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REPORT OF THE JOINT 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: 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 current composition and mandate of the Audit Body, as decided by the governing bodies in October 2002 (and revised in March 2005 to take into account the entry into force of the Supplementary Fund Protocol), is at Annex I. In this respect, the governing bodies decided at their October 2007 sessions that the mandate of the Audit Body would need to be amended to include the organisation of the tender process in respect of the appointment of the External Auditor when the time came. The Audit Body has taken this opportunity to look at its Composition and Mandate and has proposed some additional amendments to take into account developments in its activities and responsibilities since its creation in 2002. The proposed revised Composition and Mandate has been

submitted for the consideration of the governing bodies under a separate agenda item documents 92FUND/A.13/10/1, SUPPFUND/A.4/9/1, 71FUND/AC.23/6/1).

- 1.5 The Audit Body has met three times since the October 2007 sessions of the Funds' governing bodies, viz 7 December 2007, 7 March 2008 and 6 June 2008. 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 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 without the presence of the representatives of the External Auditor took place during the December 2007 meeting to discuss issues raised by the governing bodies at their October 2007 sessions in respect of the Audit Body's proposal for the appointment of the External Auditor.

2 Audit Body's programme of activities for the three-year term October 2005 to October 2008

- 2.1 At its December 2005 meeting, the Audit Body planned its programme for the three years of its mandate, taking into account the limited number of Audit Body meetings, and 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, the Audit Body considered it important to provide input;
 - Review claims handling procedures;
 - Hold discussions with the joint Investment Advisory Body (IAB);
 - Monitor submission of oil reports;
 - Monitor the preparation of 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 The Audit Body had already decided at its June 2005 meeting that, having regard to the anticipated retirement of the existing Director, it would carry out a review of the transition of management control and structures when the new Director had been appointed. A summary of the results of that review, which was carried out in the spring of 2008, are set out in paragraphs 4.14 - 4.17 below.
- 2.3 The Audit Body decided at its December 2007 meeting that, in addition to the above-mentioned regular activities and the review of the transition of management control and structures, its main area of focus for 2008 would be an evaluation of its work over the six-year period 2002 - 2008 (cf paragraph 5 below).

4 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 three Funds.

Audit Strategy for 2007 Financial Statements

- 3.2 At its December 2007 meeting, the Audit Body had the opportunity to discuss with the External Auditor the audit strategy relating to the audit of the 2007 Financial Statements. 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 Audit Body noted that the main audit risks which had been identified for 2007 were potential conflicts of interest between staff and suppliers used by the Funds, contributors' balance, contributions to the Supplementary Fund and payroll.

Interim Audit Report

- 3.4 At the March 2008 meeting of the Audit Body, the External Auditor presented an interim audit report on the audit of the IOPC Funds' 2007 Financial Statements, which had been completed in February 2008.
- 3.5 The Audit Body noted that the results of the interim testing of income, expenditure and cash balances for the three Funds were satisfactory for the purpose of the audit opinion.
- 3.6 The Audit Body also noted that significant levels of Small Tanker Owners Pollution Indemnification Agreement (STOPIA 2006) income had been received in 2007 in respect of claims assessed in the framework of the *Solar 1* incident, and that these items had been tested in detail for the first time. A sample of the claims had been checked as well as an audit trail of postings in the ledger from the first payment to the claimant and the reimbursement from the P&I Club, making sure that each claim had been posted correctly into the right accounts and for the right amounts. The Audit Body was pleased to note that the work had been completed with satisfactory results.
- 3.7 The Audit Body further noted that the External Auditor had highlighted three issues arising from the interim audit: availability of audit evidence, obtaining best value from re-occurring expenditure and conflict of interest. These issues would be discussed further during the final audit.
- 3.8 The implications for the Funds resulting from a move to International Public Sector Accounting Standards in 2010 had also been discussed by the External Auditor with the Secretariat during the interim audit.

Final audit

- 3.9 At the Audit Body's June 2008 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' 2007 Financial Statements.
- 3.10 The Audit Body was pleased to note that no unadjusted misstatements had been found in the 2007 Financial Statements and that therefore no audit adjustments had been required. This result was, in the Audit Body's view, a reflection of the diligence of the Secretariat in the area of financial control.
- 3.11 The Audit Body's attention had been drawn to the wording of draft Note 27 to the Financial Statements which had spoken of 'hedging' in respect of the use of Dual Currency Deposits (DCDs). The Audit Body shared the view of the Investment Advisory Body (IAB) that DCDs were not

'hedging' instruments and a revised text was agreed upon by the Audit Body, in consultation with the IAB, the representatives of the External Auditor and the Secretariat.

