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REPORT OF THE AUDIT BODY

Note by the Audit Body

1 **Introduction**

- 1.1 At their October 2001 sessions, the governing bodies of the 1992 Fund and 1971 Fund decided to establish a joint Audit Body for the two organisations. At their March 2005 sessions, the 1992 Fund Assembly, the Supplementary Fund Assembly and the 1971 Fund Administrative Council decided that there should be a joint Audit Body for the three Funds elected by the 1992 Fund Assembly. At their March 2005 sessions, the governing bodies decided the composition and mandate of the Audit Body as set out in Annex I of document 92FUND/A.10/24.
- 1.2 The joint Audit Body is composed of seven members elected by the 1992 Fund Assembly: one named Chairman nominated by 1992 Fund Member States, five named individuals nominated by 1992 Fund Member States and one named individual not related to the Organisations ('outsider'), with expertise and experience in audit matters nominated by the Chairman of the 1992 Fund Assembly.
- 1.3 The mandate of the members of the Audit Body is three years and the first election of members of the Audit Body was held in October 2002. In accordance with the decisions taken by the governing bodies at their March 2005 sessions, the 1992 Fund Assembly held elections of members of the Audit Body at its October 2005 session.
- 1.4 Under the Mandate of the Audit Body, three seats on the Audit Body should be filled by persons other than the incumbent members of the Body. Since only two such persons had been presented as candidates, the Assembly elected the following as new members:
 - Mr Mendim Me Nko'o (Cameroon)
 - Mr Wayne Stuart (Australia)
- 1.5 At its May 2005 session, the Assembly decided that in the event that there were less than three new nominations from 1992 Fund Member States, the requirement set out in the mandate that the term of office of three of the present members of the Audit Body was not renewable would not apply.

- 1.6 At its October 2005 session, the Assembly considered the nominations made by Member States circulated in document 92FUND/A.10/24. After a secret ballot held in accordance with the Rules of Procedure of the 1992 Assembly (cf Rules 32, 38 and 40) the Assembly elected the following incumbent members of the Audit Body for a further period of three years:
- Mr Charles Coppolani (France)
Mr Maurice Jaques (Canada)
Dr Reinhard Renger (Germany)
Professor Hisashi Tanikawa (Japan)
- 1.7 The Assembly elected Mr Charles Coppolani (France) as Chairman of the Audit Body.
- 1.8 The Assembly elected Mr Nigel Macdonald as the member of the Audit Body not related to the Organisations ('outsider').
- 1.9 The mandate of the Audit Body is as follows:
- (a) to review the effectiveness of the Organisations regarding key issues of financial reporting, internal controls, operational procedures and risk management;
 - (b) to promote the understanding and effectiveness of the audit function within the Organisations, and provide a forum to discuss internal control issues, operational procedures and matters raised by the external audit;
 - (c) to discuss with the External Auditor the nature and scope of each forthcoming audit;
 - (d) to review the Organisations' financial statements and reports;
 - (e) to consider all relevant reports by the External Auditor, including reports on the Organisations' financial statements; and
 - (f) to make appropriate recommendations to the governing bodies.
- 1.10 The Audit Body has met three times since the October 2005 sessions of the Funds' governing bodies, viz 25 November 2005, 10 March 2006 and 16 June 2006. Representatives of the External Auditor have attended these meetings and have made a significant contribution to the Audit Body's deliberations.
- 1.11 The Director and Head of the Finance and Administration Department also attended the meetings. The Director's Personal Assistant acted as the Audit Body's Secretary. Mr Willem Oosterveen, Director Elect, attended the meetings in March and June 2006.
- 1.12 The Audit Body decided that it would have two closed sessions each year with the External Auditor, one after the interim audit and one after the conclusion of the final audit. No member of the Secretariat is present at these closed sessions.
- 1.13 Closed sessions also took place without the presence of the representatives of the External Auditor during the March and June 2006 meetings to discuss the issue of the appointment of External Auditor.

2. Audit Body's programme of activities for 2006-2008

- 2.1 The new Audit Body has planned its programme for the three years of its mandate taking into account the limited number of Audit Body meetings and has identified the following activities as being those which needed to be done on a regular basis:
- Hold discussions with the External Auditor on the audit programme;
 - Review process for the preparation of the budget and express a view on it in the Audit Body's annual report to the governing bodies;
 - Consider issues of risk management: although this was the responsibility of the Secretariat, it was important to have input from the Audit Body;
 - Hold discussions with the joint Investment Advisory Body;
 - Monitor submission of oil reports;
 - Monitor the winding-up of the 1971 Fund;
 - Follow the implementation of the recommendations of the External Auditor;
 - Review the implementation of recommendations of the governing bodies;
 - Review claims handling.
- 2.2 In addition to its regular activities, at their February/March 2006 sessions the Funds' governing bodies requested the Audit Body to look into the procedure for the appointment of the External Auditor in future, including the possibility of competitive tender, and to report to them at their October 2006 session.
- 2.3 With respect to the continuing study to be undertaken by the Audit Body in relation to claims handling, the Audit Body decided that it would be useful to carry out a study to ascertain the level of satisfaction of claimants in respect of the handling by the Funds of their claims for compensation. The aim would then be to see what procedures could be changed, if any.

