



INTERNATIONAL
OIL POLLUTION
COMPENSATION
FUNDS

ASSEMBLY
12th session
Agenda item 10

92FUND/A.12/9
29 August 2007
Original: ENGLISH

SUPPLEMENTARY FUND
3rd session
Agenda item 9

SUPPFUND/A.3/7

ADMINISTRATIVE COUNCIL
22nd session
Agenda item 8

71FUND/AC.22/6

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.
- 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 members of the Audit Body elected in October 2005 for a three-year period were:
 - Mr Charles Coppolani (France) (Chairman)
 - Mr Maurice Jaques (Canada)
 - Mr Mendim Me Nko'o (Cameroon)
 - Dr Reinhard Renger (Germany)
 - Mr Wayne Stuart (Australia)
 - Professor Hisashi Tanikawa (Japan)
 - Mr Nigel Macdonald (United Kingdom) ('outsider').
- 1.4 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.
- 1.5 The Audit Body has met three times since the October 2006 sessions of the Funds' governing bodies, viz 1 December 2006, 8 March 2007 and 1 June 2007. Representatives of the External Auditor have attended these meetings and have made a significant contribution to the Audit Body's deliberations.
- 1.6 The Director and the Head of the Finance and Administration Department also attended the meetings. The Director's Personal Assistant acted as the Audit Body's Secretary. At the request of the Director, other members of the Secretariat's Management Team were invited by the Audit Body to attend discussions under certain agenda items.
- 1.7 The Chairman of the 1992 Fund Assembly attended the March 2007 meeting of the Audit Body.
- 1.8 As in previous years, the Audit Body had a closed session with the External Auditor after the conclusion of the final audit at which no member of the Secretariat was present. A closed session at which only the Audit Body members were present also took place to discuss the attendance of Audit Body members at the October sessions of the Funds' governing bodies.
- 1.9 Closed sessions also took place without the presence of the representatives of the External Auditor during the December 2006, March and June 2007 meetings to discuss the issue of the appointment of the External Auditor.

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

- 2.1 At its December 2005 meeting, the Audit Body had planned its programme for the three years of its mandate, taking into account the limited number of Audit Body meetings, and had identified the following activities as being those which needed to be carried out on a regular basis:
- Hold discussions with the External Auditor on the audit programme;
 - Consider issues of risk management: although this was the responsibility of the Secretariat, it was important to have input from the Audit Body;
 - Review claims handling procedures;
 - 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; and
 - Review the process for the preparation of the budget and express a view on it in the Audit Body's annual report to the governing bodies.
- 2.2 In addition to its regular activities, at their February/March 2006 sessions, the Funds' governing bodies 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 them at their October 2006 sessions. At the latter sessions, the governing bodies gave the Audit Body the task of preparing a detailed proposal for a procedure for the appointment of the External Auditor in the future.
- 2.3 With respect to the continuing review of 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 in what respect the claims handling procedures should 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 2006 Financial Statements.

- 3.2 At its December 2006 meeting, the Audit Body had the opportunity to discuss with the External Auditor the audit strategy relating to the audit of the 2006 Financial Statements, which covered both the timing and the scope of the audit. The representative of the External Auditor presented the time schedule of the audit and the main points of attention. He said that there was no plan to change the risk-based approach to the audit undertaken in previous years. The audit would be performed with reference to the concept of materiality and would seek to place reliance on the internal controls in place at the Funds where possible. Walk-through testing would be conducted to ensure that controls were operating as described and additional compliance testing or focussed substantive testing would be carried out where this proved to be necessary.
- 3.3 The main audit risks which had been identified for 2006 were the upgrade of the accounting software, the impact of the closure of Claims Handling Offices, contributors' balances, purchasing procedures and payroll. The Audit Body asked the External Auditor to also look at the procedural manuals (investments, payments and claims) which had been put in place as well as to examine the financial instruments used by the 1992 Fund, eg Dual Currency Deposits (DCDs).