- 3.12 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 2007.

Internal Control

- 3.13 The Audit Body noted that the Director has included, as Annex II to the 2007 Financial Statements, a Statement of Internal Control in which he has outlined the scope of his responsibilities for this important aspect of the functions of the Secretariat. In that statement he has then added comments under various headings, concluding that there exists an effective system of internal control for the financial year 2007.
- 3.14 The mandate of the Audit Body requires it to review the effectiveness of certain matters which include the internal controls operated by the Secretariat. As will be evident from this and previous reports, the Audit Body carries out a number of different types of review work to enable it to meet its mandate and this includes extensive communication with the External Auditor during the year. The External Auditor also assesses the adequacy of the internal controls as part of their work.
- 3.15 The Audit Body has discharged its mandate and reports that nothing has come to its attention (or has been brought to its attention by the External Auditor) which would call into question the adequacy or effectiveness of the internal controls of the Funds, or cause it to challenge the assurance provided by the Director in Annex II to the 2007 Financial Statements.

4 Other main issues considered

Investment Advisory Body

- 4.1 The Audit Body and the 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 at the June meeting of the Audit Body. Information is also shared by exchanging copies of the Minutes of the Bodies' respective meetings.
- 4.2 In June 2008 the IAB raised with the Audit Body the issues which had been discussed at a meeting with the representatives of the External Auditor at the end of May 2008.
- 4.3 The Audit Body was pleased to note that the IAB was monitoring the performance of financial institutions in the light of the current turmoil in the financial markets.
- 4.4 The Audit Body also noted that the IAB had discussed the 1992 Fund's exposure to Euro liabilities in respect of the *Erika* and *Prestige* incidents and which currently resulted in a cover of approximately 33⅓% but that the IAB would also be comfortable with an exposure closer to 50%.
- 4.5 The Audit Body thanked the IAB for again having shared its views with the Audit Body and expressed the expectation that this would continue with the Audit Body in its new composition.

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 At its June 2008 meeting, the Audit Body was provided with an up-date on the work that had taken place since its June 2007 meeting. It noted that risks had been identified for four out of the five risk categories and had been graded on the basis of the impact on the Organisations and the likelihood of the risk occurring. The risks that had the largest impact and likelihood had been reassessed taking into account the controls and procedures that were in place to mitigate them. Thirteen risks had been identified as being key risks across the Secretariat and had been placed on the Key Risk Register. They had also been graded on controllability and allocated to 'risk owners'.
- 4.9 The Audit Body suggested that an audit list of all changes/amendments made by users in respect of the web-based claims management system as well as in respect of FundMan should be added to the list of risks and that criticism that the Funds may be slow with the processing of claims be added under Reputation Risk.
- 4.10 The Audit Body said that it would expect the risk ratings to change from year to year and pointed out that it was important not to lose track of other risks which had been identified but which had not been classified as key risks.

Non-submission of oil reports

- 4.11 This issue had been given lengthy consideration by the Audit Body at its meetings in November 2006, and in March and June 2007 and its recommendation had been the subject of a document submitted to the October 2007 sessions of the governing bodies (document 92FUND/A.12/12/2, SUPPFUND/A.3/10/2).
- 4.12 At their October 2007 sessions the governing bodies invited the Audit Body to refine its proposal in the light of the discussions and to submit a new document on the subject to a future session of the Assembly.
- 4.13 The Audit Body has prepared a shorter document encapsulating the issues raised by Member States in October 2007 which is submitted for consideration by the 1992 Fund and Supplementary Fund Assemblies under a separate agenda item (cf document 92FUND/A/13/13/1, SUPPFUND/A.4/12/1).

Review of management control and structures following the appointment of the new Director

- 4.14 At its June 2005 meeting, the Audit Body had been of the view that it would be useful to carry out a review of the transition of management control and structures following the appointment of the new Director in 2006.
- 4.15 The conclusions of the review, which was carried out in 2008, provided the Audit Body with assurance that the overall management control and organisation structure arrangements now in place had been very thoroughly considered by the Director, that a number of changes and improvements had been made and that nothing had emerged from the review which should give rise to concern that the management control and structures in place were anything other than satisfactory. The Audit Body was pleased to note that its possible concerns regarding the transition had been unfounded.

