

UNIVERSITY OF TORONTO
THE GOVERNING COUNCIL
REPORT NUMBER 80 OF THE AUDIT COMMITTEE

March 22, 2006

To the Business Board,
University of Toronto.

Your Committee reports that it met on Wednesday, March 22, 2006 at 4:00 p.m. in the Board Room, Simcoe Hall, with the following members present:

Mr. George E. Myhal (In the Chair)	Ms Sheila Brown, Chief Financial Officer
Ms Dominique Barker	Mr. Mark L. Britt, Director, Internal Audit Department
Ms Paulette L. Kennedy	Mr. Louis R. Charpentier, Secretary of the Governing Council
Mr. Paul E. Lindblad	
Professor Gordon Richardson	
Mr. Christopher Sparks	
Mr. Mark Weisdorf*	Secretariat:
	Mr. Neil Dobbs
Ms Catherine J. Riggall, Vice-President, Business Affairs	

Regrets:

Mr. Gerald A. Lokash	Mr. Roger P. Parkinson
Mr. Richard Nunn	Mr. Robert S. Weiss
Mr. David Oxtoby	

* Participated by telephone.

In Attendance:

Ms Jacqueline Orange, member, Governing Council; Chair, Business Board
Ms Jacqueline Gibson, Special Guest
Mr. John Hsu, Managing Director, Risk Management and Operations, University of Toronto
Asset Management Corporation
Mr. Pierre Piché, Controller and Director of Financial Services
Ms Martha Tory, Ernst & Young

1. Report of the Previous Meeting

Report Number 79 (November 23, 2005) was approved.

THE FOLLOWING TWO ITEMS ARE RECOMMENDED TO THE BUSINESS BOARD
FOR ACTION.

REPORT NUMBER 80 OF THE AUDIT COMMITTEE – March 22, 2006**2. University of Toronto Asset Management Corporation: Financial Statements, 2005**

The Chair noted that the University of Toronto Asset Management Corporation (UTAM) was classified as an "incorporated business ancillary operation," like the University of Toronto Press. Unlike the situation with the other incorporated business ancillary operations, the Business Board had not asked the Audit Committee to monitor the substantive work of UTAM. The Business Board had retained the responsibility to monitor investment performance. It would receive UTAM's annual report on Monday, March 27. While UTAM's full annual report had traditionally been distributed to the Audit Committee, it was only for background information. The Audit Committee's role therefore was a limited one: to consider UTAM's financial statements and, if appropriate, to recommend them to the Business Board for "acceptance." The financial statements had been reviewed by the UTAM Audit and Compliance Committee and "approved" by the UTAM Board. The Chair invited questions and discussion. Among the matters that arose were the following.

(a) Recording of expense for fund management. In response to questions, Mr. Hsu said that 2005 had been a transitional year in the classification of expenses for fund management. The costs of UTAM's own operations would be recorded as expenses on UTAM's financial statements, and would be reimbursed by the University. Other costs would be charged against the funds themselves, including investment-management fees and the costs of the custodians that held the assets. The consulting fees recorded on the statement of operations included such costs as the performance-measurement and attribution-measurement service, a hedge-fund consultant, and subscriptions to various performance surveys such as the RBC Global Markets universe and the Cost Effectiveness Measurement Inc. (CEM) survey.

(b) Investments in real assets. In response to a question, Mr. Hsu said that the real asset category included (i) commodities, including a commodities index investment and such things as oil- and gas-related investments, and (ii) real estate.

(c) Alpha-transport program. A member referred to the alpha transport program, in which UTAM would "overlay the returns of certain Alternative Assets onto U.S. Equity Index futures holdings." The member said that this appeared to be an aggressive leveraged investment that would involve a high level of risk. Mr. Hsu responded that Mr. Chee would be better able to respond to questions about investment strategy at the Business Board meeting in the coming week. He did note that investment return could be separated into two sources: beta, which was the return of the securities index for the relevant category of investments; and alpha, which was return added above the index return through the expertise of the investment manager. Alpha transport was a mechanism to unbundle those two sources, and UTAM accomplished that by first investing in a securities index through index futures or other means that did not require a full upfront investment and then investing the available cash in low-volatility hedge funds to generate a stable source of alpha. The returns on those hedge funds, which were regarded as absolute-return funds, were very stable with an average annual standard deviation of less than 3%. The outcome was a lower risk/return profile than the comparable investments through traditional active managers who sought to select individual securities that would not only provide the index return but also alpha or return above the index return.

