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AND 1992

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REPORT OF THE AUDIT BODY

Note by the Chairman of the Audit Body

1 Introduction

- 1.1 At their October 2001 session, the governing bodies of the 1992 Fund and 1971 Fund decided to establish a joint Audit Body for the two Organisations. At their April/May 2002 sessions, the governing bodies decided the composition and mandate of the Audit Body. The joint Audit Body was to be composed of seven members elected by the governing bodies: one named Chairman nominated by Member States, five named individuals nominated by Member States and one named individual not related to the Organisations ('outsider'), with expertise and experience in audit matters nominated by the Chairmen of the respective governing bodies.
- 1.2 At a joint session held in October 2002, the Assembly and the Administrative Council elected the following as members of the Audit Body 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)
- 1.3 Mr Nigel Macdonald was elected as the member of the Audit Body not related to the Organisations ('outsider').

- 1.4 Since its establishment in October 2002, the Audit Body has met three times, viz 31 October 2002, 7 March 2003 and 10 June 2003.

2 Mandate of the Audit Body

The governing bodies of the 1992 and 1971 Funds have given the Audit Body the following mandate:

- (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 Assemblies.

3 Role of the Audit Body and its functioning

Framework for the Audit Body's work

- 3.1 The Audit Body had examined the framework recommended by the Financial Reporting Council of the United Kingdom ^{<1>}. The Body noted that the framework reflected best international practice in corporate governance and not merely a United Kingdom perspective. The framework addresses a wide range of issues including the independent composition of an audit committee, the scope of its responsibilities and guidance on how often it should meet and how it should conduct its relationships with executive management and with auditors. In the view of the Audit Body, even though the Funds are not companies, there was a need to reflect best, sensible international practice. The Audit Body decided that it was sensible to regard the recommendations as a basis to establish if the Funds were going in the right direction.
- 3.2 The External Auditor has undertaken to provide a short note once a year to the Audit Body on changes in standards/procedures which would be of relevance to the Funds.

Focus

- 3.3 It was agreed that the Audit Body needed to prioritise its work and to focus on the control environment and on carrying out an assessment of the financial and control risks in order to ensure that the external audit coverage in these areas is appropriate. Whilst the Audit Body considers that its responsibilities extend to operational effectiveness and efficiency, it considered it important to focus initially on financial control matters before broadening its work. Accordingly the Audit Body decided that it should plan its work on a three-year term

^{<1>} The Financial Report Council (UK) with its subsidiaries, the Accounting Standards Board and the Financial Reporting Review Panel, together make up an organisation whose purpose is to promote and secure good financial reporting.

basis and that it should progressively set up a map of the risks covering financial issues first. Hence, although the initial risk assessment should relate to both financial and non-financial risks, the former should be addressed first.

- 3.4 The Audit Board concluded that three meetings per year would be required initially. This will be reviewed after a full year's cycle has been completed.

Relationship with the External Auditor

- 3.5 It is clear that the function of the Audit Body is not to carry out the audit but rather to ensure that the financial and operational controls of the Funds are appropriate and to take the necessary measures so as to provide reasonable assurance to the governing bodies that they are working properly. The Audit Body is responsible for the relationship with the External Auditor who is appointed to provide independent assurance on the annual accounts, but it does not duplicate the work carried out by the External Auditor. As a result, the relationship between the Audit Body and the Funds' Secretariat on the one hand, and the independent External Auditor on the other, is of great importance.

Procedures

- 3.6 The Audit Body has considered its procedures and has established a clear pattern of working. These procedures have been incorporated into a formal document entitled Rules of Procedure. These procedures include the attendance of representatives of the External Auditor at formal meetings of the Audit Body and provide for confidential discussions to be held if the Audit Body considers this appropriate.

Honorarium

- 3.7 In accordance with the decision of the governing bodies in 2002 which created the Audit Body, it has reviewed the question of appropriate levels of honorarium for members other than the appointed expert and recommends that a figure of £1 500 per member should be payable for the period 1 November to 31 October in any year. It was noted, however, that certain members would not draw that honorarium because of relevant statutes applicable in their respective countries.

4 Main issues considered

Internal audit

- 4.1 Although it is normal for large commercial organisations to appoint an internal audit function, the Audit Body concluded that it was not appropriate to incur the cost of doing so for the Funds, and that the Audit Body will keep this issue under continued review.

IOPC Funds' Annual Report

- 4.2 The Annual Report of the Funds is a key document for delegates as well as for claimants and for contributors. A great deal of effort goes into producing and presenting information which will enable these categories of users to understand how the Funds operate and how the individual circumstances of each claim have affected the work of handling and settling claims. Originally the report was an administrative means of informing Member States, contributors and the general public about the activities that had been carried out on behalf of the Member States over the year, and included financial information (eg extracts from audited accounts) as part of that reporting of stewardship. It has, however, become a public document

of much greater importance and in effect the means of communicating to interested parties about what the Funds seek to do, and how they operate.

- 4.3 The Audit Body has therefore been giving consideration to establishing procedures to ensure that this important document continues to address the need of increasing numbers of users for comprehensive and accurate financial and other information for the full range of the Funds' activities. An ongoing project involving both the Director and other senior staff and the External Auditor is assisting the Audit Body to achieve that objective.