3 External Audit of the Funds' Financial Statements

- 3.1 The Audit Body is very appreciative of the excellent relationship which has been developed with the External Auditor, the Comptroller and Auditor General of the United Kingdom. This relationship has allowed the Audit Body to follow the different stages of the audit of the Financial Statements of the 1971 Fund, the 1992 Fund and the Supplementary Fund.

Audit Strategy for 2005 Financial Statements.

- 3.2 At its November 2005 meeting, the Audit Body had the opportunity to discuss with the External Auditor the audit strategy relating to the audit of the 2005 Financial Statements, which covered both the timing and the scope of the audit.
- 3.3 The representative of the External Auditor presented the time schedule of the audit and the main points of attention. He informed the Audit Body that the nature of the audit was similar to that of previous years as there had not been any substantive changes in the Funds which would have

necessitated any changes: audit risks, reliance on internal controls and materiality. With respect to key risks, he pointed out that as the Supplementary Fund was now in existence, the audit would take the opportunity to review the accounting policies of the Funds against the requirements of the International Standards on Auditing (UK and Ireland) and the United Nations System Accounting Standards (UNSAS). He also indicated that procedures relating to conflict of interest would be reviewed and discussed with the management of the Funds' Secretariat. The progress of the risk management strategy would also be reviewed and in particular the specific accounting risk areas which had already been identified. The Audit Body underlined the importance of knowing that the Dual Currency Deposits (DCDs) schedule had been audited, as it allowed the economic benefit of using these particular financial instruments to be monitored. The representative of the External Auditor confirmed that the DCD schedule had been checked and had been found to reflect accurately the information contained therein.

Interim Audit Report

- 3.4 At the March 2006 meeting of the Audit Body, the External Auditor presented an interim audit report on the audit of the 2005 Financial Statements, which had been completed in February 2006.
- 3.5 With respect to expenditure, internal controls on claims expenditure had been reviewed and tested. The Audit Body was informed that the interim audit had taken a spread of payments from various incidents and had not concentrated on one specific incident. Claims-related expenditure had also been reviewed and tested. Controls relating to Secretariat expenses had been reviewed and tested. The Records of Decisions of the governing bodies had been reviewed in order to confirm levies of contributions and testing had commenced on contributions and reimbursements to contributors. Internal controls over investments had been reviewed and substantive testing of investment interest income (including DCDs as mentioned above) had begun and would be concluded at final audit. As regards the balance sheets, controls over cash and bank had been reviewed and preparatory work had taken place on the Staff Provident Fund. Testing of other assets and liabilities would take place during the final audit. Progress had been reviewed in respect of the recommendations included in the 2004 Long-Form Report in the areas of a Code of Conduct, a Register of Interests and a Register of Hospitality and Gifts, a Scheme of Reservation and Delegation and a Whistle-blowing policy.

Final audit

- 3.6 At the Audit Body's June 2006 meeting, the representative of the External Auditor informed the Audit Body of the results of the final audit and of the External Auditor's intention to place an unqualified opinion on the Funds' Financial Statements for the year-end 31 December 2005.
- 3.7 The representative of the External Auditor stated that the overall result had been that no weaknesses or errors had been found across the three Funds and that the Financial Statements for each of the three Funds were free from material misstatement. He reported the key findings and recommendations of the audit, which were agreed with by the Secretariat and were endorsed by the Audit Body.
- 3.8 The representative of the External Auditor reported that he was pleased that the Funds had followed up on the recommendations pertaining to last year's Financial Statements (2004). In this respect, the Audit Body noted that a Code of Conduct, a Register of Interests and a Register of Hospitality and Gifts as well as a Scheme of Reservation and Delegation had been prepared by the Secretariat.
- 3.9 The Audit Body expressed its appreciation to the Secretariat for the way in which it had been operating and which had resulted in this outstanding audit report.
- 3.10 At the Director's instigation on hearing of the anonymous allegations which purported to disclose evidence of corruption and bribery involving a senior member of the Funds' Secretariat, the External

Auditor had carried out a thorough investigation in respect of these allegations and had found no evidence of impropriety. The External Auditor had also considered that the Director had acted correctly in his handling of these allegations and was satisfied that a sufficient level of control was in place to prevent and detect impropriety. The Audit Body noted with satisfaction the External Auditor's findings. It also noted the External Auditor's recommendation that where Funds' personnel were related parties to any internal or external party, a written agreement should be concluded to prevent the related parties engaging in Funds' business. The Audit Body noted that in this case this had been done orally and dealt with in the Power of Attorney given to the law firm concerned which excludes the related party from working on Funds' matters.

