

**CHANGES TO FINANCIAL REGULATION 14.2
CONCERNING THE PROCEDURE FOR THE
RE-APPOINTMENT OF THE EXTERNAL AUDITOR**



CONSULTATION

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**World Food Programme
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I. INTRODUCTION

1. The Executive Board Bureau has asked the Executive Board Secretariat to provide a discussion paper on the various practices in the United Nations system regarding appointment and re-appointment of External Auditors, with a view to deciding at its meeting of 5 September 2006 on the option(s) to be submitted for consideration by the Board.
2. The Division of Legal Services was called upon to produce the paper, which sets out current WFP practice and the practices of other United Nations organizations and, as requested by the Bureau, analyses trends across the United Nations and the options that might be available to WFP, including the advantages and disadvantages of each option.

II. PRACTICE AT WFP

3. The External Auditor is appointed by the Board for a four-year term covering two financial periods¹ and may be reappointed for one further four-year term. The maximum term of office for the WFP External Auditor is thus eight years, covering four financial periods (Financial Rules 14.1 and 14.2).
4. WFP's current External Auditor, the National Audit Office (NAO) of the United Kingdom, was initially appointed, through a competitive selection process,² for the 2002–2005 biennium at the Board's Third Regular Session of 2001.³ At its Second Regular Session of 2005, the Board reappointed the NAO as the WFP External Auditor for a second and final term.⁴
5. The previous WFP External Auditor was the *Cour des Comptes* of France, which was appointed for two four-year terms, the first from 1 July 1994 to 30 June 1998 and the second from 1 July 1998 to 30 June 2002 (WFP/EB.3/97/13, pp. 9 and 10). WFP did not have its own External Auditor at the time; the *Cour des Comptes* was appointed in accordance with the relevant FAO rules and procedures. No competitive process took place for the re-appointment of the *Cour des Comptes*.
6. The Bureau was asked to develop from then on procedures and criteria for the selection and appointment of the External Auditor; in the meantime, the Board re-appointed the FAO-appointed External Auditor. In its decision

¹ For the purpose of this paper, a financial period is understood to cover a biennium of two calendar years, in line with the current WFP Financial Regulations. However, the understanding is that WFP will be producing annual financial statements as of 2006.

² The requirement for a competitive selection process in the appointment of the WFP External Auditor was introduced by the Board during its Third Regular Session in 1997 (WFP/EB.3/97/13, p 9). Such a requirement, however, has not been documented with a change to Rule 14.2.

³ WFP/EB.3/2001/14, decision 2001/EB.3/6.

⁴ WFP/EB.2/2005/15, paras 47- 49.

1997/EB.3/7, the Board added that “the audit fee should not be increased, and if possible should be reduced”.

7. On the basis of that precedent and of strict interpretation of the relevant WFP Rules and Regulations, the Division of Legal Services advised that a competitive selection involving a formal tender procedure did not seem to apply in cases of re-appointment.⁵ The current External Auditor was re-appointed without a tender procedure.

III. PRACTICES IN THE UNITED NATIONS AND UNITED NATIONS ORGANIZATIONS

A) *The United Nations and United Nations programmes and funds*

8. The Board of Auditors of the United Nations is composed of the Auditors General of three member states, appointed for a non-consecutive term of office of six years' duration, starting on 1 July of the given year.⁶ A candidate may be re-appointed after an interval of one term (i.e. six years).

B) *The World Health Organization (WHO)*

9. The duration of the appointment is at the discretion of the Health Assembly. The practice has been to appoint the External Auditor for two financial periods, each consisting of two years. Hence an External Auditor is initially appointed for a term of four years. A proposed audit fee must be submitted for each financial period.
10. Extensions beyond the four-year term entail a competitive “election” in which the incumbent may apply along with other candidates. Where an incumbent is re-appointed for a second or third term, the fee for each term is unique: in other words, the incumbent must present to the WHO Assembly an application including a fee quotation for the position of External Auditor. If more than one application is presented, the Assembly proceeds to vote. An incumbent presenting an application for a second or third term may therefore quote for higher fees than those initially quoted for the first or second term of office.

