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SUPPLEMENTARY FUND
2nd session
Agenda item 10

SUPPFUND/A.2/8

ADMINISTRATIVE COUNCIL
20th session
Agenda item 9

71FUND/AC.20/7

APPOINTMENT OF THE EXTERNAL AUDITOR

Note by the Audit Body

Summary:

The Audit Body examines the procedures to be used for the appointment of the External Auditor in the future. It also recommends that the Comptroller and Auditor General of the United Kingdom, whose role is carried out on his behalf by the National Audit Office of which he is head, should be reappointed for a further period of four years from 1 January 2007, and explains the reasons for its recommendation.

Action to be taken:

- (i) to note the information contained in this document;
- (ii) to consider the Audit Body's proposal as regards the procedure for appointment of the External Auditor in the future; and
- (iii) to consider the Audit Body's proposal to re-appoint the External Auditor for the 1992 Fund, the Supplementary Fund and the 1971 Fund for a full term of four years from 1 January 2007.

1 Introduction

- 1.1 The Assembly is reminded that the mandate of the External Auditor expires on 31 December 2006 and hence that it is necessary to address the question of renewal or a changed appointment. The Audit Body prepared a note on this matter which was presented the March 2006 sessions of the governing bodies. At that meeting the Audit Body was requested by the 1992 Fund Assembly to look into the procedure for the appointment of the External Auditor in future, including the possibility of competitive tender, and to report to the Assembly at its October 2006 session. (For convenience, the relevant extract of the Record

of Decisions of the session 1992 Fund Assembly reflecting those discussions is set out below ^{<1>}.)

- 7.7 *The Assembly noted that since the term of office of the External Auditor expired at the end of 2006, the Audit Body took the view that there would not be sufficient time for the governing bodies to consider proposals on new procedures for the appointment of the External Auditor for the next period.*
- 7.8 *The Assembly noted the Audit Body's intention to recommend that the present External Auditor be reappointed for a further term. All delegations supported the proposal that the Assembly should reappoint the existing External Auditor at its October 2006 session, although there were some differences of opinion as to whether the appointment should be for the usual four-years or for a shorter period.*
- 7.9 *Some delegations expressed doubts about using an Auditor from outside the country in which the Funds were located unless there was a specific, compelling reason for change. The view was also expressed that an open competition involving the External Auditors of a large number of Member States was undesirable and that it was important to consider the likely time and cost implications for the Funds.*
- 7.10 *Some delegations, while stressing that competence was paramount, considered that the rotation of External Auditors was good in principle. One delegation made the point that since the 1992 Fund and the Supplementary Fund should have a common auditor it was important to take into account the composition of the two Funds so as to adhere strictly to Regulation 14.1 of the Funds' Financial Regulations, which required the External Auditor to be from Member States.*
- 7.11 *Most delegations were in favour of requesting the Audit Body to look at the procedure for the appointment of the External Auditor in future, including the possibility of competitive tender.*
- 7.12 *The Assembly decided to request 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 the Assembly at its October 2006 session.*
- 7.13 *In response to a question as to whether the Audit Body's mandate needed to be revised the Chairman stated that the existing mandate allowed the Audit Body to make proposals to the Assembly on specific studies.*
- 7.14 *In response to a question as to whether the Audit Body should consider appointments other than the Director and the External Auditor, the Director stated that the Audit Body could, in his view, consider the procedures for the future appointment of other external persons such as the members of the Investment Advisory Body and the external member of the Audit Body.*

^{<1>} The Records of Decisions of the 1971 Fund Administrative Council and the Supplementary Fund Assembly contain a corresponding text.

7.15 *It was noted that the Supplementary Fund Assembly and the 1971 Fund Administrative Council had, at their 2nd extraordinary session and 18th session respectively, endorsed the 1992 Fund Assembly's decisions set out in paragraph 7.12 above.*

1.2 Accordingly this note addresses two related issues: firstly, the recommendations of the Audit Body for procedures to be adopted in future for selecting and appointing the Funds' External Auditor, and secondly, because, even if accepted in full these procedures will take time to introduce, a proposal implementing the decision of the Assembly in March 2006 to reappoint the existing External Auditor from 1 January 2007.

2 Future procedures for appointing the External Auditor

2.1 For organisations like the IOPC Funds, the choice of External Auditor is of great importance. The Funds are small and although the Audit Body has an important responsibility in terms of overall oversight of the risk management and control functions of the Funds, it is itself reliant upon the quality of work carried out for the Funds by the External Auditor. External audit is not a commodity to be bought at the lowest possible price; it is an independent and challenging relationship which, when well managed, can provide not only assurance as to the adequacy of controls and accuracy of reported figures, but also added value through identification of potential risks, weaknesses and control issues which, when so identified in a timely manner, can help the Funds to ensure that a suitable control environment is maintained in future as well.