Interim Audit Report

- 3.4 At the March 2007 meeting of the Audit Body, the External Auditor presented an interim audit report on the audit of the IOPC Funds' 2006 Financial Statements, which had been completed in February 2007.
- 3.5 With respect to the area of expenditure, internal controls on claims expenditure and on claims-related expenditure had been reviewed and tested and no issues had arisen from the testing. In addition to the routine testing, the Secretariat's 'Register of Interest' had been reviewed and cross-referenced to claims-related suppliers to investigate potential conflicts of interest, none of which had been found. Control testing, substantive testing and analytical procedures relating to staff costs expenditure had been successfully completed. It was confirmed that there was adequate segregation of duties and review of staff costs expenditure by management in place. The testing of administrative expenditure relating to Secretariat expenses had been completed satisfactorily. The internal controls over investments had been reviewed and substantive testing of investment interest income had been completed.
- 3.6 Two new sources of other income had been identified in 2006 for the 1992 Fund: the reimbursement of compensation payments made by the 1992 Fund under STOPIA 2006 which was a receivable at the end of 2006 and an interim payment made to the 1992 Fund by the London Steamship Owners' Mutual Insurance Association (London Club) relating to apportionment of joint costs in respect of the *Prestige* incident. The External Auditor had advised on appropriate disclosure of both items in the accounts.
- 3.7 With respect to the balance sheet, all bank accounts had been identified and balance confirmations had been requested from all banks and financial institutions. Internal control of year-end balances would be confirmed during the final audit through bank reconciliation testing.

- 3.8 The implications for the Funds resulting from a move to International Public Sector Accounting Standards in 2010, an assessment of the appropriateness of the new performance management system developed by the Secretariat and a report on the progress in implementing the recommendations made in the External Auditor's 2005 audit report would be reviewed during the final audit.

Final audit

- 3.9 At the Audit Body's June 2007 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' 2006 Financial Statements.
- 3.10 The representative of the External Auditor stated that the overall result had been that no weaknesses or material errors had been found across the three Funds and the Financial Statements for each of the Funds were free from material misstatements. He reported the key findings and recommendations arising out of the audit, which were agreed with by the Secretariat and were endorsed by the Audit Body.
- 3.11 The representative of the External Auditor reported that he was pleased to note that, due to the introduction of the new up-graded accounting system (FUNDMAN), it had been possible to interrogate the ledgers using computer-assisted audit techniques and that this had increased the External Auditor's assurance over the preparation of the Financial Statements from the accounting records.
- 3.12 The Audit Body expressed its appreciation to the Secretariat and to the former Director, Mr Måns Jacobsson, for the way in which the Secretariat had been operating and which had resulted in an outstanding audit report.
- 3.13 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 Fund, the 1992 Fund and the Supplementary Fund for the financial year ending 31 December 2006.

4 Other main issues considered

Relationship with the joint Investment Advisory Body

- 4.1 The Audit Body and the Investment Advisory Body (IAB) are independent bodies that 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 and this is done on an annual basis. Information is also shared by exchanging copies of the minutes of the bodies' respective meetings.
- 4.2 In June 2007 the IAB reported to the Audit Body on recent developments in respect of investments of the Funds' assets. The Audit Body noted that the Funds' assets had decreased from £153 million to about £100 million and that this situation was positive for Member States as it seemed to reflect the safer transportation of oil.
- 4.3 The Audit Body was pleased to note that the IAB continued to monitor the cost-effectiveness of Investment Performance Measurement and was satisfied with the IAB's view that the monitoring process which was in place continued to be more than adequate for the time being.
- 4.4 The Audit Body noted the IAB's view that the use of DCDs had been consistently good for the Funds and that Participating Forwards worked well in a stable currency period. The Audit Body

drew comfort from the fact that, at the request of the Secretariat, the IAB had reviewed the financial risks identified by the Secretariat under the risk management process.

- 4.5 The Audit Body noted that the IAB had met with the representatives of the External Auditor on 30 May 2007 and that it intended to hold a similar meeting in 2008.

Risk management

- 4.6 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 the claims handling process, financial risk, human resource management, business continuity and reputation.
- 4.7 The Audit Body recalled 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. The Audit Body noted that the Secretariat would consider having an independent review of risks after a few years.
- 4.8 The Audit Body was pleased to note at its June 2007 meeting the progress that had been made with respect to Business Continuity (IT and premises). It also noted that the only outstanding area was Reputation risk and that this would include risks already identified under the other areas of risk which could have a reputational impact (eg fraudulent claims).

Non-submission of oil reports

- 4.9 The Audit Body has been very concerned by a number of Member States not fulfilling their obligations under the respective Fund Convention to submit oil reports and has in its annual reports to the October sessions of the Funds' governing bodies reiterated its concern.
- 4.10 The Audit Body has noted the considerable efforts made by the Secretariat over the years to engage with the Member States concerned, including on occasion visiting to provide training and familiarisation with Funds' procedures, as well as making diplomatic efforts made to secure the provision of the outstanding oil reports. These efforts had been rewarded in a number of cases by the provision of some of the outstanding oil reports, but it was the Audit Body's view that the problem remained a recurring and difficult one.
- 4.11 This issue was given lengthy consideration by the Audit Body at its meetings in November 2006, and in March and June 2007 and it is the view of the Audit Body that the problem could be addressed if the governing bodies were to take a policy decision pursuant to Article 32 of the Convention. The Audit Body's recommendation is the subject of a separate document (document 92FUND/A.12/12/2 and SUPPFUND/A.3/10/2)