- 4.16 The Audit Body noted from the review that the handover arrangements established when the former Director passed over management control to his successor were sound and that an effective transition had occurred during which proper time had been given to ensuring that significant outside relationships were handed on and that existing management arrangements were properly communicated. In addition, the Audit Body noted that a further step of significant importance to the Funds had been taken in that a database of all decisions taken by the Funds' governing bodies, classified by type of decision, was being prepared and that this gave comfort that the need to be aware of issues of precedent within the Funds would be fully addressed.
- 4.17 The Audit Body expressed its appreciation to the Director for the considerable effort he has invested personally in this review, welcoming its purpose strongly and supporting the broadening of the originally proposed scope. The Director himself had initiated one significant aspect of the review which was to use the 1998 Organisation Review of the IOPC Fund Secretariat as a comparator for part of the Audit Body's review.

Composition and mandate of the Audit Body

- 4.18 At their October 2007 sessions, the governing bodies decided that the mandate of the Audit Body would need to be amended to include the organisation of the tender process in respect of the appointment of the External Auditor when the time came.
- 4.19 The Audit Body has taken this opportunity to look at its Composition and Mandate and has proposed some additional amendments to take into account developments in its activities and responsibilities since its creation in 2002. The proposed revised Composition and Mandate has been submitted for the consideration of the governing bodies under a separate agenda item (document 92FUND/A.13/10/1, SUPPFUND/A.4/9/1, 71FUND/AC.23/6/1).
- 4.20 The Audit Body's internal Rules of Procedure will be updated in due course in the light of the 1992 Fund Assembly's decision with respect to a revision of the Composition and Mandate.

Winding up of the 1971 Fund

- 4.21 The Audit Body has carried out a review of this issue and is of the view that progress towards the completion of the 1971 Fund's obligations concerning all pending incidents and their relevance for the winding-up are under permanent and constant observation and review by the Secretariat, and the 1971 Fund Administrative Council. At the present time, the Audit Body can only encourage the Secretariat to pursue its course of action as described in document 71FUND/AC.22/13.
- 4.22 The Audit Body is further of the view that it will be the task of the Audit Body in later years to decide if and when there is a need for its advice and assistance in respect of the winding up proceedings. For the time being, the Audit Body has nothing of substance to report on this subject.

International Public Sector Accounting Standards

- 4.23 The Audit Body noted that the representative of the External Auditor had, in his Report on the 2006 Financial Statements to the 1992 Fund Assembly in October 2007, recommended that the Secretariat submit a proposal to the Assembly, by its 2008 regular session, seeking its approval of the adoption of the International Public Sector Accounting Standards (IPSAS) by the IOPC Funds, in principle, from the financial year 2010. The Audit Body also noted that, although the IOPC Funds were not part of the UN system and therefore not obliged to follow UN accounting standards in the preparation of their Financial Statements, each of the IOPC Funds' governing bodies had, in the past, approved the use of the UN accounting standards, where appropriate, for the preparation of their Financial Statements.

- 4.24 The Audit Body discussed the implications of the implementation of IPSAS for the IOPC Funds and, in particular, the move from 'obligations' to 'accruals' and the possibility that this might cause a problem with accruing for payment of compensation.
- 4.25 The Audit Body agreed with the proposal of the Secretariat to seek the approval of the adoption of IPSAS by the IOPC Funds, in principle, from the financial year 2010 although it reserved its position as to whether the Funds should be at the forefront of those organisations implementing IPSAS.

Administrative monitoring

- 4.26 In March 2008, the Audit Body was given a presentation of the IOPC Funds new web-based claims management system, which was being used for the first time in respect of the *Hebei Spirit* incident which had taken place in the Republic of Korea in December 2007, and had the opportunity to ask questions.
- 4.27 The Audit Body expressed the view that, in addition to the Claims Manager handling the incident, the Head of the Claims Department should also have a record of the levels of access assigned to the experts in order to be able to cross-check the decisions taken in respect of access to the system. It also felt that there should be a segregation of responsibility between the Funds' IT Manager and the designer of the system to ensure an independent source of technical support.
- 4.28 The Audit Body was pleased to note the External Auditor's offer to provide independent assurance that the necessary controls were in place in respect of the security of the data in the system in the form of an IT audit.
- 4.29 The Audit Body was of the opinion that the new system would provide the potential for both reducing time (and therefore improving efficiency) in assessing claims as well as in improving transparency due to the protections and safeguards built into the system, and would make the management of incidents much easier.