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(Cont'd)

(d) Performance relative to benchmarks. A member complimented UTAM on its presentation of the information about its performance relative to various benchmarks, which was well done and neutral in tone. Another member observed that the comparison of performance to peer funds used the RBC Global Services universe of funds. He was unsure that the RBC universe was the correct one to use. The University should aspire to have its endowment fund perform well in comparison to the top University endowment funds in the U.S. Mr. Hsu responded that the University's endowment had in fact performed extraordinarily well in 2005 against the U.S. National Association of College and University Business Officers (NACUBO) universe, with its performance ranking 4th out of approximately 600 funds. UTAM had, however, chosen not to use that comparison because the performance of that universe was calculated in U.S. dollars, and a part (but not all) of the outperformance of the University of Toronto endowment was a function of the relative appreciation of Canadian-dollar-denominated assets versus their U.S. counterparts. There would be imperfections in the comparisons to any fund universe, and UTAM always looked at a variety of comparisons. The member observed that the most important factor was the attribution analysis showing the reasons for performance, whether they be the level of risk assumed, currency, or other factors.

The Chair thanked Mr. Hsu and his colleagues for their report and congratulated them on their good performance for 2005.

On the recommendation of the Vice-President, Business Affairs,

YOUR COMMITTEE RECOMMENDS

THAT the audited financial statements of the University of Toronto Asset Management Corporation, December 31, 2005, be accepted.

3. Policy on Use of the External Auditor for Non-Audit Services

The Chair noted that the Committee had previously discussed the possibility of a policy to govern the use of the University's audit firm for non-audit services. The matter was clearly a topical issue in the corporate world. The accounting firms themselves had developed policies to limit non-audit assignments for their audit clients, and it was appropriate to have a clear policy statement to ensure that the audit firm's independence was not impaired by the prospect of lucrative non-audit assignments.

Ms Brown said that in formulating the proposed policy, she and her colleagues had studied relevant legislation in both Canada and the United States: the Sarbanes-Oxley Act of 2002, the U.S. National Association of College and University Business Officers (NACUBO) advisory report on the U.S. universities adaptation of the Sarbanes-Oxley rules, and the Canadian Institute of Chartered Accountants' (C.I.C.A) New Canadian Independence Standard, which regulated Canadian audit firms. The basic recommendation of the proposed policy was that all

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non-audit services to be performed by the external auditors should be approved in advance. At present, the appointment of the external auditors was approved by the Governing Council on the recommendation of the Business Board and the Audit Committee. Governing Council approval for all non-audit assignments would clearly not be workable on a day-to-day basis. Therefore, it was proposed that the Governing Council delegate its authority to the Chair of the Audit Committee. The Chair could either approve the non-audit engagement, seek the Committee's advice, or require that the assignment receive governance approval. In addition, it was proposed that the Governing Council delegate its authority to the Chief Financial Officer to approve engagements for certain specified non-audit assignments up to a maximum cost of \$250,000. Those specified assignments would be: tax matters, participation in the annual risk-assessment process, advice with respect to accounting for individual transactions or types of transactions, and advice on financial-statement note disclosures. All non-audit assignments would continue to be reported annually to the Audit Committee.

Among the topics of discussion were the following.

(a) Proportion of non-audit services up to \$250,000 not requiring approval. In response to questions, Ms Brown said that most non-audit assignments were relatively small ones within the categories that could be approved by the Chief Financial Officer. The only relatively costly assignments had been tax consulting, in particular advice on recovery of payments of the Goods and Services Tax. In such cases, it was difficult to know the amount of the fee until the ruling was made, because the fee depended on the amount of the recovery. Ernst & Young's review of the prospectus for a debenture issue would not require approval because the outcome of the firm's participation would be an audit opinion.

