



**INTERNATIONAL
OIL POLLUTION
COMPENSATION
FUNDS**

ASSEMBLY
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Agenda item 12

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REPORT OF THE AUDIT BODY

Note by the Audit Body

1 Introduction

1.1 At a joint session held in October 2002, the 1992 Fund Assembly and the 1971 Fund Administrative Council elected the following as members of the joint Audit Body for these Funds for a period of three years:

Professor Eugenio Conte (Italy)
Mr Charles Coppolani (France) (Chairman)
Mr Maurice Jaques (Canada)
Mr Heikki Muttilainen (Finland)
Dr Reinhard Renger (Germany)
Professor Hisashi Tanikawa (Japan)

1.2 Mr Nigel Macdonald was elected as the independent expert member of the Audit Body not related to the Organisations.

1.3 The Audit Body's mandate was determined by the governing bodies at their October 2002 session 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 Assemblies.
- 1.4 At their March 2005 sessions, the 1992 Fund Assembly, the 1971 Fund Administrative Council and the Supplementary Fund Assembly decided that the Audit Body should be a joint Body for all three Funds.
- 1.5 The Audit Body has met three times since the October 2004 sessions of the Funds' governing bodies, viz 26 November 2004, 8 April 2005 and 17 June 2005. Representatives of the External Auditor have attended these meetings and have made a significant contribution to the Audit Body's deliberations.
- 1.6 As in previous years, the Audit Body had a meeting with the members of the joint Investment Advisory Body (IAB) for the three Funds.
- 1.7 The Director and Head of the Finance and Administration Department also attended the meetings. The Director's Personal Assistant acted as the Audit Body's Secretary.
- 1.8 The Audit Body decided that it would have two closed sessions each year with the External Auditor, one after the interim audit and one after the conclusion of the final audit. No member of the Secretariat is present at the closed sessions.

2 External Audit of the Funds' Financial Statements

- 2.1 The Audit Body is very appreciative of the good relationship which has developed with the External Auditor, the Comptroller and Auditor General of the United Kingdom, and the staff of the National Audit Office (NAO). This relationship has allowed the Audit Body to follow the different stages of the audit of the 1992 and 1971 Funds' Financial Statements.

2003 Financial Statements

- 2.2 At its November 2004 meeting, the External Auditor presented the Audit Body with an Audit Memorandum and End-of-Audit Report to Management, which was provided to the Secretariat in respect of the 2003 Financial Statements (approved by the governing bodies at their October 2004 sessions). This document brings to the attention of the Secretariat less significant issues which do not need to be brought to the attention of the governing bodies. A closed session of the Audit Body, which the External Auditor attended, took place to discuss the issues raised.

Audit strategy as regards the 2004 Financial Statements

- 2.3 At the November 2004 meeting the Audit Body discussed with the External Auditor the Audit Strategy document relating to the audit of the 2004 Financial Statements. The External Auditor presented the time schedule of the audit and the main points of attention. He indicated that the intention was to keep a watching brief on the risk management procedures being formulated by the Funds' Secretariat and to monitor the establishment of the Supplementary Fund.
- 2.4 With respect to specific account area risks, the representative of the External Auditor said that it was good practice to review the accounting policies used and that in this respect the NAO was discussing the benefits of moving to International Accounting Standards with other

clients, including the United Nations. The Audit Body felt, however, that the Funds were closer to a bookkeeping organisation rather than an accounting organisation (inasmuch as there were no valuations, fixed assets, intangibles, goodwill etc) and that what was more important were the standards under which the audit itself was carried out.

Interim audit

- 2.5 At the Audit Body's meeting in April 2005 the External Auditor presented the results of the interim audit of the 2004 Financial Statements, which had been completed in February 2005. He informed the Audit Body that the main focus of the interim audit had been on income and expenditure.
- 2.6 The Audit Body discussed the report on the interim audit in some detail.

Final audit

- 2.7 At the Audit Body's June 2005 meeting, the representative of the External Auditor informed the Audit Body of the results of the final audit and of the External Auditor's intention to place an unqualified opinion on the Funds' Financial Statements for the year-end 31 December 2004.
- 2.8 With respect to expenditure, it was noted that claims expenditure had fallen significantly compared to 2003 due to progress towards the winding up of the 1971 Fund and the reduction in compensation payments relating to the *Erika* and *Prestige* incidents in respect of the 1992 Fund.
- 2.9 The representative of the External Auditor said that as part of the audit the internal controls operated by the Funds had been reviewed and supported an unqualified audit opinion.
- 2.10 In addition to its work in support of the audit opinion, the External Auditor, at the request of the Audit Body, had reviewed the arrangements for accurate reporting of Dual Currency Deposits (DCDs) and had found them to be satisfactory.
- 2.11 The representative of the External Auditor stated that, notwithstanding the small size of the Secretariat, the IOPC Funds had been exemplary in setting a best practice governance agenda and that the External Auditor in his Report would make recommendations in order that the Funds continue to provide the best level of assurance to Member States.
- 2.12 The representative of the External Auditor stated that the External Auditor welcomed the development by the Director (encouraged by the External Auditor) of a single document by the Secretariat summarising from existing Regulations and Administrative Instructions the delegated authority for committing the IOPC Funds.
- 2.13 The Audit Body noted that the External Auditor would recommend further improvement to the internal control framework by recommending that the IOPC Funds should produce a statement on internal control, which would become part of the Financial Statements. This would record the responsibilities of the Director and reinforce the Director's accountability for them.
- 2.14 The Audit Body was informed that other recommendations would include a more formal code of conduct for IOPC Funds staff, the introduction of registers of interests and for recording of hospitality and gifts, an annual declaration by staff of compliance with the requirements of the Financial Regulations and Administrative Instructions by staff and for the Funds to consider