2.2 The Audit Body has an important responsibility in assisting the External Auditor to make the relationship dynamic, rather than merely static checking, and thereby can help a good auditor provide an excellent service to the Funds. On the other hand, if the External Auditor was offering poor staffing, lack of continuity or had a lack of appropriate grasp of the risk environment, those weaknesses could not be rectified by the Audit Body's interaction with the External Auditor, although the Audit Body would expect to identify them. Thus the Audit Body sees part of its role, on behalf of the governing bodies, as monitoring the external audit relationship and helping to enhance its effectiveness through the interaction that occurs at each meeting and, on occasion, between meetings.

2.3 The Audit Body firmly believes that the choice of External Auditor must take into account a number of factors including competence, understanding of the specific legal and operating environment of the Funds, staff availability and continuity. Cost is of course an important consideration, but it is not the most important one.

2.4 With regard to the tender process to be used for selecting the External Auditor, the Audit Body sees its role as providing a mechanism which is approved in advance, rigorous and precise so that the governing bodies, when they receive the Audit Body's recommendation, may be confident that proper process has been followed and so be confident that the recommendation is independent and sound. Although it might be argued that there is no need to decide on such a procedure until shortly before the audit tender process is due to begin, the Audit Body considers it would be advantageous to develop and agree the procedure in good time beforehand, so that the governing bodies may be confident that an appropriate procedure has been adopted which will then be used in due course.

2.5 Accordingly the Audit Body proposes to develop such a procedure so that it can be brought to the governing bodies for approval two years before it would be applied.

- 2.6 The procedure will include: proposals for eligibility for tender, tender rules, timing, terms of reference, considerations and criteria that the Audit Body consider essential and a proposed framework for the selection process.
- 2.7 The Audit Body anticipates that, once approved, the procedure will lead to a clear and open competition and that the consequent selection of the most suitable appointee would be rigorous and clear. The Audit Body recognises, however, that the governing bodies may themselves wish to have a closer understanding of how the tenderers have responded to the process and hence be able to make their own assessment of the relevant merits of the different proposals. Whilst there is a need to ensure that the selection process is manifestly independent and transparent, it would be impractical to create a process that tried to involve all the many Member States. Although the Audit Body itself is independent and its members have been elected individually by the 1992 Fund Assembly, it would welcome and proposes a separate oversight of the selection process by the Chairman of 1992 Fund Assembly, the Chairman of the 1971 Fund Administrative Council and the Chairman of the Supplementary Fund Assembly at the time of the tender, so that governing bodies may have the highest possible level of assurance that the agreed procedures have indeed been applied impartially and properly.
- 2.8 The Audit Body seeks a mandate from the governing bodies to prepare such a procedure for submission to the governing bodies at least two years ahead of the expiry of the next term of appointment of the External Auditor.

3 Reappointment of the current External Auditor from 1 January 2007

- 3.1 At their March 2006 sessions, the governing bodies noted that the Audit Body was fully satisfied with the service provided by the present External Auditor, the Comptroller and Auditor General of the United Kingdom, whose role is carried out on his behalf by the National Audit Office. They further noted the Audit Body's intention to recommend that the present External Auditor be reappointed for a further term.
- 3.2 All delegations took the view that it would be appropriate for the appointment of the existing External Auditor to be renewed from 1 January 2007. The Audit Body was asked to put forward proposals that would give effect to this decision and implicitly to consider the term of that reappointment.
- 3.3 It has been the normal practice in the past for the External Auditor to be appointed for a period of four years and the Audit Body has considered whether there were any special reasons which should cause it to recommend any change to that established procedure. It does not consider that there are any such reasons; indeed it considers that any change would be detrimental to the interests of the Funds.
- 3.4 The matters that the Audit Body has kept in mind in forming this view are that it considers that the existing external audit arrangements are entirely satisfactory, and that the impending change in the appointment of the Director means that it would not be appropriate to create a further significant and unnecessary change by recommending a short-term reappointment. Conscious also that in 2008 the majority of the elected members of the Audit Body will have to stand down without being eligible for re-election and of the importance of some continuity of arrangements, the Audit Body does not consider that it would be appropriate for the term of office of the External Auditor to end at the same time or shortly afterwards because it would be of benefit for the Funds that the new members of the Audit Body at that time should have had time to familiarise themselves with the issues and arrangements and so be well placed to manage the selection pressures to be introduced thereafter.

3.5 Accordingly the Audit Body recommends that the Comptroller and Auditor General of the United Kingdom, whose role is carried out on his behalf by the National Audit Office of which he is head, should be reappointed for a further period of four years from 1 January 2007.

4 Action to be taken by the governing bodies

The governing bodies are invited:

- (i) to note the information contained in this document;
 - (ii) to consider the Audit Body's proposal as regards the procedure for appointment of the External Auditor in the future; and
 - (iii) to consider the Audit Body's proposal to re-appoint the External Auditor for the 1992 Fund, the Supplementary Fund and the 1971 Fund for a full term of four years from 1 January 2007.
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