(b) Advice on accounting matters. A member asked whether it was appropriate for the Chief Financial Officer to be able to approve the external auditors' providing advice on accounting for major transactions. The result would be the external auditors would then audit the accounting based on the advice it had given. Ms Brown replied that in such cases, the University was basically asking what the rules were and avoiding accounting that the auditors would find to be unacceptable. Ms Tory added that in such cases, her firm would provide advice on appropriate accounting, the University would make its decision on the accounting, and the auditors would determine whether the University's decision was correct. The question had been debated extensively in the U.S., and it was clear that the new rules were not meant to suggest that clients could not talk to their auditors. Ms Riggall gave an example of a recent, valuable consultation on accounting treatment. The University had considered the possibility of a parking garage on one of its campuses that would be University-owned but constructed, financed and managed by an external service-provider. The University had hoped that the project might have been excluded from its balance sheet so as not to use up its own borrowing capacity, which was needed for higher priority projects. Because the University had been advised that such an accounting treatment would not be appropriate, it had decided not to proceed with the project.

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(c) Provision of management services by the audit firm. A member asked whether the audit firm would be permitted to provide consulting services in such non-financial areas as compensation matters. Ms Brown replied that such consulting might be possible, but it would clearly require separate approval. She anticipated that in such a case, the Chair might wish to require that the Audit Committee review the assignment.

(d) Proportion of non-audit services. A member said that his key concern would be the ratio of non-audit to audit services. He would be concerned if the total fees generated by non-audit services became too great. It would therefore be important that the Chair, in considering authorization of non-audit services, have a written report of the total of the fees that would be generated by all non-audit services in the fiscal year to date. The Chair noted that the Committee would continue to see the annual report on the overall use of the audit firm's services. The proposal for pre-approval was meant as more an early-warning or preventative system. Ms Tory added that the member could take comfort from the fact that the scope of services provided by Ernst & Young was now much smaller and more constrained than it had been previously. For example, Ernst & Young had some years ago participated in the "rethinking administration" exercise. That previous level of participation could generate a significant level of fees relative to the current situation, in which the scope of non-audit work was much smaller. The only non-audit work currently performed by Ernst & Young that generated significant fees was in the tax area. Ms Tory did not anticipate any other areas that would generate significant fees. The Chair observed that the matter of materiality was important. The University was unlikely to generate non-audit assignments with fees high enough to tempt a firm the size of Ernst & Young to risk its independence.

(e) Delegation of authority to the Chair. A member asked whether it was fair to ask the Chair, a volunteer, to undertake the responsibility of ruling on requests for the use of the audit firm for non-audit services. One possibility was to make the Chair's approval subject to confirmation by the Committee at its next regular meeting. Another member asked whether such an arrangement was usual. The Chair replied that he would not be uncomfortable to assume the responsibility. It would be an expedient arrangement, enabling fast decisions, and it was a normal arrangement in the corporate world. In the case of a difficult request, the Chair could and would refer the matter to the full Committee. In response to a question about practice elsewhere, Ms Tory said that in the not-for-profit sector, having any policy to regulate the use of the audit firm for non-audit services was unusual at this time. She noted that the proposed policy provided a spectrum of options for the Chair. He could readily deal with matters that were not especially significant and refer others. Over time, a base of precedents would be built up, providing further comfort for the Chair for future decisions. The member who raised the matter agreed that the matter would be of less concern with the development of a body of precedent.

(f) Tax consulting. A member referred to the provision delegating to the Chief Financial Officer authority to approve the use of the audit firm for tax consulting. The provision cited a number of specific areas of tax consulting and was, therefore, possibly too specific. Ms Brown replied that the delegation was specifically not limited to the named areas, which were provided

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to illustrate the kind of tax consulting work currently performed. In response to a question about a particular area, “the broad based tax implications for individual transactions,” the objective was to be able to seek advice from Ernst & Young for decisions about whether individuals performing certain work assignments should be compensated as consultants or employees.

On the recommendation of the Chief Financial Officer,

YOUR COMMITTEE RECOMMENDS

THAT the proposed Policy on Use of the External Auditor for Non-Audit Services, a copy of which is attached hereto as Appendix “A”, be approved.

THE FOLLOWING ITEMS ARE REPORTED TO THE BUSINESS BOARD FOR INFORMATION.