- 3.11 In the light of the information provided by the External Auditor and the assurances given by the audit, the Audit Body recommends that the governing bodies approve the accounts of the 1971, 1992 and Supplementary Funds for the financial year ending 31 December 2005.

4 Other main issues considered

Review of budget process

- 4.1 The mandate of the Audit Body is to review process and governance issues on behalf of the Funds' governing bodies. It is important to emphasise that the Audit Body is not responsible for overseeing the budget creation, submission or approval by the governing bodies. The Audit Body is, however, responsible for two oversight roles relevant to the financial control environment of the Funds, ie satisfying itself that the budget creation, submission and approval processes appear to be working properly and being satisfied that the subsequent control and monitoring of outgoings (and the coding of the expenditures) provide comfort that the 'actuals' are indeed as they say they are.
- 4.2 With the help of the Secretariat, the Audit Body carried out a review of the budgets for the last six years in order to look at the spend pattern. As would be expected, these figures showed that certain projected expenditures, such as accommodation costs, were budgeted accurately and there was no need to create a contingency for additional costs. Other projected costs, such as personnel costs and public information, showed significant differences between budgeted and actual numbers. In part, some of that difference was caused by the fact that the budgets had to be set before the United Nations had determined salary scale and allowance levels for the coming year. Other elements included explicit allowances for additional staffing posts, which would become necessary if significant incidents were to occur.
- 4.3 The six-year figures themselves have shown this pattern consistently and there is no evidence or suggestion from these figures that the Secretariat takes advantage of surplus budget figures by increasing expenditure simply because it is allowed to do so. Further, the Audit Body itself, and of course Member States through the Assembly, draw direct comfort as to the propriety of actual expenditures, their accurate classification and reported accuracy, from the audit carried out by the External Auditor and from the Director's comments on the Financial Statements, which report on administrative expenditure outcomes. It is clear that the External Auditor checks actual expenditures to the approved budget, by headings, as part of their overall audit checking of the Secretariat expenditures, to ensure that all are properly authorised.
- 4.4 The Audit Body expressed the view that the current budget process was satisfactory. In agreement with the Director, it has however proposed the introduction of more user-friendly budget documents for all three Funds and the inclusion of the six-year trend information.
- 4.5 The Audit Body fully supports the Director's initiative of preparing a Budget Manual.

Relationship with the joint Investment Advisory Body

- 4.6 The Audit Body and the Investment Advisory Body (IAB) are independent bodies which each report directly to the governing bodies. Nevertheless, both bodies recognise that it is important that they hold discussions with one another so as to share information in respect of financial risk which is done on an annual basis as well as by exchanging copies of the Minutes of their respective meetings.
- 4.7 In June 2006 the IAB reported to the Audit Body on recent developments in respect of investments of the Funds' assets and, in particular, on the tools which were being used by the IAB to measure investment performance. The Audit Body took the view that the monitoring process currently used by the IAB, ie its regular scrutiny of money market deposits placed and foreign exchange deals transacted, was being carried out effectively by the IAB. The IAB agreed that if cost-effective proprietary software for the monitoring of investments became available, it would bring this to the attention of the Audit Body.
- 4.8 The Audit Body noted that the IAB had met with the representatives of the External Auditor on 30 May 2006 and that it intended to hold a similar meeting in 2007.

Risk management

- 4.9 The Audit Body has continued to monitor the risk management process which has been adopted by the Secretariat. The five areas of risk that have been identified by the Funds' Secretariat are those relating to reputation, the claims handling process, financial risk, human resource management and business continuity.
- 4.10 The Audit Body was pleased to note the progress that had been made and noted that the Director's aim was to have the process completed before his successor took up office.
- 4.11 The Audit Body also noted that, as chief administrative officer of the Funds, the Director was accountable for the day-to-day management of risk throughout the Organisations. On the recommendation of the External Auditor, the Director had included in the 2005 Financial Statement of the IOPC Funds a Statement of Internal Control that sets out the Director's responsibilities in this area.
- 4.12 The Audit Body noted that, in order to keep it informed of the management of risk, a report would be presented by the Secretariat to the June meetings of the Body on an annual basis. This report would cover the main risks faced by the Organisations and what actions had been taken, if any, to mitigate those risks to an acceptable level.

