



International Oil Pollution
Compensation Funds

Agenda Item 6	IOPC/OCT22/6/3	
Date	13 September 2022	
Original	English	
1992 Fund Assembly	92A27	●
1992 Fund Executive Committee	92EC79	
Supplementary Fund Assembly	SA19	●

APPOINTMENT OF THE EXTERNAL AUDITOR

2024 ACCOUNTING YEAR

Note by the Audit Body

Summary:

The current term of the External Auditor, BDO International LLP (BDO), covers the financial years 2020–2023. As a result, their period of office will end following their report on the 2023 Financial Statements at the 2024 regular sessions of the governing bodies. The management of the selection process of the External Auditor falls within the mandate of the Audit Body. Therefore, the Audit Body has prepared this document to alert the governing bodies to the various options and related issues regarding the appointment of the External Auditor. The Audit Body recommends that the governing bodies consider a way forward to ensure sufficient time for an orderly transition of responsibilities if a new External Auditor is to be recommended and appointed.

Action to be taken:

1992 Fund Assembly and Supplementary Fund Assembly

- (a) Take note of the information contained in this document;
- (b) Consider possible approaches that could be taken for the appointment of the External Auditor (see section 6), namely:
 - (i) a full tender process (with or without the incumbent (BDO));
 - (ii) an objective assessment by the Audit Body of the qualifications and performance of BDO; or
 - (iii) a straightforward re-appointment of BDO for a limited period.
- (c) note the Audit Body's recommendation for a straightforward re-appointment of BDO for a two-year term or any period that the governing bodies may deem necessary, on an exceptional basis (see section 8); and if so,
- (d) decide whether to amend Financial Regulation 14 of the 1992 Fund and the Supplementary Fund as set out in paragraph 9.2.

1 Introduction

- 1.1 At their October 2019 meeting, the governing bodies decided to re-appoint BDO International LLP (BDO) as the IOPC Funds External Auditor for a second four-year term covering the financial years 2020–2023. As a result, BDO's period of office will come to an end following their report on the 2023 Financial Statements to the regular sessions of the governing bodies in 2024.

- 1.2 Given the protracted timescale involved in organising and conducting a tender process — one of the options to be considered — there is a need to alert the governing bodies to the various options and related issues regarding the appointment of the External Auditor to ensure that there can be sufficient time for an orderly transition of responsibilities if a new External Auditor is to be appointed.
- 1.3 This issue falls within the Audit Body mandate, which states the Audit Body shall ‘manage the process for the selection of the External Auditor.’ Notwithstanding this, the Secretariat are closely involved in the process with a heavy time commitment, and the Chairs of the 1992 Fund Assembly and Supplementary Fund Assembly are also invited to be involved in the process.

2 Background

- 2.1 BDO was appointed as the Funds External Auditor for an initial period 2016–2019, which was subsequently extended to 2023. Previously, the Funds were served by the UK National Audit Office (NAO) from their inception until the conclusion of the 2015 accounting year.
- 2.2 For information, a brief history of the periodic appointment processes is set out in Annex.
- 2.3 The appointment of the External Auditor has been considered by the governing bodies on several occasions, and it is particularly relevant to note that the Audit Body’s proposals contained in document IOPC/OCT19/6/1 were accepted by the governing bodies at their October 2019 meeting (document IOPC/OCT19/11/1, paragraph 6.1.14).
- 2.4 At that meeting, the governing bodies amended Financial Regulation 14.1 to state:

‘An External Auditor, who shall be the Auditor-General (or officer holding the equivalent title) of a Member State, or a commercial firm with the requisite capabilities nominated by a Member State or identified by the Audit Body, shall be appointed in the manner and for the period decided by the Assembly. Ordinarily, such appointment will be for four years and be the result of a tender process conducted by the Audit Body and its subsequent recommendation to the Assembly.