4. Financial Report and Supplementary Financial Report: Template for Revised Reports

Ms Brown said that the administration had been implementing a continuing program to improve financial reporting. The most recent addition had been the annual report on the endowment. The objective of the program was to provide good, clear explanations of what was happening in the financial management of the University. The current project was to improve the annual Financial Report, which included the audited financial statements, and the Supplementary Financial Report. There was no proposal to change the audited financial statements themselves. There would be no change in the scope or cost of the external audit. The notes to the financial statements might be modified in the usual course of events. The draft notes, without the year-end numbers, would, as usual, be brought to the Committee in May. The proposed change would expand the financial highlights section of the annual Financial Report, eliminate the separate Supplementary Financial Report, and establish a much-modified version as an Appendix to the Financial Report. The Appendix would be improved to provide a clear explanation, by fund, of the information in the financial statements. Members would recall that the reporting on all of the University’s four fund groups (the operating fund, the ancillary operations fund, the capital fund and the restricted funds) was combined in the audited financial statements. In the new, Supplementary Report, the reader would have better information on each of the four funds, including substantial text to explain the numbers reported. Ms Brown noted that she had based the proposed format on the orientation information that had been presented to the Business Board over a number of meetings in the previous year; those presentations had been very well received.

Ms Brown said that the document currently before the Committee provided the format of the new report, using 2005 numbers. Ms Brown planned to produce a very similar document for the Committee’s review with 2006 numbers for the June meeting. However, producing such a complex report in time for the June meeting would be very challenging. There was a great deal of very detailed information to be reported and explained. It was often difficult to obtain the

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information related to investments so soon after the April 30 end of the fiscal year. The University of Toronto Asset Management Corporation was making every effort to find a way to provide the necessary information at as early a date as possible. If Ms Brown and her colleagues did have difficulty providing the report for the June meeting, then she would in June forward the audited financial statements with much more abbreviated explanatory information, and she would continue to work towards delivering the full content in the new template for the 2007 year end.

Ms Brown invited members' comments and suggestions for improvement both at this meeting and over the next few days. The Chair thanked Ms Brown and her colleagues for bringing forward the new format and for their willingness to undertake the daunting task of preparing such a report in the short time between year-end and the Committee's June meeting. In the course of discussion, a number of members commented favourably on the proposed new format. One noted that it showed clearly the key drivers of financial performance.

Among the matters that arose in questions and discussion were the following.

(a) Management's assessment of new developments. A member asked whether the report for 2005-06 would include an assessment of such developments as the Government of Ontario's recent announcement concerning permissible tuition-fee increases. Ms Brown replied that she planned to include information on the financial impact of such major developments as: the tuition-fee announcement, the government-grant announcement, the new Medical Academy to be established at the University of Toronto at Mississauga, and the plan to increase graduate-student enrolment. There would be need for considerable care in including forward-looking information, which required a greater element of judgement in comparison to the explication of financial performance in the past.

(b) Investment information. A member asked whether the difficulty in having investment information on time for the report arose in part from the fact that UTAM's year end was December 31 whereas the University's year-end was April 30. Would it be useful to change UTAM's year-end date to the same as the University's? Ms Brown replied that the use of the December 31 year-end had begun with the establishment of UTAM. That year-end was standard in the investment industry, and it facilitated the evaluation of performance data, especially comparisons against industry benchmarks and peers. The year-end work required on the University's investments would be necessary in any event. The problem was the tight timetable and the lengthy process requiring work by the custodians and the auditors. This represented one of the largest of the year-end processes.

(c) Explanations of major changes in the financial information. A member suggested that it would be helpful to readers of the report to have explanations of the reasons for very large year-over-year changes in the information presented in the financial statements.