5 Evaluation of the work of the Audit Body during the period 2002 - 2008

The Audit Body has prepared a document summarising the work which it had undertaken since its establishment in 2002 as well as the philosophy and approach which it had adopted during that six-year period. It was felt that this document would be helpful to the new members of the Audit Body who would be elected in October 2008 and might also assist the Funds' governing bodies to understand the underlying approach adopted by the Audit Body during its first two three-year periods of work so as to be able to evaluate its contribution to the overall process of governance of the Funds' activities. This document is at Annex II.

6 Future of the Audit Body

- 6.1 When the Audit Body was established in 2002, the governing bodies decided that the functioning of the Audit Body should be reviewed by the governing bodies every three years on the basis of an evaluation report from its Chairman (documents 92FUND/A.7/29, Annex II, paragraph 9 and 71FUND/AC.9/20, Annex I, paragraph 9). The governing bodies will therefore carry out such a review at their October 2008 sessions.
- 6.2 The Audit Body forms an integral part of the governance of the Funds. Whilst it may be said that the Audit Body itself is not the proper entity to recommend its own continuation, it notes that the External Auditor has emphasised the importance that he attaches to its existence. The Director has stated that he considers that the Audit Body contributes significantly to the effective governance of the IOPC Funds.

- 6.3 The Audit Body recommends, therefore, that the Body should be instructed to continue its work under such a mandate and with such membership composition as the governing bodies may decide.

A handwritten signature in black ink, appearing to read 'Coppolani', written over a horizontal line.

Charles Coppolani
Chairman
15 August 2008

* * *

ANNEX I

COMPOSITION AND MANDATE OF THE JOINT AUDIT BODY OF THE 1992 FUND, THE 1971 FUND AND THE SUPPLEMENTARY FUND

(As decided by the governing bodies in October 2002 and revised in March 2005 to take into account the entry into force of the Supplementary Fund Protocol)

N.B. A proposed revised Composition and Mandate has been submitted for the consideration of the governing bodies under a separate agenda item (document 92FUND/A.13/10/1, SUPPFUND/A.4/9/1, 71FUND/AC.23/6/1).

- 1 The Audit Body shall be 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. Nominations, accompanied by the curriculum vitae of the candidate, should be submitted to the Director at least six weeks in advance of the session at which the election will take place.
- 2 Members of the Audit Body shall hold office for three years, once renewable. Of the first Audit Body to be elected, the term of three of those elected from 1992 Fund Member States shall not be renewable.
- 3 The members of the Audit Body shall perform their functions independently and in the interest of the Organisations as a whole. The members elected from 1992 Fund Member States shall not receive any instructions from their Governments.
- 4 Travel and subsistence expenses of the six members of the Audit Body elected from 1992 Fund Member States shall be paid by the Organisations. The member not related to the Organisations ('outsider') shall be paid travel expenses and an appropriate fee.
- 5 The Audit Body shall:
 - (a) review the effectiveness of the Organisations regarding key issues of financial reporting, internal controls, operational procedures and risk management;
 - (b) 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) discuss with the External Auditor the nature and scope of each forthcoming audit;
 - (d) review the Organisations' financial statements and reports;
 - (e) consider all relevant reports by the External Auditor, including reports on the Organisations' financial statements; and
 - (f) make appropriate recommendations to the governing bodies.
- 6 The Audit Body shall normally meet at least twice a year. The Chairman of the Audit Body and the External Auditor may request that additional meetings should be held. The meetings shall be convened by the Director, in consultation with the Chairman of the Audit Body.

- 7 The External Auditor, the Director and the Head of the Finance and Administration Department shall normally be present at the meetings.
- 8 The Chairman of the Audit Body shall report on its work to each regular session of the governing bodies.
- 9 Every three years the functioning of the Audit Body and its mandate shall be reviewed by the governing bodies on the basis of an evaluation report from the Chairman of the Audit Body.

