

 <p><b>INTERNATIONAL OIL POLLUTION COMPENSATION FUNDS</b></p>	<b>Agenda item: 6</b>	<b>IOPC/OCT10/6/3</b>	
	Original: ENGLISH	25 August 2010	
	1992 Fund Assembly	<b>92A15</b>	•
	1992 Fund Executive Committee	<b>92EC49</b>	
	Supplementary Fund Assembly	<b>SA6</b>	•
1971 Fund Administrative Council	<b>71AC25</b>	•	

## APPOINTMENT OF EXTERNAL AUDITOR

### OUTCOME AND ANALYSIS OF, AND RECOMMENDATIONS FOR THE EXTERNAL AUDIT APPOINTMENT PROCESS

#### Note by the Audit Body

<b>Summary:</b>	<p>Following an external audit tender process conducted in accordance with the procedures agreed by the governing bodies in 2007 and re-confirmed in 2009, the Audit Body unanimously recommends that the Comptroller and Auditor-General of the United Kingdom (National Audit Office) (hereinafter referred to as the National Audit Office) should be reappointed as the IOPC Funds' External Auditor for a further period of four years.</p> <p>Whilst bringing this recommendation, the Audit Body also brings recommendations, based on the experience gained in this process, for a change in the way the issue of the external audit appointment is periodically addressed.</p>
<b>Action to be taken:</b>	<p><u>1992 Fund Assembly, Supplementary Fund Assembly and 1971 Fund Administrative Council:</u></p> <p>(a) to take note of the information contained in this document; and</p> <p>(b) to consider the recommendations contained in paragraph 4 of this document.</p>

#### 1 **Background**

- 1.1 Since their inception, the IOPC Funds have been audited by the National Audit Office. The external audit appointment has normally been made for a four-year period. This has facilitated a periodic review of the working relationship. Clearly the annual audit has also provided an opportunity for either party to raise any matters of concern, including any matters giving rise to tension or discomfort in the working relationship.
- 1.2 The Audit Body does not believe that either the present or the previous Director have ever had grounds for any significant dissatisfaction with the performance of the External Auditor, nor that the working relationship with the National Audit Office has ever been considered to be unsatisfactory. Whilst that past experience gives comfort that the external audit relationship has been considered satisfactory, it does not make it impossible for an unsatisfactory situation to arise at some time in the future or for a change be considered desirable. Future arrangements must therefore allow for that possibility.
- 1.3 The Audit Body was created in October 2002 to provide additional and independent assurance to Member States that the effectiveness of the Funds is monitored regularly with regard to key issues of financial reporting, internal controls, operational procedures and risk management. In addition to that monitoring role, the Audit Body was required to promote the understanding and effectiveness of the audit function within the Funds and to provide a forum to discuss internal control issues, operational

procedures and matters raised by the external audit. This created a new opportunity for the Funds' relationship with the External Auditor because the Audit Body immediately became very close to the heart of the working relationship surrounding the external audit and quickly established an effective relationship with the External Auditor. The External Auditor has subsequently made it clear to the Audit Body and to the governing bodies how useful he has found this additional forum for dialogue in improving his ability to focus (and scope) his work appropriately and as a further means of discussing the outcome of their findings.

- 1.4 At the October 2006 sessions of the governing bodies, Member States accepted the Audit Body's suggestion that the National Audit Office should be reappointed for a further four-year period and agreed that the Audit Body's terms of reference should be changed to make it clear that it would have responsibility in future for bringing forward recommendations to Member States about the appointment of the External Auditor. It was also agreed that there should be a competitive tender in 2010.
- 1.5 Competitive tenders were therefore sought this year in accordance with detailed procedures approved by the governing bodies at their October 2007 sessions. What was not expected was that the open invitation for competitive tender would fail to elicit bids from any other potential candidates, such that the existing External Auditor would be the only available nomination for reappointment.
- 1.6 The Audit Body does not know why no other eligible candidates applied to submit a tender. But any tender process requires a very considerable investment in time, effort and out of pocket costs, from any candidate seeking appointment. The external audit fees have not been large in the past and it could be that prospective candidates did not consider the effort, or the rewards, worthwhile.
- 1.7 Although only one tender was received, in the form of the submission from the National Audit Office, the Audit Body has taken steps to ensure that the arrangements and coverage that he will provide are satisfactory.