C) *The Pan American Health Organization (PAHO)*

11. The duration of the appointment of the External Auditor is at the discretion of the Governing Body and may vary. Currently, the practice is to appoint the External Auditor for a two-year financial period. Should the External Auditor be re-appointed for another two-year financial period, no competitive process takes place but the fees are re-negotiated. The re-negotiation of fees is subject to a decision by executive management.

⁵ See the Legal Opinion of 18 May 2005 addressed to the Secretary to the Executive Board. The current texts are silent on the issue of re-appointment.

⁶ General Assembly resolution A/res/55/248 of 31 January 2005.

- D) *The Food and Agriculture Organization of the United Nations (FAO)*
12. The External Auditor receives an initial mandate for two biennia, with the possibility of an extension for one further biennium. No formal policy has been agreed for a renegotiation of the fee upon extension. After this period of four or six years, the contract must be re-tendered; bids are invited from all Member Nations.⁷ There are currently no limits on the number of terms for which an External Auditor may be re-appointed, even though the matter has been under discussion since 1998.⁸
- E) *The United Nations Educational, Scientific and Cultural Organization (UNESCO)*
13. The initial appointment of the External Auditor is for three financial periods – that is, three periods of two calendar years – or a term of six years. There is no bar to renewal of the appointment. The fees cannot be re-negotiated in the course of a term. An incumbent wishing to run for a second term must present a bid along with other potential candidates; such a bid must include details of the fees. There is no bar to an incumbent asking for higher fees for the second term of office. It is then up to the General Conference to assess the bids and appoint the External Auditor. UNESCO has informed us that an incumbent running for another term is in fact likely to present higher fees, because the changing nature of operations may require changes in the skills of the External Auditors, which may lead to an increase in the fees. The General Conference ultimately decides whether “value for money” will be obtained and may thus accept such an increase in the fees.

IV. ANALYSIS

14. It is evident that there is no single policy across the United Nations system concerning the terms of appointment and the process for re-appointment of External Auditors. The different appointment methods seek to maintain a balance between the benefits of continuity and the benefits of change and reasonable rotation. This is the case even in organizations such as UNESCO where there is no bar to renewal of appointment.
15. The trend is that where there is no bar to the renewal of an External Auditor’s appointment, re-appointment in most cases involves a competitive process, in the course of which a quotation for fees is also submitted.

⁷ Finance Committee Decision, 107th Session, May 2004.

⁸ 90th Session of the Finance Committee of FAO held from 21 to 25 September 1998, documents reference FC89/7 and FC 90/12.

16. The Joint Inspection Unit (JIU) has recommended to the various organizations to which it provides reports that they may wish to institute limits on the terms of office of External Auditor.⁹ In May 2002, the European Commission (EC) issued a similar recommendation to its member states that included a rule on rotation of “Key Audit Partners” after seven years¹⁰ and a statement that the Audit Partner should not be allowed to return to the Audit Client engagement until at least two years had elapsed since the date of their replacement.
17. Most United Nations organizations do not impose limits on the terms of External Auditors.¹¹
18. There are advantages and disadvantages to the rotation of External Auditors, and the balance is not an easy one to strike. The most commonly argued advantages of regular rotation are:
 - i) Visible independence: auditors are unlikely to be influenced by friendships or identify with management.
 - ii) Audit efficiency and effectiveness: a fresh perspective is achieved, underpinned by international auditing standards, which may make a difference to the quality of the audit.
 - iii) Involvement of more audit institutions: this enables an organization to benefit from a broader range of experienced auditors.
19. The commonly argued disadvantages of regular rotation are:
 - i) Additional costs for the client and the auditor under two categories:
 - ◆ cost of management in the selection process; and
 - ◆ cost of integrating, educating and inducting the new auditors.
 - ii) Increased risks of audit failures: an auditor needs time to develop the necessary knowledge of a client; there is evidence that most audit failures occur during the first and second year of an audit engagement.¹²

⁹ See for instance JIU Report JIU/REP/2002/08 on the review of management and administration in FAO; see also JIU Report JIU/REP/2001/5 on the review of management and administration of WHO, in which the JIU recommended that the organization “...considers limiting the External Auditor’s term of office to a non-consecutive term covering several financial periods in order to allow reasonable rotation while preserving some needed continuity...”.