If the Audit Body assesses the External Auditor’s performance to be satisfactory, the External Auditor’s initial appointment may be extended for a further period of up to four years. The External Auditor may serve for this further period if the Audit Body after undertaking an objective assessment of the qualifications and performances of the incumbent External Auditor recommends to the Assembly an extension of the term of appointment. After serving as an External Auditor for two consecutive periods, the appointment of the External Auditor may, in exceptional circumstances, be extended and such an extension must be by way of a full tender process. The Assembly decides on the manner and the period applicable to such an extension based on a recommendation by the Audit Body.’

- 2.5 Further consideration of whether it is appropriate for an incumbent External Auditor who has served two four-year terms to be considered for a further term was set out in paragraphs 3.4 and 3.5 of document IOPC/OCT19/6/1.
- 2.6 The Audit Body concluded in its recommendations in 2019 that, given all commercial audit firms have strict rules on partner rotation to minimise the risk of loss of independence, there was a sound case for a change in audit organisation following a full tender after two terms of four years. However, the re-appointment of the incumbent for one further term after having already served two four-year terms, was not ruled out. In such circumstances, it would be for the governing bodies to decide whether such re-appointment should be for four years or a shorter period.

3

3 Comparison with current best practice

- 3.1 Mandatory rotation of audit firms has been the subject of regulator action within the European Union (and elsewhere) as part of a programme of audit reforms and the drive to improve audit quality and ensure auditor independence.
- 3.2 The current UK regulations (applicable since June 2016) stipulate rotation of auditors for public interest entities after 10 years, extendable for a further 10-year term if there is a tender process. There is no presumption or requirement for rotation after a shorter period, e.g. four years, but market practice is often to do an internal review in conjunction with audit partner rotation. Accordingly, the current Funds' policy is broadly in line with market best practice.

4 Market context*External factors*

- 4.1 When deciding on the appointment of an external auditor, it is paramount to take into consideration the market conditions. Since the introduction of mandatory tendering in 2016, the UK audit market has seen continued tendering activity, with most corporations tendering every 10 years unless there is a specific reason to do so at an earlier date. At the point of retendering, it has been less common for the incumbent auditor to be re-appointed, and in some cases, they are not invited to the tender.
- 4.2 The extensive UK independence rules and associated cooling in periods for a new auditor were published in March 2020. The new rules have meant that audit tenders typically run at least a full year ahead of appointment.
- 4.3 Many audit firms are declining to tender due to additional regulatory constraints and resource shortages.
- 4.4 The cost base is increasing significantly, and annual rate rises of 20%^{<1>} are not uncommon in the current market.
- 4.5 Potential further changes in the auditor landscape are anticipated following the publication of the Department for Business, Energy and Industrial Strategy (BEIS) reforms on restoring trust in audit and corporate governance.
- 4.6 It is the Audit Body's view that a tender process may not give the governing bodies enough relevant candidates to choose from, taking into account the current market conditions.

Internal factors

- 4.7 The Secretariat of the IOPC Funds is undergoing some significant changes for the first time in many years, including changes within the Finance team.
- 4.8 It is not unlikely that the incumbent internal auditor, Mazar, would be interested to tender. However, due to the new 12-month cooling in period, if an audit tender for the financial year 2024 were to be run, in say, June 2023, Mazars, our incumbent internal auditor (IA), would either be precluded from tendering or would need to postpone any internal audit work until after the outcome of the tender and if successful would not be able to complete any further IA work for the remainder of the year.
- 4.9 The proposed year of change, 2024, would coincide with changes in the Audit Body to a new Audit Body 8.

<1> Bloomberg report 20 May 2022.

5 **BDO – qualifications and performance**

- 5.1 The Audit Body has been very satisfied with the effectiveness and quality of the BDO audit to date and, in particular, the performance of the partner, Mr David Eagles.
- 5.2 Under the UK independence rules, Mr David Eagles would be permitted and is willing to serve a further two-year term covering the accounting years 2024–2025.