Non-submission of oil reports

- 4.13 The Audit Body has been very concerned by a number of States not fulfilling their obligations under the respective Fund Convention to submit oil reports. At the Audit Body's June 2006 meeting, the Director presented a report on this issue. He pointed out that, although the situation had improved, as at June 2006 there were 26 States which had outstanding oil reports in respect of the 1971 Fund and/or the 1992 Fund and that some States had reports outstanding for many years. The Audit Body noted that Funds' staff travelling to Member States with outstanding oil reports raised this issue with the authorities concerned.
- 4.14 The Audit Body noted that some progress had been made in the submission of oil reports, but wishes to reiterate its great concern that a number of States do not fulfil their treaty obligations to

submit oil reports, since without oil reports the contribution system cannot work in an equitable manner.

Winding up of the 1971 Fund

- 4.15 The Audit Body has followed developments towards the winding up of the 1971 Fund and, in particular, the efforts made by the Director to finalise pending incidents. It also noted that the major incidents which may cause a delay in the winding up of the 1971 Fund were the *Nissos Amorgos* and *Pontoon 300* incidents.
- 4.16 The failure of a number of States to fulfil their treaty obligations as regards the submission of oil reports could cause serious difficulties in connection with the winding up of the 1971 Fund.
- 4.17 The Audit Body also took note of the situation as regards outstanding contributions. The Audit Body considers it important that the Director continues his efforts to make those contributors who are in arrears pay the amounts due.

Claims Handling Efficiency Review


- 4.18 As part of the Audit Body's wish to follow up on the findings of the claims handling review carried out in 2005, it was decided to experiment by preparing a short questionnaire for claimants designed to identify whether there were any matters about which claimants were concerned or other relevant matters with regards to claims handling of which the Funds themselves were not fully aware. It was recognised that it would not be appropriate to circulate any such questionnaire in respect of claims which had not yet been assessed and agreed and then settled. It was also recognised that it would not be appropriate to use such a questionnaire, even on a test basis, in respect of old incidents.
- 4.19 A recent incident, in which an oil spill had been caused in the Republic of Korea by an uninsured vessel, where, but for the existence of the IOPC Funds, claimants would not otherwise have been able to recover anything, and where the full amount of assessed claims had been paid out was chosen as a basis for the initial trial of the questionnaire. It was anticipated that, in view of these circumstances, claimants would be likely to be willing to give the time necessary to provide a response, seeing this questionnaire as evidence of the commitment of the Funds to providing a service to any community affected by an oil spill falling within the relevant legal framework under which the IOPC Funds operate.
- 4.20 Not all claims arising from this incident have yet been assessed and settled and so the results summarised here are incomplete. Nevertheless it is evident that even in an incident of this type, where without the Funds' existence claimants would have suffered considerable loss and would not have been able to find financial relief, their responses are somewhat confused and critical.
- 4.21 It appears that claimants do not understand that the purpose of the assessment process is to check that the amount claimed is a genuine reflection of loss suffered in accordance with the framework laid down in the applicable international conventions and in accordance with established practice. Instead they see it as an unwelcome process under which their own assertions of loss can be significantly challenged, such that their claims are reduced to figures (in some cases) well below what they consider to be a proper measure of loss.
- 4.22 It is probably not surprising that claimants whose claims have been significantly reduced as a result of the assessment process (often, but not always, because their claims are considered to be excessive and unsupported and not prepared on any reasonable basis) do not welcome that challenge. What is somewhat surprising is that so many claimants are critical of the claims

handling process itself. In this incident, the elapsed time between receipt of claim, assessment and then settlement was quite short, less than seven months; nevertheless claimants considered it was much too long.

- 4.23 Although the results of this initial attempt at seeking reactions of claimants to the way their claims have been handled by the Funds, by means of a questionnaire used after their claims have been settled, have not produced a clear picture from which significant recommendations can yet be established, the exercise is not considered a waste of time or effort. The Audit Body envisages that the questionnaire will be further refined in future. It also envisages that, as the remaining claims stemming from this incident are assessed and settled, the final picture provided by the questionnaires will enable some recommendations to emerge. For example it is already evident that claimants would like to have further information about the assessment process and the stage that their own claim has reached. It is not yet evident, however, that such information can be provided without significant additional costs.
- 4.24 It is the intention of the Audit Body to present an analysis of the results of this questionnaire as well as possible recommendations for the handling of future incidents to a future session of the 1992 Fund Assembly.

Appointment of the External Auditor

- 4.25 At their February/March 2006 sessions, the Funds' governing bodies had supported the Audit Body's proposal that the existing External Auditor should be re-appointed at their October 2006 session, although there were some differences of opinion as to whether the appointment should be for the usual four-year term or for a shorter period, and had requested the Audit Body to look into the procedure for the appointment of the External Auditor in future, including the possibility of competitive tender, and to report to it at its October 2006 session.
- 4.26 The outcome of the Audit Body's consideration of this issue is the subject of a separate document (documents 92FUND/A.11/12, SUPFUND/A.2/8 and 71FUND/AC.20/8).



Charles Coppolani
Chairman
27 July 2006