¹⁰ See EC Recommendation of 16 May 2002: “Statutory Auditor’s Independence in the EU: a set of Fundamental Principles”, 2002/590/EC, published in the Official Journal “L” series 191/22. See in particular paragraph 10.

¹¹ There are no such limits at the International Fund for Agricultural Development (IFAD), the International Telecommunication Union (ITU), WHO, the World Intellectual Property Organization (WIPO), the International Atomic Energy Agency (IAEA), UNESCO and the United Nations Industrial Development Organization (UNIDO), for instance. To date only the United Nations, FAO and WFP have a limit on the terms of office of their External Auditor.

¹² See FAO Finance Committee Document FC 107/11, 107th session of the Finance Committee, May 2004.

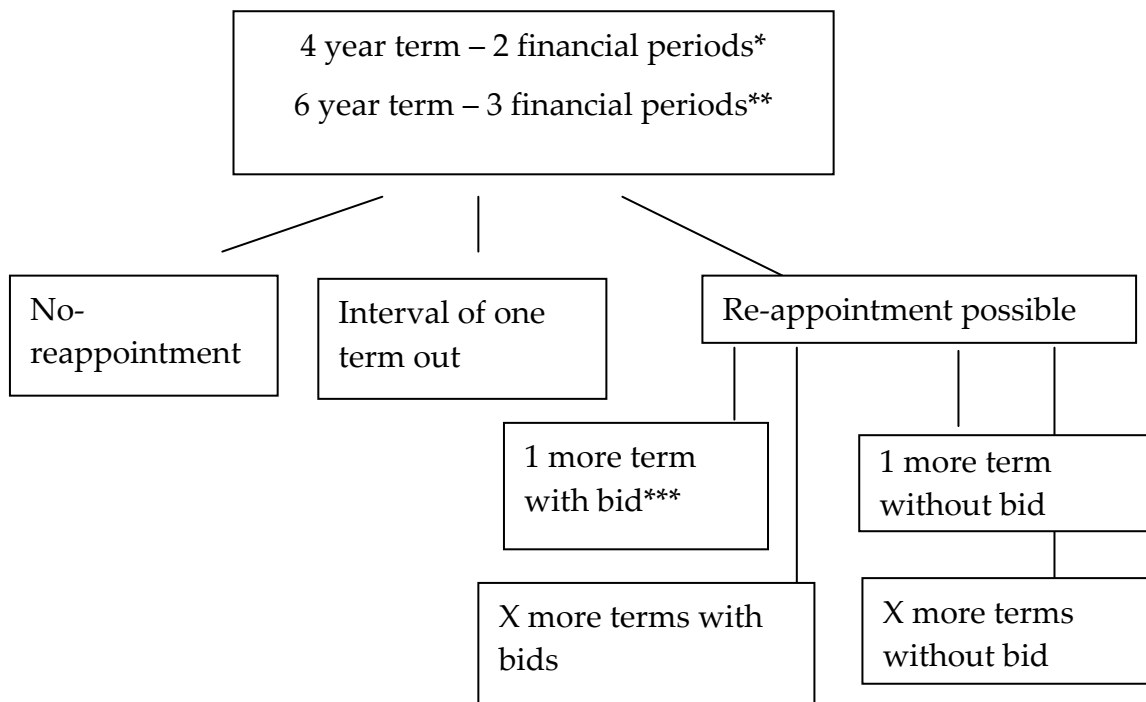
iii) Reluctance to invest: the auditor may feel reluctant to invest time and resources.