## **2 Assessment of the National Audit Office of the United Kingdom's tender**

- 2.1 The formal tender submission from the National Audit Office was reviewed in detail by the Audit Body in advance of the meeting at which the National Audit Office was interviewed, and by prior agreement each member of the Audit Body took a specific area relevant to aspects of the audit or its management and explored those matters in depth by means of detailed questions to the representatives of the National Audit Office. The Chairmen of both the 1992 and the 1971 Funds attended the interview with the National Audit Office as observers.
- 2.2 Matters explored included the National Audit Office's assessment of risk, its understanding of the legal framework of the Funds, the planned approach to providing audit coverage of computerised accounting and claims handling systems, understanding of the governance of the Funds and the role of Member States and the governing bodies, continuity of staffing and knowledge, whether, and if so the extent to which, the National Audit Office considered it appropriate to offer advice outside the audit area, and the availability of relevant external expertise relating to claims handling matters, if needed. The Audit Body noted with satisfaction that the National Audit Office proposed future fees which were directly comparable with those charged in the past.
- 2.3 The Audit Body is fully satisfied as a result of its enquiries, that the answers provided give assurance that the external audit relationship will continue to be constructive and effective. The responses from the National Audit Office demonstrated that, although the fees chargeable are not large, and the Organisations are not substantial in size, they valued the working relationship and wished to continue serving the IOPC Funds. Indeed, subsequent to the completion of the tender process, the National Audit Office remarked that they had found the process very rigorous and also helpful in ensuring that the circumstances and audit needs of the Funds, and the mix of abilities provided by the National Audit Office, would remain thoroughly aligned.

### **3 Considerations and consequences**

- 3.1 Tender costs do not just lie with prospective candidates. A very considerable amount of time and effort was put into both preparing and carrying out the procedures for the competitive tender by the Secretariat, and of course a considerable amount of time of the Audit Body members was also involved. The matter took priority in the work plan of the Audit Body for the current year. With hindsight it can be seen that, without a genuine competition between tenders, the cost/benefit test for use of time was not met.
- 3.2 Further, for the future, there is unlikely to be any benefit for the Funds if the incumbent knows that there is little realistic likelihood of change. There is also potential risk of a weakening in the Secretariat's and the Funds' position, although the Audit Body does not believe that this has happened on this occasion. The Audit Body is also mindful of the Fund's interest in maintaining effective control over any future proposed increase in fees.
- 3.3 The Audit Body takes the view that it has the responsibility to develop and maintain an effective relationship with the External Auditor that makes it possible for the Audit Body to see right into the heart of the working relationship with the Funds. Because the Audit Body is made up of independent outsiders, its role brings genuine strength to the governance processes of the Funds and enables the nature of that relationship to be monitored effectively on an ongoing basis.
- 3.4 The Audit Body also considers that an audit is not a commodity, bought and sold at the cheapest price for a precisely defined standard product, but instead a dynamic relationship in which success is measured by the quality of assurance provided, and hence of the work done, and that this is the only sensible means of evaluating the cost/benefit equation. The inclusion from the outset of a paid independent expert member of the Audit Body is intended to help ensure that its dialogue with the External Auditor is effective and well-informed, and hence to make a significant contribution to this aspect of its governance responsibility.
- 3.5 At the October 2009 sessions of the governing bodies, the independent external expert member of the Audit Body reported on the preparations already made, and said, among other things, 'Rotation of the appointment of External Auditor for its own sake is not considered by the Audit Body to be a relevant or desirable objective and the current External Auditor remains eligible for reappointment, if nominated. The objective of this comprehensive approach is to provide all Member States with the highest possible level of confidence that a rigorous process has been followed as a result of which there can be real assurance that the best candidate for appointment has been secured.'
- 3.6 Hence the Audit Body considers that the key source of comfort for the governing bodies, namely that the External Auditor is operating effectively and that the audit relationships are satisfactory, must come from the reports they receive from the Director, the External Auditor and from the Audit Body itself. It is possible that, at some time in the future, the Director or the Audit Body, or both, may cease to be satisfied on this point, but that situation would only be expected to arise when matters have been discussed with the External Auditor and the outcome of the discussions leads to the view that the relationship is not as it should be and that unresolved issues remain. In that case, the governing bodies would be recommended to seek an alternative External Auditor, through a process of competitive tender.
- 3.7 The important difference in that case would be that Member States would then be aware that a change in appointment was under active consideration, and eligible candidates might be expected to consider seriously the opportunity of seeking appointment.
- 3.8 It is with that background that the Audit Body brings to the October 2010 sessions of the governing bodies recommendations with regard to future reappointments and competitive audit tenders generally, as well as its recommendation for the reappointment of the Comptroller and Auditor-General of the United Kingdom as the External Auditor of the IOPC Funds.