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(d) Liabilities not included in the balance sheet. A member suggested a more complete discussion of two major liabilities that were not included in the financial results: the \$347-million for deferred maintenance and \$264-million not yet recorded for employee future benefits. He noted that a high proportion of defined-benefit pension plans in Canada and the United States were significantly underfunded. In the U.S., that had led to considerable pressure to eliminate defined-benefit plans or to reduce their benefits. Management of the Ontario Teachers' Pension Plan had for several years been cautioning that liabilities had been growing faster than assets, notwithstanding excellent investment performance, requiring either an increase in contributions or a reduction in benefits. It would therefore be appropriate to include in the 2006 Financial Report some assurance that the matter was being addressed at the University of Toronto. Ms Brown thanked the member for the suggestion, which was a very helpful one. While there was some discussion of the matter in the "salaries and benefits" section beginning on page 13, it would be useful to add some further information. In particular, it would be important to note that in the determination of the current value of the liabilities, the University was required to use the current long-term bond rate rather than a long-term bond rate over a longer time horizon. With the lower current rate being used to determine the present value of the future payments, the liability was much larger. The University had been giving a great deal of thought to the matter, and it would be worthwhile to elaborate on the information provided in the report. The member commented that the reader would take comfort from the assurance that the matter was receiving active consideration.

(e) Credit rating. A member suggested that the University's credit ratings be included in the report; it would be comforting for the reader to know of the outstandingly good ratings. Ms Brown said that she would consider including the credit ratings in the 2006 report.

(f) Management's assessment of trends and of the overall financial condition of the University. A member suggested the inclusion of management's views on the University's overall financial direction in key areas and of its overall financial condition. Ms Brown replied that the covering "green sheet" usually included an assessment of key trends. She would consider including such information in the new report, perhaps in an Executive Summary at the beginning.

The Chair thanked Ms Brown and her colleagues for the template for the new report, which he praised. The presentation of the template represented a very good start to the production of the first financial report in the new format.

5. Internal Audit Policy: Revision - Initial Discussion

Mr. Charpentier said that the Internal Audit Policy had not been revised since 1992. The objective at this time was to invite members' comments on the draft of a revised Policy. That would lead to further thought and changes. There would also be consultation with the University's senior executive group. The outcome of the consultations would be reflected in a

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revised draft to be brought to the Committee in May. Provided that the Committee was satisfied, it would be asked to recommend the revised Policy to the Business Board for approval.

Mr. Britt said that the proposed, revised policy had been developed by comparing the current policy with an authoritative policy produced by the Institute of Internal Auditors Research Foundation. In preparing the draft, Mr. Britt had sought to update the language and provide more specific provisions. New sections included: audit planning, audit reporting lines, and the Director's functional and administrative reporting lines – the Director's reporting to the President or designate as well as to the Audit Committee. The proposed Policy also included a Code of Ethics. That Code had been in existence throughout Mr. Britt's tenure as Director, but it was important that it be located in the Policy and reviewed by the Audit Committee. Finally, the working of the proposed Policy clarified the provisions dealing with: the Department's access to information, the responsibilities of the divisions and departments that were audited, and the Internal Auditor's reporting of unresolved areas of concern following reviews of academic or central administrative divisions.

Among the matters discussed were the following.

(a) Department name. A member noted that the term "internal audit" had certain negative connotations. Might it be worth considering an alternative name like the "risk management" department to encourage closer working relations and to encourage budget units to be proactive in seeking help? A member commented that three separate services were usually provided: compliance, audit and risk-management. The current function of the Department, and the responsibilities outlined in the proposed Policy, clearly stressed audit functions and related services. Risk management was carried out elsewhere in the University. The member therefore thought that a name like risk-management department would be misleading. Ms Riggall and Mr. Charpentier noted that a proposal to change the name of the Department, and to appear to change its function, would likely set off a lengthy debate. Another member noted that the University's Internal Audit Department was generally viewed in a positive light; a name change would not be necessary to encourage better working relations. In addition, the name "internal audit" did convey a level of authority that would at times be helpful.

(b) Role of the Department in monitoring compliance with non-financial policies. A member asked whether the Department played a role in monitoring compliance with policies other than financial ones, for example the Employment Equity Policy. Mr. Britt and Mr. Charpentier replied that the University had other processes to monitor such compliance. For example, there was an Employment Equity Officer and an annual report to both the Academic Board (for employment equity for faculty) and to the Business Board (which monitored equity for other staff). The University also had a number of other specialized equity officers who made annual reports to the University Affairs Board.