6 **Options**

- 6.1 Given the above and mindful of the timetable, the governing bodies will need to decide on the process to be adopted. This document aims to set out the various options together with corresponding evaluations, and a recommendation as to the way forward. The options are as follows:

Option 1: A full tender for the 2024 accounting year, inviting national auditors and commercial firms to apply for a four-year term. BDO would not be invited to tender, having served two four-year terms and it would be hoped that other audit organisations would be interested in tendering.

Option 2: A full tender, inviting national auditors and commercial firms to apply for a four-year term, including BDO, given their excellent performance and the Audit Body's assessment of current market conditions. There could be a limit proposed on the term BDO would serve if they were elected, as envisaged under the financial regulation.

Option 3: An objective assessment by the Audit Body of the qualifications and performance of BDO to date as a basis for a decision of the governing bodies of whether to re-appoint BDO for a further two-year term or any term that the governing bodies may consider appropriate, including the fee and personnel, or revert to a tender (i.e. option 1).

Option 4: A straightforward re-appointment for a further two-year term^{<2>}, assuming BDO are willing to serve a further term, which they have confirmed. A full tender would then be undertaken in 2024 for the accounting year 2026.

Option 1 – A full tender

- 6.2 A full tender, similar to that undertaken in 2014/2015, is arguably the safest way of demonstrating that appointments made represent the best value for money as they result from a competitive process and a 'level playing field'.
- 6.3 The most recent tender in 2015 did produce a good result in terms of service level obtained at a competitive fee.
- 6.4 The Funds are served by the External Auditor, BDO, and by Mazars providing internal audits. The auditor independence rules have tightened since the Financial Regulation on the appointment of the auditor was last updated in 2019, and as a result, existing service providers, most notably Mazars, if invited to tender, would need to stop internal audit work by the end of 2022 to have a 12 month cooling off period. Given any tender process would run in June 2023, the Funds would essentially have no work performed by internal auditors for six months. It would be preferable to fix a future date for a tender whereby Mazars could

^{<2>} While Financial Regulation 14.1 stipulates that the additional third term could be for up to four years, it is proposed that in the event that BDO is reappointed this would be for only a two-year period to align with the 10-year timeframe the current partner Mr David Eagles could serve under independence rules.

participate, assuming they wished to do so, without impacting the ongoing and important work on the Funds' internal control framework.

- 6.5 Given the current market context and uncertainty around the auditor landscape, it is possible that there is a return to previous attempts that were not successful, as they failed to attract bidders, and with the incumbent precluded under this option, there could be minimal or no competitive process. Audit tenders are expensive for the commercial firms and national auditors of Member States in terms of time to prepare the bids and, in the case of the latter category, travel costs.
- 6.6 In addition, there is an extensive time commitment required from the Secretariat in inviting bids, organising and conducting familiarisation visits and managing the process (as well as dealing with the transition necessary as a result of the change of auditor). Notwithstanding the fact that the Secretariat is well functioning, there is now a new management team, and the tender process will be an extensive task.

Option 2 – A full tender with BDO participation

- 6.7 In addition to points raised in paragraphs 6.2 to 6.6 above, it is debatable whether a tender would be of much interest to an audit organisation if the incumbent who has provided good service at a competitive fee has been asked to retender under exceptional circumstances.

Option 3 – Formal review of the incumbent

- 6.8 A further option represents a hybrid of the first two options and blends the need to obtain value for money, ensure independence and a commitment to continuing service quality.
- 6.9 In summary, the process would involve inviting BDO for a formal review session with the Audit Body involving the Secretariat and the Chairs of the Funds' Assemblies) for a structured review covering, *inter alia*, the following:
- (a) Review of service to date with emphasis on value delivered and any lessons to be learned
 - (b) Proposal for key team members in the third term addressing continuity and independence issues
 - (c) Audit approach proposals
 - (d) Fee proposals

- 6.10 Following this review, the Audit Body would be in a position either to recommend re-appointment or that a formal tender be undertaken. This approach is similar, in practical terms, to the approach adopted by Audit Body 3 when there were no bidders other than the NAO and Audit Body 6 when BDO was re-appointed for a further four-year term.
- 6.11 An objective assessment of the External Auditor by the Audit Body is already envisaged in the Financial Regulations as a relevant alternative to a tender process, however, to be used for an extension of the initial four-year period.

