low the probability of the occurrence of the risk, its impact, and the level of provisions to mitigate the risk. Over time, the report had come to include too many categories of risk at greatly differing levels of importance to the University. Therefore, about three years ago, the administration had developed a different approach, identifying thirteen high-level categories of risk. The last of them was reputational and strategic risk, which would be the outcome of the occurrence of risky situations described in some other category / categories.

Ms Riggall said that it was decided to identify a high-level officer, often the President or a Vice-President, who would be the “owner” of the risk category, responsible for controlling the risks in the category. To prepare the Report now before the Committee, each “owner” had been asked to review the area and to update the report, identifying new aspects of risk within the area, describing steps taken to mitigate the risk, and evaluating the overall risk remaining. The

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outcome had been consolidated into a draft report, which had been discussed at a meeting of the University's senior executive group (the President and Vice-Presidents' group). All participants were comfortable with the report now before the Committee.

Ms Riggall continued that a draft of the report had also been taken to the Risk Forum, a broader group of officers who had responsibility for some element of risk control. That group of about thirty staff members included those responsible for financial services, information technology, legal matters, etc. The Risk Forum had originally made an effort to produce a reasonably simple map of the various risks and their impact. Those efforts had not, however, led to an approach that was sufficient to provide a good communication of the risks the University faced, their degree of probability of occurring, their impact, etc. The effort had, however, succeeded in fostering a useful dialogue within the Risk Forum. The outcome, with respect to reporting to the Audit Committee, was the use of the same format as the previous year.

The Committee discussed a number of general matters, including the following.

**(a) Recent steps taken to deal with risks.** A member noted the statement in the report that "the risk universe is becoming more complex, increasing the need for more oversight, more policies and more proactive reviews." The member asked for some examples of steps that had been taken. She cited the establishment of a Governing Council Pension Committee as, perhaps, one of them. Ms Riggall and Mr. Britt cited the Procurement Policy that would be proposed to the Business Board at its meeting of April 4, 2011 (developed in response to a directive from the Government of Ontario), a policy on expenses (also being developed in response to a Provincial Government directive) and the establishment by the Vice-President, Research of the Research Oversight and Compliance Office.

**(b) Urging for an integrated overview of risk.** A member said that the previous format for the risk-assessment profile had been very helpful in providing an integrated picture of risk at the University, making clear the ranking of risk involved in each factor. Such a ranking would be especially helpful for the Audit Committee in view of the greater responsibility it had taken on for monitoring risk and in view of the Business Board's expectations of the Committee with respect to that role. It should be able to comment on the overall state of risk and the mitigation of risk at the institutional level.

Ms Riggall replied that the administration had not given up on its attempt to rank risks. It had simply found that the particular format it had used had not proven useful. The Risk Forum could continue to discuss the matter. It was, however, a difficult matter. As an example, she cited student-related risk. It included, on one hand, risk related to the number of student applications, yield on applications and ultimate enrolment. There were risks involved in having too few or too many students. However, it also included risk to students from various activities on and off campus and risk caused by other students' actions on campus. How would those factors be

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ranked? The member encouraged the administration to continue its efforts to present a picture of the relative importance of risk; the Business Board expected the Committee to have an overall grasp of the risk situation, and the Committee was obliged to demonstrate that it had such an overview.

Later in the discussion, a member noted that some risks touched on a number of areas in the report. For example, certain legal risks affected student risks, and vice versa. How were efforts to control inter-related risks integrated? Ms Riggall replied that the answer to the question depended on the areas of risk. In the example cited, there had been concern at the University, arising from serious incidents elsewhere, of the risk of very harmful actions being taken by a mentally disturbed student. In an effort to mitigate that risk, a cross-functional committee met weekly to deal with situations that some member of the University had identified as a potential risk. That group included staff from the student affairs group, the University police, the Human Resources Department and the relevant Faculty or College. The group sought to assess situations that had been noticed and, where appropriate, to intervene and make every effort to ensure that help was provided to the student. One lesson had emerged from a severe incident elsewhere: the recognition that some staff members at that university had been concerned about a potential problem but had not known that others were similarly concerned and had not been aware of an avenue to take action. The University of Toronto group had found that at some of their weekly meetings there was no potential problem to be addressed; at other meetings there was more than one.

**(c) Committee responsibility for oversight of risk management and information required to carry out that role.** A member observed that the Audit Committee and the Business Board in many ways shared responsibility for risk management. While the Audit Committee received a great deal of information about financial risk, it did not receive all pertinent information. As an important example, the Business Board received the annual operating budget and was expected to scrutinize the budget for its financial prudence, determining whether its assumptions were reasonable and whether the level of risk involved in those assumptions was reasonable. The Audit Committee did not receive that information. Therefore, to call the Committee the Audit and Risk Committee might overstate the Committee's role.