#### 4 Recommendations

- 4.1 Following careful review by the Audit Body and the Secretariat of the tender received from the Comptroller and Auditor-General of the United Kingdom and the steps taken to ensure that the arrangements and coverage will be satisfactory, **the Audit Body recommends his re-appointment for a further four-year period.**
- 4.2 The Audit Body believes that recent experience has shown that a strategy for enabling Member States to gain independent assurance as to the quality of external audit service based on the principle of periodic competitive tender did not deliver the results anticipated. The only way that it might be revitalised would be if the existing criteria for eligibility of External Auditors were to be widened<sup><1></sup>. But changing the eligibility criteria to include independent accounting firms would have significant additional implications, including the likelihood of very much greater audit cost and the need to be satisfied that the relevant expertise applicable to auditing an international governmental organisation would be available. **The Audit Body does not recommend that the approach of changing eligibility criteria be considered further at this time.**
- 4.3 **The Audit Body recommends that the primary independent comfort on which Member States should rely in order to be satisfied that the external audit relationship is effective is the review and monitoring function carried out by the Audit Body.** The Audit Body considers that this should provide Member States with ongoing assurance as to whether the External Auditor is likely to remain the most suitable choice.
- 4.4 **The Audit Body recommends that there should be no automatic periodic competitive tenders for the external audit appointment for the Funds unless there is a breakdown in the audit relationship.**
- 4.5 **Accordingly the Audit Body further recommends that:**
- (a) **the external audit relationship should continue to be kept under regular ongoing review by the Director and the Audit Body (and by the Chairmen of the IOPC Funds' governing bodies if they choose to attend Audit Body meetings as occasional observers);**
  - (b) **both should report to the governing bodies from time to time on this matter, and that Member States should use those reports as the means of monitoring the nature of the ongoing relationships;**
  - (c) **a thorough review of all relevant matters and considerations should take place, led by the Audit Body, in the year before a recommendation for reappointment of the External Auditor would otherwise be brought to Member States, and that any recommendation for reappointment (or otherwise) should reflect that careful consideration, and provide sufficient detail for an informed discussion to take place when these matters are brought to the governing bodies, including any concerns if the Director or the Audit Body are not fully satisfied with the external audit relationship;**
  - (d) **if the Audit Body is satisfied that the external audit relationship appears to be fully satisfactory, its recommendation for reappointment would be considered according to the normal four-year timetable; and**
  - (e) **where no tender process has taken place for some time, the Audit Body should give thought as to whether they consider such a process would be likely to provide overall benefit to the Funds in forming their recommendation to the governing bodies, having had careful regard to the experience gained with the audit tender in 2010.**

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<sup><1></sup> The Funds' Financial Regulations require that, to be eligible, an External Auditor, must be the Auditor-General (or officer holding the equivalent title) of a Member State.

**5**     **Action to be taken**

1992 Fund Assembly, Supplementary Fund Assembly and 1971 Fund Administrative Council:

The governing bodies are invited:

- (a) to take note of the information contained in this document; and
  - (b) to consider the recommendations contained in paragraph 4 of this document.
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