Option 4 – Straightforward re-appointment for a two-year period

- 6.12 This option has the merit of being 'cost-free' in terms of the time involved by the Audit Body, Secretariat and the Chairs of the Funds' Assemblies. It would also be cost-free to BDO.

7 Evaluation and recommended approach

7.1 The following advantages and drawbacks have been identified for each option:

7.2 Option 1 – A full tender during financial year 2023

- (a) Consistent with the sentiment expressed at the 2010 and 2019 meetings of the governing bodies requesting delivery of ‘periodic tenders’ and in line with Financial Regulation 14.1
- (b) Rebuttable presumption that a tender is the best way of ensuring value for money is obtained- although any headline monetary savings are offset against the costs of disruption to the Secretariat from the tender process and possible transition to a new auditor. Current market conditions would be likely to result in cost increases, not decreases
- (c) Risk of minimal tendering firms given current market conditions
- (d) Costly and time-consuming

7.3 Option 2 – A full tender during financial year 2023 with BDO participation

- (a) As in option 1 above
- (b) Other commercial firms may be dissuaded from tendering because of the inclusion of an effective incumbent auditor, especially if the timeframe for appointment is restricted to 2 or 4 years

7.4 Option 3 – A formal review of the incumbent

- (a) Provides a blend of the advantages of the other options in that it combines economy with value for money as long as the conclusions of the review are satisfactory
- (b) A process consistent with the current satisfaction of the service provided by BDO
- (c) Consistent with current corporate governance best practice, i.e. ongoing reviews and subject to a formal tender at no more than 10 years after the initial appointment
- (d) Assuming a satisfactory outcome, the re-appointment of BDO for a further term would avoid disruption to the working of the Secretariat at a time of considerable change to senior management, defer a formal tender to a future date whereby Mazars could participate without impinging on their internal audit work and allow time for greater certainty around potential audit tender participants
- (e) If the outcome of the review were to be unsatisfactory, the timescale for a tender and appointment of a new auditor would be tight, and further risks limited participants given current market conditions
- (f) Would require approval from the governing bodies as the current Financial Regulation 14.1 requires a full tender before re-appointment for a further third term

7.5 Option 4 – A straightforward re-appointment for two years

- (a) As in option 3 above and avoids time to be spent by Secretariat, Chairs of the Funds’ Assemblies and BDO in administering and concluding a review process
- (b) Alignment of the period of tenure of BDO in terms of partner independence timeframe and UK market best practice (i.e. 10 years)
- (c) May not be consistent with the need to ensure value for money is obtained beyond the original service period of 2020-2023 (although BDO may commit to continue with a similar fee level albeit with market inflation anticipated). However, this may nevertheless present better value for money given the existing knowledge of the BDO team.

8 Recommendation by the Audit Body

8.1 In order to ensure the best services by the External Auditor, the External Auditor has to be appointed before the end of 2023. This leaves little time to encourage and find relevant parties for a full tender process. Also, having regard to the above considerations, and in particular, the exceptional circumstances which

exist within the external audit market and the significant changes within the Secretariat, the Audit Body recommends the adoption of Option 4: a straightforward re-appointment of BDO for a two-year term.

- 8.2 This option is recommended on the basis that it takes account of the fact that the current External Auditor is providing a good service; is consistent with best practice; has regard to the circumstances prevailing in the Secretariat; delivers value for money, and it also allows the maximum options for tendering firms for the 2026 appointment, the process for which would commence in 2024.
- 8.3 It should be noted that the above approach is not intended to act as a template to be followed at the conclusion of the next period of tenure by the External Auditor.