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ANNEX II

The work of the Audit Body during the years 2002 to 2008

Introduction

1. The Audit Body of the IOPC Funds was established by the IOPC Funds' governing bodies at their sessions in October 2002 and its role stems directly from its mandate. It held its first meeting in October 2002 and has met at least three times a year since then. The Audit Body has developed Rules of Procedure codifying its working practices.
2. The Chairman of the Audit Body has submitted a detailed report each year to the Funds' governing bodies. In addition, he has attended sessions of the governing bodies to respond to questions about the work of the Audit Body. A comprehensive view of the scope and coverage of the Audit Body's work during its first six years of life, and of the scope and coverage of the external audit work can best be gained by reading the detailed reports. However those reports do not aim to describe the philosophy and approach adopted by the Audit Body.
3. This note has been prepared by the Audit Body during 2008 to provide an overview of its activities during the first six years of its existence and because the composition of the Audit Body will change significantly following the Funds' October 2008 sessions at which time the term of office of its first Chairman and many of its members will come to an end. In setting out its philosophy and approach during those years, the intention is not to constrain successor Audit Bodies, but rather to assist them to gain an understanding of the reasoning behind the approach adopted so that the experience thus gained can inform future choices and the approach adopted by the successor Body. This paper may also provide other interested readers with an insight not necessarily available in the Audit Body's annual reports to the Funds' governing bodies.
4. It is helpful to keep in mind that audit committees (of which the Audit Body is but one form) have only been in existence since the late 1970s and that their value as part of effective governance did not become widely accepted within countries of the Organisation for Economic Co-operation and Development (OECD) until the 1990s. Indeed, the IOPC Funds are still one of the few entities within the many UN/Intergovernmental organisations to have such a body. There is still no standardised way in which audit committees operate although there is now much greater commonality of approach than was the case even 20 years ago.
5. Whilst the mandate of the Audit Body has always framed its purpose, it is not prescriptive and from the outset the Audit Body had to decide on the detailed scope of its work and the way it should operate. Indeed it gave considerable thought to these issues at its second meeting which was held in March 2003 and has continued to keep them under regular review ever since. In this respect it should be noted that the Audit Body has proposed some amendments to its Composition and Mandate to take into account developments in its activities and responsibilities since its establishment in 2002. These will be considered by the Funds' governing bodies at their October 2008 sessions.
6. The current mandate requires the Audit Body to:
 - (a) review the effectiveness of the Organisations regarding key issues of financial reporting, internal controls, operational procedures and risk management;
 - (b) 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) discuss with the External Auditor the nature and scope of each forthcoming audit;
 - (d) review the Organisations' financial statements and reports;

- (e) consider all relevant reports by the External Auditor, including reports on the Organisations' financial statements; and
- (f) make appropriate recommendations to the governing bodies.

The Audit Body's approach

7. The Audit Body has not seen its role as being constrained only to financial matters although its mandate clearly requires it to exercise oversight of the way management discharges its responsibility to maintain effective financial control and this remains of great importance to the Audit Body. Nor has the Audit Body seen its role as one focussed principally on gaining comfort that the External Auditor has conducted his work with sufficient thoroughness to provide appropriate reassurance on the annual Financial Statements, or sought to rely simply on the assurance provided by the external audit as to the effectiveness and efficiency of the Funds' operations. It has instead interpreted its mandate in a more comprehensive manner.
8. The Audit Body decided that it would monitor the procedures used by the Funds for risk management of all activities. This decision informed not only the overall strategy adopted by the Audit Body but also led to specific work which is described under the heading 'Risk management procedures' (cf paragraphs 19 - 21 below).

Financial control

9. The Audit Body decided that its oversight of financial reporting and internal control should extend beyond the systems designed to ensure that budgetary mechanisms are effective and provide assurance that Secretariat expenses are properly controlled and reported. It decided that it should also gain a thorough understanding of the way in which claims handling - the *raison d'être* of the Funds' existence - was managed by the Funds. The Audit Body also decided that it should monitor the procedures whereby contributions to the General and Major Claims Funds were calculated and received, including oversight of the submission of oil reports from Member States.

Annual Report preparation

10. The Audit Body also concluded that, as well as reviewing the Funds' Financial Statements and reports, it should review the procedures under which the Annual Report of the Funds was produced and, in particular, the extensive part of the contents which was not subject to audit by the Funds' External Auditor, in order to be satisfied that the numerical and financial data presented in those sections had been subject to careful review.