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(c) Independence of the internal auditor. The Chair said that there was currently a strong stress on the independence of the audit function. There should be no question as to the ability of the Director to make his views known outside of the usual line of management. The proposed Policy, under “Audit Reporting,” provided that the Director would, if he had a serious concern “inform the one-level-up report including, if necessary, the relevant Vice-President, the President and/or Chair of the Audit Committee.” The Chair urged that the provision be amended to give the Director unfettered, direct access to the Audit Committee, the Business Board or the Chair of the Governing Council when the Director thought it appropriate. The use of the term “if necessary” could be open to interpretation in such a way as to limit the Director’s access. It would be appropriate, if using the phrase, to make it clear that access was available if the Director thought it necessary. Ms Tory concurred that an absolute right of access would be an important element of the policy.

(d) Access to information. A member noted similarly the need for strengthening the provision on “access to information.” If access to necessary information were denied, “the Director would inform the one-level-up report including, if necessary, the relevant Vice-President, the President and/or the Chair of the Audit Committee.” Again, the language should make clear the unfettered right of access to the most senior officers and to governance, if the Director thought it necessary. In addition, it should be made clear that the outcome would be that the necessary information would be provided.

(e) Internal Audit reports. A member asked for clarification of the statement that internal audit reports were “distributed as appropriate.” Mr. Britt said that the final reports on the individual audits were distributed to the unit head, to the administrators up the unit’s reporting line, to the administrator up Mr. Britt’s reporting line (i.e. to the Secretary of the Governing Council acting on behalf of the President), to the external auditor, to the Chief Financial Officer and to others as the Director thought appropriate, for example another Vice-President.

(f) Decision not to implement an internal audit recommendation. In response to a question, Mr. Britt said that a unit-head might from time to time choose to accept a risk rather than devoting the resources necessary to improve the unit’s financial operations or controls. If Mr. Britt was concerned about the outcome, he would record his concern in the final report. If, however, the unit chose for good reason to accept a relatively small risk, Mr. Britt would not pursue the matter.

(g) Mandate and the availability of resources. It was noted that the statement of the Department’s mandate included the caveat “to the extent resources are available” both in the listing of the Department’s basic audit functions and in setting out its role as a consulting resource upon the request of University administrators. Mr. Britt said that the caveat was not intended to limit the Department’s mandate. It was intended to make it clear that the Department’s ability to carry out its mandate was subject to its ability to attract and retain its full staff complement. He stressed that it was important to distinguish between the basic aspects of the mandate and the consulting role, which had to be regarded as secondary, subject to resource availability. He could formulate language that would make that clearer. The Chair suggested

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that the mandate eliminate the reference to resource limitations. Mr. Charpentier said that the phrase that the mandate “includes” the various items would make it apparent that it might not be possible to carry out all aspects all the time. A member noted also that the Department would continue to establish a plan to carry out its mandate according to its identification and assessment of risk. Mr. Britt concurred that the Department did allocate its resources to high-risk areas.

Mr. Charpentier said that Mr. Britt would make changes in the light of the discussion and refer the proposal to an appropriate committee of the University’s senior executive group. The new draft would be brought back to the Committee at its May meeting and, with the Committee’s agreement, forwarded to the Business Board and the Governing Council.

6. Audit Committee Terms of Reference: Amendment - Initial Discussion

Mr. Charpentier said that the draft proposal to revise the Committee’s terms of reference was again intended to enable members to provide comments. That would lead to further thought and changes, with the outcome to be brought to the Committee in May. The Secretary reported that the proposal had been the product of a working group of members. An earlier draft had been reviewed and revised at a second meeting of the working group (for which, unfortunately, two members had been out of the country and unable to participate). Pursuant to current thinking, stressing that audit committees should consist of independent directors, the draft proposed that the Committee consist normally of members of the Governing Council or the Business Board who were not University faculty, staff or students. The Committee had a long tradition of having amongst its members a senior member of the faculty with expertise in accounting who could provide an alternative source of advice. It had been thought that academic tenure conferred sufficient independence that a senior professor of accounting could be included amongst the independent directors. The quorum for the Committee would change from three external members to one half of the voting members, other than the *ex officio* members. The general definition of the Committee’s function had not been changed. There had been extensive changes to the description of the Committee’s particular duties. That description had been reordered under several headings: financial reporting, external auditors, internal auditor, financial controls and control environment, risk management and other. The specific changes were described in the covering memorandum.