Claims Handling Office visit

- 4.4 On behalf of the full Audit Body, the independent member of the Audit Body visited the Claims Handling Office in Lorient, which had been established by the 1992 Fund and the P & I Club to handle the *Erika* incident. His report indicated that the procedures operated at the office worked well and that financial controls were appropriate. Assessment of the claims in this incident had been greatly assisted by the availability to claimants of much information prepared for normal taxation reasons and so providing information as to their level of business being achieved before the incident. One of his key findings was that, in establishing such an office, it was important to take into consideration the very high level of local anger and anxiety that any substantial incident would almost certainly create. It was very easy for local people, aggrieved at the damage they had suffered as a result of an incident, to assume that the Fund was in some way a representative of those responsible for the incident, or of the insurers who were assumed to be trying to minimise their liability, rather than being an independent body whose *raison d'être* was to ensure that local communities were not simply left to fend for themselves.
- 4.5 As a result, there was exceptional pressure on staff of a Claims Handling Office who had to handle claims on a daily basis from a community which could well be hostile. Further, the reason for payments not being made immediately was not that the Fund was seeking to avoid or delay settlement, but rather that the administrative work involved was enormous. Hence there were some advantages for the Fund and for the staff themselves if not all staff employed to serve in such an office were drawn solely from the immediate locality.

Relationship with Investment Advisory Bodies

- 4.6 The Audit Body recognised that the Investment Advisory Bodies ('IABs') had been providing specific assurance to the governing bodies for many years. Accordingly, both Bodies need to establish an appropriate relationship, to ensure that each understood the scope of each other's responsibilities so as to avoid duplication and also so as to avoid the risk that each might think the other was covering something that in fact was not within the scope of either.
- 4.7 A joint meeting was held and proved extremely useful for this purpose. The Audit Body noted that the IABs have established procedures which enable them to be confident that investments are made only in highly-rated institutions and that they monitor financial risk in relation to investment activity on an ongoing basis. Both Bodies agreed that it would be valuable to hold such liaison meetings periodically in future.

Risk management

- 4.8 The Audit Body regards monitoring of risk management as central to its function. Work has already begun on the development of an appropriate framework for assessing risk within the Funds and this area represents a significant part of the expected focus for the Audit Body over the coming year.

Distribution of administrative costs between the 1992 and 1971 Funds

- 4.9 The Audit Body noted that, in accordance with decisions by the governing bodies, the costs of running the joint Secretariat would be distributed between the 1992 and 1971 Funds on a percentage basis, which, for the financial year 2002, had been set at 70% to be paid by the 1992 Fund and 30% by the 1971 Fund. The corresponding figures for the 2003 financial year were 80% for the 1992 Fund and 20% for the 1971 Fund.
- 4.10 The Audit Body took note of the fact that the work carried out by the Secretariat in respect of the 1971 Fund continued to decrease. It noted that the Director intended to propose to the governing bodies that for the 2004 financial year the 1971 Fund should pay a flat management fee to the 1992 Fund, the amount of which to be agreed between the governing bodies. The Audit Body considered that this would be a pragmatic and sensible approach.
- 4.11 With the passage of time, it is inevitable that the work required in respect of the 1971 Fund will decrease further in proportion to the ongoing work of the 1992 Fund. The proportions of administrative costs charged to the two Funds are determined by the governing bodies on the Director's proposal with the aim of reflecting a fair allocation of the underlying costs. The Audit Body intends to review the allocations in future years, with the aim of satisfying itself that the allocations are reasonable.

5 Outcome of the annual audit and comments on the Financial Statements

- 5.1 At an early stage the Audit Body discussed in detail the *modus operandi* used by the External Auditor with his representatives and satisfied itself that the scope of the audit appeared to be comprehensive and adequate.
- 5.2 Following the completion of the annual audit, the Audit Body met with representatives of the External Auditor and received his detailed report. The detailed report summarised the work carried out, and the findings, all of which were satisfactory. The Audit Body noted that the External Auditor had carried out a combination of audit checks and tests on Fund contributions and other miscellaneous and interest income, on claims and claims-related expenditure and on payroll and non-payroll parts of the Secretariat expenses. The External Auditor had also audited the cash and investments, accounts receivable and payable, unliquidated obligations and inter-Fund balances. He had also tested fixed asset records to specific items and reviewed the presentation of the financial statements as a whole. As a result, the Audit Body was satisfied that the extent of the audit examination was appropriate and did not consider it necessary to ask the External Auditor to carry out any further work in connection with the accounts.
- 5.3 The Audit Body noted that a number of Member States did not fulfil their obligations to submit oil reports and that some States had reports outstanding for many years. It shared the serious concerns expressed repeatedly by the governing bodies in this respect, since it was crucial for the functioning of the international compensation regime that these reports were actually submitted.

6 Winding up of the 1971 Fund

The Audit Body took note of the progress towards the winding-up of the 1971 Fund. It considers this a very important issue and will follow closely the developments in this regard.

7 **Conclusion**

The Audit Body welcomes the outcome of a recent Diplomatic Conference resulting in the maximum amount available in respect of each incident being greatly increased. The Audit Body recognises that this increase will make the need for transparency, already long recognised by the governing bodies, even more important than in the past and is addressing its responsibilities with this important development in mind. The Audit Body will work with the Director to ensure that this area continues to receive a high level of attention.

8 **Recommendations**

The Audit Body recommends that the governing bodies approve the accounts of the 1971 and 1992 Funds for the Financial Year 2002.

Charles Coppolani
Chairman
10 July 2003