V. REVIEW OF FEES PRIOR TO REAPPOINTMENT

20. Among the organizations surveyed that permit consecutive reappointment of the External Auditor,¹³ UNESCO and WHO submit any new fee structure proposed by the External Auditor for review by the governing body, which assesses the reasonableness of the proposed fee increases. At FAO, where the policy provides for the possible extension for an additional biennium, no formal policy has been adopted for re-negotiating fees upon extension.

VI. OPTIONS

21. The graph below depicts the various options that the Board may wish to consider, followed by an analysis of the advantages and disadvantages of these options. As mentioned in footnote 1, a recommendation will be made to the Board to move to a one-year financial period in order to comply with International Public-Sector Accounting Standards (IPSAS). In considering the options below, the Bureau may wish to keep this in mind and consider all options for limited terms on the basis of one-year financial periods.



* Or four financial periods when WFP moves to a one-year financial period standard.

** Or six financial periods when WFP moves to a one-year financial period standard.

*** Where a bid is presented, a competitive process takes place that includes fee quotations. A re-appointment without a bid, however, does not imply that the Board does not have the right to examine and agree to any changes to the original fee structure.

¹³ FAO, UNESCO, WHO and PAHO.

VII. POSSIBLE OPTIONS

22. **Option A:** One term of four years covering two financial periods, with no re-appointment.
23. Such an option would be unique in the United Nations system: most organizations allow for at least one renewal after a four-year term. Only in the case of a six-year term do organizations disallow re-appointment. This option might defeat the purpose of continuity by allowing too rapid a rotation; it would also have the disadvantage of increasing costs.
24. **Option B:** One term of four years followed by a second term of four years, with competitive process including fee quotation.
25. The Board may wish to discuss whether to limit the appointment to two terms of four years each or to allow an incumbent to run for a third term or more. The Board would have to consider this when deciding on the appointment, taking into consideration past performance, fees, continuity and the need for rotation. In considering this option, the Board may wish to take into account the fact that any competitive process involves costs for the organization and the auditors seeking appointment. Any competitive process requires considerable time and resources on the part of the Board and WFP.
26. **Option C:** As currently, one term of four years followed by a second term, with no competitive process. Added conditions could be an assessment of the quality of the services being provided, re-negotiation of the original fee structure and approval of any changes prior to reappointment. Should the Board decide to retain this option, it might wish to consider any or all of the following sources of advice for those issues: the Executive Director (who may, in turn, rely on advice from the current Audit Committee), the Bureau or an Audit Committee of the Board, if and when established.
27. **Option D:** One term of six years covering three financial periods, with no possibility of re-appointment. This is the United Nations option. The Board would need to consider the appropriateness of a longer-term appointment.

VIII. DISCUSSION OF THE BUREAU

28. At its meeting on 5 September 2006, the Bureau expressed a preference for option C above and requested a recommendation on the changes that may be required to the Financial Regulations on this subject. During the informal consultation on this issue on 9 October 2006, additional clarifications were requested as to the advantages and disadvantages of Option C.
29. The main advantage of Option C is that it allows reasonable rotation of external auditors while preserving the required continuity; it therefore appears to strike the right balance between these two competing criteria. An incumbent would only be able to remain in service for a period of two

terms, or eight years. In view of the practices prevailing in other United Nations organizations, eight years is neither too long nor too short a period for the services of the External Auditor: it would provide the External Auditor with sufficient time to invest resources and enough time to become familiar with the intricacies of WFP's work, thus limiting the risk of audit failures and curtailing the costs associated with the turnover. A reasonable argument can be made to the effect that that limitation of the term of tenure in itself provides a certain level of independence, certainty and transparency.¹⁴