Among the matters that arose in discussion were the following.

(a) Incorporated business ancillary operations. The Committee had been asked by the Business Board to carry out that Board’s stewardship responsibility with respect to the incorporated business ancillary operations. A member supported the proposal that the Board be asked to rescind that instruction. It had seemed odd for the Committee to devote a large proportion of its time to monitoring the financial performance of those relatively small operations. In response to a question, Ms Riggall said that an important element in the proposal was the fact that the incorporated business ancillary operations had their own Boards, which were responsible for their financial performance. They did review and approve their financial

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statements. It was, nonetheless, important that the financial statements, as part of the annual reports, be presented to the Business Board for information so that the University's governance would know how the operations were faring.

(b) Budget. A member noted that the budget was a key part of the financial control environment. It seemed to him unusual that the Audit Committee would have no formal role with respect to the budget. Another member said that it was difficult for the Committee, without seeing the budget, to judge the appropriateness of financial disclosures such as those in the new Financial Report.

Ms Riggall and Ms Brown replied that the annual budget report, following extensive administrative review, was recommended to the Planning and Budget Committee of the Academic Board of the Governing Council. Because universities were largely self-governing institutions, budget allocations were the responsibility of the academic side of governance, which sought to ensure that the budgets reflected academic priorities and plans. Following the recommendation of the Planning and Budget Committee, the budget proceeded to the Academic Board. It was also reviewed by the Business Board, which was charged to provide advice with respect to the budget's financial prudence. The Budget then proceeded to the Executive Committee of the Governing Council and to the Governing Council itself. Ms Riggall concluded that, as a practical matter, it would be difficult to add one further layer of review by the Audit Committee. A member added that it would be a real cause of concern within the University if the Audit Committee, consisting largely of external members, were to have a degree of responsibility for budget allocation decisions.

Asked about practice elsewhere, Ms Tory said that many other governance systems had both an audit committee and a finance committee, with the latter having responsibility for the budget. In the University of Toronto system, the Business Board carried out many of the functions of the finance committee.

A member noted that members of the Audit Committee had, in at least one previous year, been invited to attend meetings of the Business Board as guests when key financial items were on the agenda. If there continued to be members of the Audit Committee who were not also members of the Business Board, it might be useful to revive that practice. Another member asked whether the Committee reviewed comparisons, at mid-year or at the end of the year, of actual revenue and expense compared to the budget. That practice would give the Audit Committee some comfort. Another member suggested that it would be useful to monitor variances before the end of the year. Ms Brown replied that the Supplementary Financial Report did provide a variance report for the operating budget. In the new financial report, there would be an enhanced commentary on the variances. A member noted that the Committee did review a number of reports on the financial soundness of such major financial elements as the pension plan and the endowment.

(c) Membership. In response to a question, Ms Riggall said that ideally, all members of the Committee would be members of the Governing Council or the Business Board. The Committee

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was, however, a technical committee, and it was important that members have financial expertise. If an insufficient number of members of the Governing Council or Business Board with financial expertise could be found to serve, the Board would continue to have the opportunity to co-opt others with such expertise to serve on the Audit Committee. Ms Brown stressed the key reason for the proposed preference that members of the Audit Committee also be members of one of the senior bodies: it was very difficult for members of the Audit Committee who did not serve on a senior body and who met only four times a year to gain a good understanding of the very complex University structure and operations required as context for considering the Committee's business. It would be ideal, therefore, for Audit Committee members to have both financial expertise and a good understanding of the University deriving from service on the Governing Council, the Business Board or both. Ms Orange agreed that it was important that Audit Committee members have a good understanding of the bigger picture. She noted that the proposed change would have implications for recruitment to the Business Board. The membership of the Audit Committee had in recent past years served as the source of some of that recruitment.

In response to a question, Mr. Charpentier described the process for appointing members to the Committee. Members of the Governing Council were appointed by the Council itself, on the recommendation of the Chair of the Council. Other members were appointed by the Business Board on the recommendation of a representative nominating committee called a Striking Committee. Because that process was established by general Governing Council policies that applied to all boards and committees, it was not included in the Audit Committee's terms of reference.