also a 'whistle-blowing' policy which was of particular importance in the absence of an internal audit function.

- 2.15 With respect to risk management, the Audit Body was informed that the External Auditor had noted the systematic process that was being pursued to address this issue but had emphasised the importance of completing the process prior to the arrival of the new Director in November 2006.
- 2.16 With respect to the role of the Audit Body, it was noted that the External Auditor continued to regard the Audit Body as a beneficial and essential part of the IOPC Funds governance framework as it provided a more detailed scrutiny on key matters.
- 2.17 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 and 1992 Funds for the financial year ending 31 December 2004.

3 Other main issues considered

Financial and Internal Regulations

- 3.1 In the light of the entry into force of the Supplementary Fund Protocol in early 2005, changes to the Financial and Internal Regulations which the Director intended to propose to the governing bodies were discussed by the Audit Body at its November 2004 meeting. The Audit Body noted in particular that there was a need to make the provision in the Financial Regulations in respect of *ex gratia* payments clearer. At its meeting in April 2005, the Audit Body took note of the changes to the Regulations which had been adopted by the Funds' governing bodies at their March 2005 sessions and expressed its satisfaction with these amendments.

Procedures for recruitment of new Director

- 3.2 In accordance with the request of the governing bodies of the 1992 Fund and the 1971 Fund at their October 2004 sessions, the Audit Body had prepared a document setting out a detailed job description and competency requirements for the post of Director as well as a proposed timetable for the election and the transition from the present to the new Director. This document was submitted to the 1992 Fund Assembly at its March 2005 session. At this session the Assembly made some adjustments to the job description and to the list of competences. The Audit Body's proposals with respect to the timetable and transition period were accepted as well as the deadline of 30 June 2005 for the submission of candidatures.

Relationship with the joint Investment Advisory Body (IAB)

- 3.3 The Audit Body and the IAB are independent bodies which each report directly to the governing bodies. Nevertheless, both bodies recognise that it is important that they hold discussions with one another so as to share information in respect of financial risk.
- 3.4 In April 2005 the IAB briefed the Audit Body on recent developments in respect of investments of the Funds' assets. The Audit Body noted that the governing bodies had in March 2005 approved the Director's proposal, in accordance with the IAB's recommendations, that the Financial Regulations should be amended so as to permit investments up to a maximum amount of £25 million (instead of up to £15 million, which was previously the maximum) with any one institution when the three Funds' combined assets

exceeded £300 million. As the Funds' assets are currently well below £300 million, this higher limit has not yet been utilised.

- 3.5 The Audit Body recalled that in October 2003 the governing bodies of the 1992 Fund and the 1971 Fund had approved the Funds' holding of Certificates of Deposit. To date none had been purchased but the IAB considered that it was good to have such instruments available for the future. In respect of DCDs, the Audit Body took note of the fact that since March 2002, 21 such transactions had been undertaken, resulting in additional interest of £89 000 having been earned. Given the 1992 Fund's requirement for Euros to meet claims arising from the *Erika* and *Prestige* incidents, the Audit Body noted the IAB's view that the DCDs had great merit for the 1992 Fund. It was also noted that, on the IAB's recommendation, the Director had increased the limit for such deposits from £15 million to £20 million. The Audit Body further noted that the IAB continued to look at new investment products that would be of interest to the Fund, provided that they respected the investment criteria for the Funds, namely security, liquidity and yield in that order.
- 3.6 At the meeting it was agreed that the Audit Body and the IAB would exchange copies of their Minutes.

Risk management

- 3.7 Five areas of risk had been identified by the IOPC Funds' Secretariat, namely: Reputation Risk, Claims Handling Process, Financial Risk, Human Resource Management and Business Continuity.
- 3.8 At its June 2005 meeting, the Audit Body considered a risk management process adopted by the Funds at the proposal of their consultants. The Audit Body was briefed by the Director and by the consultants on the progress made. The Audit Body noted that a considerable amount of work had been carried out on financial risks and that a timetable had been set for addressing other risk areas, with a view to completing the work on risk management prior to the new Director taking up his responsibilities in November 2006.
- 3.9 The Audit Body welcomed the work which had been carried out and stressed the importance of this project being pursued as speedily as possible.