Another member disagreed. He thought it appropriate for the Audit Committee to be the "flash point" to assess and comment on risk. It was, of course, important to define the risk to be monitored in an appropriate way. But, some single committee with fiduciary responsibility had to identify and assess major risks. He cited the example of an organization where all other committees were asked to report to the committee responsible for risk on their risk-oversight activities. The outcome was a culture where risk was taken seriously and where efforts were made to understand and mitigate important risks over the long term. It was best practice for that fiduciary function to be undertaken by the committee responsible for audit matters. The Audit

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Committee was concerned with financial risk, and therefore audit and general risk monitoring went hand in hand. The member consequently supported the idea of Audit Committee becoming the Audit and Risk Committee and taking on that role.

The member who had expressed concern observed that most audit committees, in taking on this role, would receive the same reports as the senior governance body(ies). The Business Board, but not the Audit Committee, received reports on such areas as Human Resources matters and health and safety. While many members of the Audit Committee were also members of the Business Board and received that information, enabling them to make judgements about risks, other members of the Audit Committee did not receive the information. The Committee itself, and those members who were not also members of the Business Board, received only the brief risk-assessment profile now before the Committee.

A member noted that audit committees in most cases consisted entirely of members of the Board of Directors and reported directly to that Board. The situation in the University of Toronto was unusual. It was the case, however, that the Chair of the Audit Committee was a member of the Business Board and was usually a member of the Governing Council. Another member commented that it was the norm in business that the audit committee was also the risk-monitoring committee because almost every risk touched on financial risk. If the University's Audit Committee lacked the necessary information, then the answer to the concern was to ensure that the necessary information was provided.

The member who had raised the concern observed that while it would be useful to provide key information to the Audit Committee as well as the Business Board and other governance committees, the current review of governance was seeking to eliminate duplication. It would be more efficient either to provide that all members of the Audit Committee be selected from among members of the Business Board or that the responsibility for risk assessment be shared with that Board, with the Business Board being responsible, for example, for risk management with respect to Human Resources. The Audit Committee would be responsible solely for financial risk. The member was concerned about the Committee's taking on a comprehensive risk-monitoring mandate without having the reports necessary to carry out the mandate.

Another member, who was a member of the Implementation Committee of the Task Force on Governance, confirmed that the objective of current proposals for governance reform was to streamline processes and to eliminate duplication. There was need, therefore, to marry the elimination of duplication with the assurance that issues were being dealt with, and dealt with by the most appropriate body.

Ms Riggall observed that the Implementation Committee for the Task Force on Governance was also stressing having Board and committee members with the skills and competencies needed to deal with particular issues. The Audit Committee was classified as a technical committee or an

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expert committee rather than as a representative committee (the description of most other committees of the Governing Council). It was intended that Audit Committee membership would be selected specifically to have the knowledge and experience required to deal with risk management. While the majority of members of the Business Board were external to the University, its membership was also constituted so as to represent the views of various constituencies in the University including faculty, staff, and students.

A member observed that even in the area of finance, the Audit Committee was responsible for recommending approval of the financial statements to the Business Board, but it did not receive the financial forecast and it did not receive the budget report.

The Chair said that the solution might be to invite members of the Audit Committee who were not members of the Business Board to attend key meetings of that Board, such as the meeting that dealt with the annual operating budget, in order for them to have the opportunity to be informed of the broad range of risk facing the University. That would make sense at least pending the outcome of the current review of governance, when the responsibility for risk oversight could be assigned in a manner that would be most effective and that would at the same time avoid duplication of effort. The Committee could consider the matter again after the completion of the review of governance to satisfy itself that there was appropriate monitoring of risk in the governance system.

Mr. Charpentier agreed. Various delegations of authority would take place as a result of the review of governance. They would seek to remove duplication, and they would at the same time seek to ensure that the appropriate governance body, with the necessary expertise, was responsible for particular functions. Ms Riggall noted that meetings of the Business Board were generally open meetings that could be attended by anyone, and Mr. Charpentier stressed that regular communication could be provided to members of the Audit Committee to let members know about areas of potential interest to them from the point of view of risk assessment.

**(d) Proposal to focus on a limited number of areas of risk management.** A member proposed that the Committee could most effectively discharge its duty to monitor risk management by not only reviewing management's annual report on risk, but also by focusing its attention on a few major areas of risk each year. It could ask that the senior staff responsible for those areas attend and comment on the risks and on the efforts to mitigate the risks in their area. The Committee could make a judgement whether the policies in the areas were effective, whether best practices to mitigate risk were being followed, and whether risk was being adequately mitigated. By focusing on a limited number of areas, the Committee would be best able to provide good advice.

Ms Riggall asked about the means for selecting the limited number of areas for review. Did the Committee wish to select those issues? Did it wish advice or suggestions from the administration? The member suggested that Ms Riggall present all broad areas for initial

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discussion and that the Committee then chose areas to pursue. The Chair said that the current report could serve as the basis of a Committee selection of areas. She noted that the current report presented a great deal of information on risk in the areas of environmental and individual health and safety. The Committee might therefore wish to consider other areas where there was less information available.

Another member urged that Ms Riggall recommend areas where Committee review in any year would be most helpful. Subsequently, the Committee also asked for the feedback of the Internal Auditor.