Internal and external audit

11. At its first meeting the Audit Body agreed that the size of the IOPC Funds' Secretariat did not warrant the appointment of an internal auditor. The Audit Body decided that, as well as considering all relevant reports by the External Auditor, its role should extend to building an effective working relationship with the representatives of the External Auditor, who have been invited to attend all Audit Body meetings. The working relationship has extended to obtaining an understanding each year of the audit planning process, including an oversight of their intended audit approach and methodologies and, as part of that, the Audit Body has been told of specific areas for focus in the coming year and has had the opportunity to comment on the overall plans.
12. More recently the Audit Body has seen a demonstration of the electronic audit tools used by the External Auditor, allowing him to review every accounting entry within the accounting system in order to identify and target specific transactions and accounting entries that he may wish to examine for audit purposes in greater detail. These matters have been reported on in some detail in the Minutes of the Audit Body's meetings.

13. As audit work occurs, the Audit Body has learned at its meetings of progress and has been provided with a summary of the report produced at the end of the audit, including any comments, criticisms or recommendations made. Whilst the External Auditor is responsible to the governing bodies for his audit, the process adopted by the Audit Body has been strongly welcomed by the External Auditor, and has enabled the Audit Body to gain comfort that the scope and coverage of the external audit is appropriate, as well as to report to the governing bodies on its conclusions.

The Funds' investment activities

14. From the outset the Audit Body decided that, as part of that overall monitoring role, it would seek to understand how the Investment Advisory Body (IAB) operated and, to that end, would seek to develop and maintain an on-going relationship with its members. It recognises that the IAB reports directly to the governing bodies and has not attempted to impose itself on that reporting responsibility. It has invited the members of the IAB to attend part of the Audit Body's meeting once a year and receives the Minutes of the IAB's quarterly meetings. During the meetings with the Audit Body the IAB has explained its own approach to risk management and has informed the Audit Body of important decisions taken and of significant transactions recommended, and the financial results of those transactions have also been made available. The Audit Body has also been provided with a copy of the Funds' Investment Manual codifying the procedures in place. The IAB has made it clear that it welcomes the opportunity to meet with the Audit Body on an annual basis and that, as part of the governance structure of the IOPC Funds, it shares the objective of seeking to ensure that procedures are robust, effective and well-controlled.

Claims handling

15. As part of its work to understand and monitor claims handling procedures, the Audit Body has carried out several reviews. It carried out on-site reviews of two of the largest current incidents which have been dealt with during its tenure, the *Erika* and *Prestige* incidents. These on-site reviews allowed the Audit Body to form an independent view of the effectiveness of the Funds' claims handling procedures. The conclusions reached indicated that claims handling was properly managed but the reviews also gave rise to certain recommendations to the Secretariat which were accepted and acted on.
16. A subsequent claims handling efficiency review was carried out by the Audit Body on a substantial number of incidents which had either been closed or which were nearly at that stage, to see whether the costs of claims handling revealed any unexpected trends or occurrences. That review also examined whether the patterns of elapsed time in processing claims, and/or the pattern of quantum of claims approved in relation to claims originally made, might suggest that it would be desirable for additional or extended procedures to be adopted in future. Again the conclusions reached suggested that, whilst the overall procedures had worked satisfactorily, there were certain recommendations for the Secretariat to consider in future incidents allowing improved transparency over claims handling costs and elapsed time during claims assessment. All these recommendations were also accepted by the Secretariat.
17. A further review was conducted, using an experimental questionnaire in connection with a recent incident, to see whether the perceptions of claimants revealed any unexpected patterns of claims handling which would be of relevance to the oversight role of the Audit Body. Again the conclusions reached suggested that procedures had worked satisfactorily and showed clearly that even when claimants had had their claims assessed and had been paid very promptly, many remained unhappy. Following this review, certain recommendations were also made to the Secretariat which were again accepted and acted upon.
18. In connection with its on-going monitoring interest in the claims handling procedures used by the Funds, the Audit Body was recently shown a presentation of the new web-based claims handling system, which has been developed by the Funds. The Audit Body saw that the new system allowed a higher degree of management oversight, through the high degree of transparency now available to the Secretariat from the system, and was informed about a number of new controls built into the system to ensure that unusual items were highlighted, and that follow-up actions were instigated in a timely way. The Audit Body also

learned that the new claims handling system provided a complete built-in audit trail, ensuring that every entry in or interaction by anyone with the system was recorded and could be examined later if necessary.