30. There may be further justifiable and legitimate advantages to foregoing the competitive process for a one-time reappointment. First, the management of a selection process for the External Auditor entails significant costs to WFP, which may be quantified in terms of time and of human and financial resources. Once the process is completed, and assuming that the incumbent Auditor is not being re-appointed, WFP is likely to incur further costs associated with the induction and training of the new External Auditor. Foregoing the competitive process for re-appointment for one further term yields a financial benefit for WFP.
31. In terms of performance and quality of service, foregoing the competitive process for a one-time reappointment can be justified in view of the need to ensure continuity and to increase the involvement and commitment of the External Auditor and to ensure familiarity with WFP's operations.
32. There are also significant advantages in requiring a competitive process at the end of each term. It can be argued that a competitive process at the end of each term ensures greater transparency and enhances the image and reputation of WFP. It is also possible that WFP could benefit financially if it were able to attract an External Auditor willing to perform the functions at a lower cost. But the immediate financial reward could be compromised later by factors such as those mentioned above. Examination of prevailing practices and current trends – to judge by the practice at the ICC – indicate that the requirement for a competitive process at the end of every term is not necessary and does not preclude a reasonable renegotiation of the fees.
33. It is interesting to note that arguments developed in different fora regarding the appointment of external auditors tend to deal with issues of term limits or, more recently, the possibility of extending the invitation to

¹⁴ In this context, it is interesting to note that the recently established International Criminal Court has also opted for its Auditor to be appointed for a period of four years, with the possibility of renewal without a competitive process; but the terms and conditions of the renewal are explored in detail. Fees are re-negotiated and any increase is assessed in terms of its reasonableness in the light of factors such as increases in work load and the size of the Court. The Auditor is encouraged to indicate a limit on the annual increase of fees for the renewed period. What is taken into account is thus the predictability of the costs of the Audit and the flexibility to add additional components to the work should the need arise.

bid to the audit institutions of the Member States and to qualified private-sector audit firms. It appears that organizations are largely left to use their discretion and previous practice.

34. To implement the Board's intention with regard to option C, current Financial Regulation 14.2 would need to be amended to reflect requirements for a review of the quality of services, a re-negotiation of the fee and for examination and approval of any changes in the fee prior to reappointment. In accordance with General Regulation XIV.4, such an amendment may be made by the Board after receiving advice from the ACABQ and the FAO Finance Committee.

IX. PROPOSED CHANGE TO FINANCIAL REGULATION 14.2

35. Currently, Financial Regulation 14.2 reads:

“The External Auditor shall be appointed for a four-year period covering two financial periods. He or she may be reappointed for only one further four year term”.

36. To implement the Board's intentions as described above and to document the Board's 1997 decision to require a competitive process for the selection of the WFP External Auditor,¹⁵ the Rule should be amended to read as follows:

“The External Auditor shall be appointed, through a competitive selection process, for a four-year period covering two financial periods. The External Auditor may be reappointed for only one further four-year term. Re-appointment does not require a competitive selection process but shall be subject to: (i) an assessment of the services provided, (ii) renegotiation of the fee structure and (iii) Board approval of any changes to the original fee structure”. (Underline denotes additional language).

X. SUMMARY

- a) Current WFP practice is in line with the practices of other United Nations organizations and with JIU recommendations on the subject in that it provides for competitive selection of the External Auditor and establishes a term limit.
- b) One advantage of the WFP practice is that it provides for competitive selection on appointment but allows for re-appointment for a further term without the necessity of a competitive process; this gives the possibility of continuity if the Board considers it necessary and reduces the administrative burden and associated costs.

¹⁵ See footnote 2, Section II above.

- c) In cases of reappointment, the Board could consider introducing requirements for: i) an assessment of the services provided by the External Auditor, ii) a renegotiation of the fee and, iii) Board approval of any changes to the original fee structure.
- d) The Bureau has expressed a preference for Option C which, if approved by the Board, would require an amendment to current Financial Regulation 14.2. It would be appropriate also to amend the Rule to document the Board's requirement for a competitive selection process upon appointment.