**(e) Risk appetite.** A member suggested that subsequent reports include a statement of risk appetite. Such a statement would move the process forward by making it clear whether management was content to accept the residual risk remaining in each area.

Ms Riggall replied that in most cases, management would prefer to have more oversight, stronger controls and stronger compliance procedures in place. However, in a situation of limited resources, it had to devote most of those limited resources to completing the work of the University rather than to its oversight. The exception was certain areas where the Government required oversight procedures, which had to be completed even though the Government did not supply the additional resources required for that oversight.

The member commented that a statement of risk appetite would nonetheless be useful, in that it would make clear that the University had decided to accept a given level of risk for reason of limited resources rather than leaving an expectation that all risk would be reduced to the lowest level possible. She cited the risk tolerance established for UTAM's investment of University funds and pension funds as an example. Although it might, after a bad year, be argued that the risk tolerance had been set at too high a level, the definition did make clear the risk appetite, did enable UTAM to make decisions guided by the definition, and did provide the University with an important criterion by which to evaluate performance.

Another member stressed that overseeing the determination of risk appetite was not an appropriate responsibility for the Audit Committee. Rather, it was that of the Governing Council and management. The Audit Committee's responsibility was to understand risk and to ask questions about the steps taken to mitigate the risk. The overall risk management report was a valuable exercise in that it forced thinking about risk. The proposal to focus attention on a limited number of areas of risk each year would help to discipline the Audit Committee process.

The member who had raised the matter reiterated her view that a statement of risk appetite would be important for the Committee to understand whether actions taken to mitigate risk had been adequate to meet the acceptable risk-management goal rather than to measure those actions against the reduction of the risk to the lowest possible level.



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The Committee completed a detailed review of the “Assessment of Risk and Risk Management in the University of Toronto.” At the conclusion of the discussion, the Chair observed that the Committee had come to three general conclusions. First, it would be helpful for the Audit Committee to be advised of the agendas of Business Board meetings when that Board would consider matters that would be of relevance to the Audit Committee’s work with respect to oversight of risk management. Second, the Committee would expect to learn of the conclusions of the Implementation Committee for the Task Force on Governance with respect to what Board or Committee would be responsible for governance oversight of risk management in the area of information and information technology. Third, the Committee would in the 2011-12 year focus its attention on a limited number of areas of risk that might include: pension-plan risk, faculty risk, government risk and risk presented by the overall economic environment. In addition, there might be attention given to selected areas of legal risk. Another member thought it worth considering insurance risk, information-technology risk and certain legal risks. However, he urged that the administration offer suggestions for sectors where Committee concentration would be most valuable.

The Chair noted that the risk-assessment document was particularly sensitive. The discussion of areas of residual risk, in particular, could cause harm if it became public. It was therefore especially important that members ensure that the report remain confidential.

**5. Enrolment Report to the Ministry of Training, Colleges and Universities, 2009-10: Audit Report**

The Chair said that the Enrolment Report was prepared each year for the Ministry of Training, Colleges and Universities. The report was the basis of the University's claim for per-student operating grants. The audit of the report was also useful to the external auditors in substantiating the government-grant income reported on the University’s financial statements.

A member noted with surprise that the enrolment numbers (a) were expressed to three decimal places, and (b) were reported solely in terms of basic income units rather than students. He found the report singularly uninformative. Ms Tory said that the report was prepared as required by the Government.

**6. Date of Next Meeting**

The Chair reminded members that the next regular meeting was scheduled for Tuesday, May 10 at 4:00 p.m.

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**7. Report of the Administration**

**University Credit Rating**

Ms Brown reported that the University's credit was rated by three agencies. Two ratings had been received just before the Christmas break and were unchanged: Moody's at Aa1 and the Dominion Bond Rating Service at AA. The rating from Standard and Poor's had been received only a few days ago. It too was unchanged, but the rating was given a negative outlook because of the financial condition of the pension plan. The agency was uncertain about the effect on the University's unrestricted net assets of the large, special pension-plan contributions that would be required. In response to a member's question, Ms Brown said that the required pension-plan contributions would have no effect on the University's operations, apart from those caused by budget pressures. They would cause no change with respect to its outstanding debentures; there were no restrictive covenants attached to any of the debentures. It was uncertain whether there would be any effect on a future debenture issue. No university had been to the market to issue debentures since the financial crisis of 2008. A member observed that the University had ample collateral to back any borrowing. Ms Brown noted that the University provided the credit-rating agencies with a list of all of the key relevant documents, which were available on the web, and it held a long annual meeting with each agency to discuss the University's assets and liabilities, including those that did not appear on the balance sheet. She stressed that notwithstanding the negative outlook included in the S&P rating, all of the University's credit ratings were very good ones.

THE COMMITTEE MOVED *IN CAMERA*.

**8. *In Camera* Meeting with the Internal Auditor**

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

THE COMMITTEE COMPLETED ITS *IN CAMERA* SESSION.

The meeting adjourned at 6:45 p.m.

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Secretary

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Chair

May 5, 2011