Risk management procedures

19. The Audit Body asked the Secretariat to suggest a methodology for ensuring that the risk management procedures of the Secretariat could be monitored so that their effectiveness might be considered by the Audit Body in a constructive way. The Secretariat has given a great deal of thought to this issue, which has led to some significant initiatives. It proposed, and the Audit Body agreed, that there were five relevant areas of risk to consider, namely reputation, claims handling process, financial, human resource management and business continuity.
20. Recognising that documenting procedures is an important but insufficient step to ensure effective risk management, the Secretariat has adopted an approach designed to ensure that within these headings all significant risks are identified by means of a thorough review for each main area of the Funds' responsibilities, involving all relevant members of the Secretariat so that all points of view can be considered. Following on from this, the key risks are then identified and procedures are confirmed or established which ensure that the key risks are managed. The procedures are then codified in manuals for claims handling, investment management, payments and so on which become the method of ensuring that on-going working practices can be seen to address these risks. The Secretariat has agreed that it will review the risk assessment process periodically to ensure that the key risks identified and managed remain those of most importance to the Funds and will keep the Audit Body informed regularly of how this on-going review process is working.
21. In addition, the management information systems now in use are expected to identify unusual trends in expenditure or income. (For example, as described above, recent developments with the web-based claims handling system are expected to provide significantly-improved automated controls and greater facilities for oversight of the claims handling activity, on a real time basis for claims handling activity occurring anywhere in the world).

Other matters

22. As will be clear from scrutiny of the Audit Body's annual reports to the October sessions of the governing bodies, the Audit Body has also considered numerous other specific matters. These include:
 - developing the procedures for selection and appointment of the External Auditor (subsequently approved by the governing bodies);
 - reviewing the allocation of administrative costs between the three Funds;
 - oversight of progress towards the winding up of the 1971 Fund;
 - monitoring the position where Member States are in arrears with their obligations to submit oil reports, and bringing proposals to the governing bodies for changes in the operating procedures of the Funds to stimulate improved compliance with the obligations of the Convention in this regard;
 - reviewing the budget process to ensure that it works effectively and that it enhances financial control appropriately;
 - reviewing revised Financial and Internal Regulations following the entry into force of the Supplementary Fund Protocol in early 2005;
 - supporting the introduction of a Statement on Internal Control, forming part of the Financial Statements and recording the responsibilities of the Director in this important area; and
 - monitoring the effectiveness of the transition arrangements following the transfer of responsibilities from the previous Director to the new Director to ensure that the management structure and controls now in place are effective.

To help it monitor implementation of all its recommendations and decisions, the Audit Body maintains a list of such matters which it keeps under regular review.

Hazardous and Noxious Substances (HNS)

23. The IOPC Funds Secretariat's responsibilities do not, at this stage, extend to management of the operation of the HNS Convention. In the event that the responsibility for management of the operation of the HNS Convention were to be added to the role of the Secretariat, it is likely that the role of the Audit Body would be extended to provide similar oversight.
24. Whilst it may reasonably be expected that the procedures of the existing systems (including the web-based claims management system) would provide a suitable basis for most of the administrative support needed to handle HNS claims, the mechanism for identifying and calculating contributions would be different from that applicable to the International Oil Pollution Compensation Funds' regime and the nature of expertise required for claims handling might differ significantly. Furthermore the overall risk review would need reassessment.
25. These are matters that the new Audit Body will need to keep under review if the Secretariat is asked to take on the management of the operation of the HNS Convention. Specifically the Audit Body will need to form a view as to the extent to which the existing financial and control systems would need to be extended or adjusted to meet the new circumstances. Staffing and organisational implications would also need to be considered.

Conclusion

26. Members of the current Audit Body recognise that the working practices that they have adopted may need to be modified in the light of future changes. This note has been prepared to assist members of the Audit Body elected in 2008, as well as the Funds' governing bodies, to understand the philosophy and approach applied by the Audit Body during its first six years in giving effect to its mandate. Individual members of the Audit Body who served during the first six years would be pleased to respond to any enquiry from their successors, with the aim of assisting the Audit Body to continue to make a valuable contribution to the effective governance of the IOPC Funds.