9 **Amendment to Financial Regulation 14.1**

- 9.1 In the event that the governing bodies approve the recommendation of the Audit Body, a small amendment, as set out in paragraph 9.2, would be required to financial regulation 14.1.
- 9.2 The changes proposed for Financial Regulation 14.1 of the 1992 Fund and Supplementary Fund:

Current text	New text (proposal)
<p>Financial Regulation 14.1</p> <p>An External Auditor, who shall be the Auditor-General (or officer holding the equivalent title) of a Member State, or a commercial firm with the requisite capabilities nominated by a Member State or identified by the Audit Body, shall be appointed in the manner and for the period decided by the Assembly. Ordinarily, such appointment will be for four years and be the result of a tender process conducted by the Audit Body and its subsequent recommendation to the Assembly.</p> <p>If the Audit Body assesses the External Auditor's performance to be satisfactory, the External Auditor's initial appointment may be extended for a further period of up to four years. The External Auditor may serve for this further period if the Audit Body after undertaking an objective assessment of the qualifications and performances of the incumbent External Auditor recommends to the Assembly an extension of the term of appointment. After serving as an External Auditor for two consecutive periods, the appointment of the External Auditor may, in exceptional circumstances, be extended and such an extension must be by way of a full tender process. The Assembly decides on the manner and the period applicable to such an extension based on a recommendation by the Audit Body.</p>	<p>Financial Regulation 14.1</p> <p>An External Auditor, who shall be the Auditor-General (or officer holding the equivalent title) of a Member State, or a commercial firm with the requisite capabilities nominated by a Member State or identified by the Audit Body, shall be appointed in the manner and for the period decided by the Assembly. Ordinarily, such appointment will be for four years and be the result of a tender process conducted by the Audit Body and its subsequent recommendation to the Assembly.</p> <p>If the Audit Body assesses the External Auditor's performance to be satisfactory, the External Auditor's initial appointment may be extended for a further period of up to four years. The External Auditor may serve for this further period if the Audit Body after undertaking an objective assessment of the qualifications and performances of the incumbent External Auditor recommends to the Assembly an extension of the term of appointment. After serving as an External Auditor for two consecutive periods, the appointment of the External Auditor may, in exceptional circumstances, be extended and such an extension must be by way of a full tender process. The Assembly decides on the manner and the period applicable to such an extension based on a recommendation by the Audit Body.</p>

10 **Action to be taken**

1992 Fund Assembly and Supplementary Fund Assembly

The 1992 Fund Assembly and the Supplementary Fund Assembly are invited to:

- (a) take note of the information contained in this document;
- (b) Consider possible approaches that could be taken for the appointment of the External Auditor (see section 6), namely:
 - (i) a full tender process (with or without the incumbent (BDO));
 - (ii) an objective assessment by the Audit Body of the qualifications and performance of BDO; or
 - (iii) or a straightforward re-appointment of BDO for a limited period
- (c) note the Audit Body's recommendation for a straightforward re-appointment of BDO for a two-year term or any period that the governing bodies may deem necessary, on an exceptional basis (see section 8); and if so,
- (d) decide whether to amend Financial Regulation 14 of the 1992 Fund and the Supplementary Fund as set out in paragraph 9.2.

* * *

ANNEX

A brief history of the periodic appointments and processes followed is set out below:

- 2002: NAO* reappointed for four-year term on recommendation of Director.
 - 2006: NAO reappointed for four-year term on recommendation of the Audit Body with the request by governing bodies for Audit Body to come forward with proposals for future tender process. Audit Body given the responsibility for managing the process.
 - 2010: NAO reappointed for four-year term following a tender process which failed to attract other Member State national auditor bidders and following a review of the NAO bid by the Audit Body.
 - 2015: NAO re-appointed for one year following their initial intention not to seek re-appointment but following a tender process that failed to attract other Member State national auditor bidders.
 - 2016: BDO** appointed for a four-year term following tender process that included commercial firms for the first time.
 - 2019: BDO appointed for a second four-year term following a formal review process.
-

* National Audit Office of the United Kingdom (NAO)

** BDO International LLP (BDO)