A member suggested that a Committee of independent members would imply no faculty, staff or student members. The Chair noted that, at the recent meeting of Chairs and members of Ontario university audit committees, there had been considerable stress on audit committees including only independent members in order to avoid any potential conflict. He asked Ms Tory to comment on the usual practice. Ms Tory replied that the recent stress on independence had arisen in the corporate environment where members of senior management had been members of audit committees. It was recognized that it would clearly be inappropriate for the officers who had signed off on the financial statements then to be members of the committee that judged them. On many boards, where there were union or staff representatives, it was the usual practice that those directors would not sit on the audit committee. In other situations, as at the University of Toronto, it was possible to recognize the unique situation of the institution and permit some internal membership. She noted that it was unusual that the President of the University was a voting member; that did not occur elsewhere. The Chair said that it was certainly appropriate that the very large majority of voting members be independent, external members. He did not think that one or two employee members would impair the overall objectivity of the Committee. Presumably, those members would not participate in discussion in any situation where there was a potential conflict of interest. A member stressed that the non-external members should not be present for *in camera* parts of the meeting such as the private discussions with the auditors.

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(d) Access. A member referred to section 6.2, Access, which stated that the external and internal auditors would have access to the Chair of the Audit Committee “on serious matters within the scope of their duties that cannot be resolved through normal administrative reporting.” It was suggested and generally agreed that the section should be amended to provide unqualified access “on matters within the scope of their duties.” The auditors would no doubt seek access only with respect to serious matters that could not be resolved.

(e) Whistle-blower provision. A member referred to section 5.1.4(d), which charged the Committee to periodically review the whistle-blower provisions in place at the University and their operation. Was there risk that the current provision might intrude on the jurisdiction of the University Ombudsperson? The Secretary replied that members of the University most often approached the Ombudsperson when they had concerns not about the financial wrong-doing of others but about denial of appropriate treatment to themselves. Mr. Charpentier undertook to cross-check the terms of reference of the Ombudsperson’s Office with respect to this matter.

The Chair reminded members that a revised draft of the terms of reference would be put before the Committee at the May meeting.

7. Report of the Administration**(a) University of Toronto Innovations Foundation**

Ms Riggall reported that the functions of the University of Toronto Innovations Foundation would, as at April 30, 2006, be brought into the University. While the corporation would remain in existence for a transitional period, the Foundation would cease to be regarded as an incorporated business ancillary operation of the University. A team was working on the transition. All staff and revenue-producing license agreements would be transferred to the University. It might prove expedient for the Corporation to retain ownership of agreements that were not producing revenue rather than incur the expense of their transfer. The Corporation would continue in existence for as long as necessary to accomplish the full transition, with its Board continuing to function for the interim period. In response to a question, Ms Riggall said that there were prospects that some of the license agreements currently held by the Foundation could produce a significant stream of revenue that would be used to reduce the amount of the Foundation’s current debt to the University. In response to another question, Ms Riggall said that the current Innovations Policy, which included provisions for the ownership of intellectual property and for the sharing of any revenues produced by such property, was being reviewed, but the current policy would remain in effect until replaced. The University would wish to discuss proposals to change the policy with the Faculty Association.

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7. Report of the Administration (Cont'd)

(b) Other Matters

Ms Riggall stated that she knew of no other matters that should be reported to the Committee at this time. Ms Brown, Mr. Charpentier and Mr. Britt stated that they knew of no matters that should be reported to the Committee at this time.

8. Dates of Next Meetings

The Chair reminded members that the next regular meeting was scheduled for Wednesday, May 17, 2006 at 4:00 p.m. At that meeting, the Committee would:

- consider the notes to the financial statements;
- review the annual risk-assessment profile;
- review the annual report on insurance and risk-management related to insurance;
- review the Internal Audit Annual Report and Audit Plan, and hold the annual private meeting with the Internal Auditor;
- consider the proposed revised Internal Audit Policy and the revised Committee terms of reference.
- receive a financial report on capital projects.

The Chair also reminded members of the time change for the June meeting to review the audited financial statements. That meeting was now scheduled for Wednesday, June 21, 2006 at 5:00 p.m.

The meeting adjourned at 5:55 p.m.

Secretary

Chair

May 17, 2006