Claims Handling Efficiency Review

- 4.12 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.
- 4.13 The N^o7 Kwang Min incident in the Republic of Korea in November 2005, in which an oil spill had been caused by an uninsured vessel, was chosen as a basis for the initial trial of the questionnaire. The short trial questionnaire used was developed by the Secretariat and the Audit Body, in the knowledge that this was a specialist field and that, if the results of the

questionnaire proved useful, the development of any future questionnaire would probably benefit from specialist expertise.

- 4.14 The main results of the analysis of the questionnaire can be summarised as follows:
- 4.14.1 But for the existence of the 1992 Fund, claimants affected by this particular incident would not have received any compensation for damage resulting from the spill. All the claims for the incident were assessed quickly and those claimants who accepted the assessed amounts of compensation were paid promptly, without any need for pro-rating. However, the response to the questionnaire did not show that, overall, claimants were satisfied. The reasons given for dissatisfaction reflected a number of issues, including lack of familiarity with the compensation regime including the Fund's purpose and procedures, concern by claimants that they were not able to provide some of the information requested, concerns about the absence of knowledge of what was happening while their claims were being assessed.
- 4.14.2 Following careful review of the results, the Audit Body formed the view that the results did not reveal any significant weakness which had not already been identified and addressed by the Secretariat. However the Audit Body considered that the results of the questionnaire highlighted the importance of the Secretariat's oversight of delays in assessment and the specific trends and issues arising in respect of each issue.
- 4.14.3 In this context, the Audit Body was pleased to note that the Secretariat had well-developed plans for a further and significant upgrade to the database system used to manage claims which would allow greater detail and hence greater oversight and analysis of other relevant management information relating to claims handling. It considered that use of management information systems to allow such monitoring and oversight was highly desirable and fully supported the Secretariat in its plans to complete the development and implementation of this improved system.
- 4.14.4 The Audit Body also noted that the Secretariat had taken a considerable number of initiatives in recent years intended to address the underlying causes of concerns such as those raised by questionnaire respondents, including the provision of detailed written guidance as to the compensation regime and its procedures, and the provision of guidance for each incident to assist claimants. In addition the Secretariat has provided training courses in a number of countries to help prepare authorities and those likely to be involved in assessing claims to be ready for an incident should one occur.
- 4.14.5 The Audit Body concluded that the questionnaire had been useful in providing confirmation that there were not any unforeseen issues and considered that it could be worthwhile to develop a questionnaire for use on some future incidents, so long as the questionnaire was properly constructed using specialist expertise. The Audit Body also acknowledges that it is inevitable that those affected by an incident find the whole process stressful and unwelcome and that this will colour their communications with the Funds and their responses to any questionnaire.

Appointment of the External Auditor

- 4.15 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 sessions, 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.
- 4.16 The outcome of the Audit Body's initial consideration of this issue was reported to the governing bodies at their October 2006 sessions (cf documents 92FUND/A.11/12, SUPPFUND/A.2/8 and 71FUND/AC.20/7).

- 4.17 At these sessions, the governing bodies had given the Audit Body the task of preparing a detailed proposal for a procedure for the appointment of the External Auditor in the future.
- 4.18 As a result of the Audit Body's deliberations on this matter, a document has been produced by the Audit Body which is the subject of a separate agenda item (document 92FUND/A.12/10, SUPPFUND/A.3/8 and 71FUND/AC.22/7).
- 4.19 In the event that the governing bodies decide on the procedures set out in the document, the mandate of the Audit Body would need to be amended to include this additional responsibility.

Attendance of Audit Body members at the October sessions of the IOPC Funds' governing bodies

- 4.20 Mindful of the cost implications of the Audit Body members' attendance at the October sessions of the IOPC Funds' governing bodies on an annual basis, the Audit Body had taken the decision in June 2006 that, apart from in the post-election year, only the Chairman and the outside expert would attend these sessions as it was felt that some members who were on their second term were already well known to delegates.
- 4.21 In the light of a review of this question in June 2007, the Audit Body agreed upon a rota system whereby new members could attend the meetings the October following their election, members wishing to stand for re-election could attend in the election year and attendance in the other years would be on a rotation basis for members other than the Chairman and the outside expert. It was further agreed that any member working on a specific issue within the Audit Body might attend the October sessions, as long as there was a measurable justification for travel.



Charles Coppolani
Chairman
29 August 2007