Non-submission of oil reports

- 3.10 The Audit Body has been very concerned by a number of States not fulfilling their obligations under the respective Fund Convention to submit oil reports. At the Audit Body's April 2005 meeting, the Director presented a report on this issue. He pointed out that, although the situation had improved with respect to the 1971 Fund, as at 31 March 2005 there were still 25 States which had outstanding oil reports in respect of the 1971 Fund and/or the 1992 Fund and that some States had reports outstanding for many years. He explained the procedures followed by the Secretariat for requesting States to submit oil reports and the follow-up when reports were not submitted. He stated that the issue of non-submission of oil reports had been considered by the governing bodies of both the 1971 and 1992 Funds every year and outlined the different initiatives that had been taken over the years in an attempt to improve the situation. He pointed out that it was important to distinguish between non-submission of oil reports by States and non-payment of contributions by individual contributors.
- 3.11 Members of the Audit Body raised the question of whether sanctions could be imposed on States which did not fulfil their treaty obligations. The Director replied that the governing bodies had concluded after lengthy consideration that unless the 1992 Fund Convention were

amended, the scope for sanctions was extremely limited. He stated that the governing bodies had considered that the only 'sanction' considered legally possible was that the Assembly took the non-submission of oil reports into account when electing members of the Executive Committee, and the Resolution on the Establishment of the Executive Committee for the 1992 Fund contained a provision to this effect. In this context he pointed out that when the Supplementary Fund Protocol was adopted, provisions had been inserted under which compensation would be denied temporarily or permanently in respect of States that failed to fulfil their obligation to submit oil reports. He also mentioned that as regards the 1971 Fund, the Administrative Council had decided that no reimbursements in respect of surpluses on Major Claims Funds would be made to contributors in States which had any outstanding oil reports.

- 3.12 The Audit Body wishes to reiterate its great concern that a number of States do not fulfil their treaty obligations to submit oil reports, since without oil reports the contribution system cannot work in an equitable manner. The Body recommends, therefore, that these matters should be dealt with in any review of the Conventions.

Winding up of the 1971 Fund

- 3.13 The Audit Body has followed developments towards the winding up of the 1971 Fund. At its June 2005 meeting, the Director provided information on this matter.
- 3.14 The Audit Body noted the efforts made by the Director to finalise pending incidents. It also noted that the major incidents which may cause a delay in the winding up of the 1971 Fund were the *Nissos Amorgos* and *Pontoon 300* incidents.
- 3.15 The Audit Body took note of the situation as regards the non-submission of oil reports. In the Body's view, the failure of a number of States to fulfil their treaty obligations in this regard could cause serious difficulties in connection with the winding up of the 1971 Fund. The Audit Body also took note of the situation as regards outstanding contributions. It noted that the situation had improved considerably during the period 2002-2005. The Audit Body considers it important that the Director continue his efforts to make those contributors who are in arrears pay the amounts due.

Claims Handling Efficiency Review

- 3.16 At the first meeting of the Audit Body in 2002 it was agreed that a phased programme of review work would be carried out during the first three-year period of the Audit Body's existence. Regard was had to the fact that the External Auditor already paid close attention to the financial controls over the Secretariat costs and expenses and to the balances of funds held.
- 3.17 Accordingly the Audit Body decided that its initial work would focus on assessing the extent and adequacy of the financial controls in place for claims settlement, and on examining the overall risk framework for the Funds. The next phase would be to extend the examination of the claims settlement procedures, by looking closely at the way major claims were being handled, in order to understand and assess the processes adopted. It was agreed that the last phase of the initial three-year period would be an examination of the efficiency with which the Funds handled and settled claims. That planned pattern of work has guided the activities of the Audit Body since then.

- 3.18 At the December 2004 meeting of the Audit Body, it was agreed that a review of the claims settlement procedures would be carried out enabling the Body to form a view about the efficiency of those procedures. This review was carried out in 2005 and a report on the review is presented as a separate document (92FUND/A.10/12, SUPPFUND/A/ES.1/7 and 71FUND/AC.17/7).

4 Future of the Audit Body

- 4.1 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 (document 92FUND/A.7/29, Annex II, paragraph 9 and 71FUND/AC.9/20, Annex I, paragraph 9). The governing bodies will therefore make such a review at their October 2005 sessions.
- 4.2 The Audit Body forms 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.
- 4.3 The Audit Body recommends that the Body should be instructed to continue its work under such a mandate and with such membership composition as the 1992 Fund Assembly may decide.

5 Future work

On the assumption that the Audit Body will be maintained, the Audit Body recommends that the future work programme should include a continuing focus on risk management, effective financial control and efficient procedures, monitoring the transition of management control following the new Director taking over responsibility in November 2006, and a continuation of the review of the effectiveness of claims handling procedures.



Charles Coppolani
Chairman
