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Term of Office of the External Auditor

1. On 3 May 2017, the attached proposal by Canada was communicated to the Programme and Budget Committee of the Board of Governors.

2. As recommended by the Programme and Budget Committee, on 14 June 2017, the Board recommended that the General Conference decide that the appointment of the Agency's External Auditor shall be made through a competitive selection process for a non-renewable six-year term starting from the audit of the financial statements for the financial year 2022, with another appointment possible only after a break of at least one term.

EXPLANATORY MEMORANDUM

Term of Office of the External Auditor

I. ISSUE

According to fundamental auditing standards, an effective External Auditor is to be independent, both of mind and in appearance. Of the various measures which exist to ensure such independence, a key one is the periodic rotation of the External Auditor.

Member States may wish to consider that the International Standards of Supreme Audit Institutions, developed and issued by the International Organisation of Supreme Audit Institutions (INTOSAI) recommends that "an appointment of between 4 and 8 years will provide a reasonable balance between the additional costs of changing an external auditor and the benefits of the change."

At the IAEA, the term for the External Auditor is not stipulated in the Financial Regulations of the Agency, but is determined by the General Conference on a periodic basis. Current practice is for the IAEA General Conference to appoint an External Auditor for a term of two years, after which the term may be renewed.

It is proposed that the term of office the External Auditor be extended in order to improve efficiency, reduce costs, maximize independence, ensure regular rotation and maintain accountability.

II. BACKGOUND

The main advantages of auditor rotation are considered to be:

Independence: Long-term relationships between auditors and their clients increase the risk of audit failure as, in such relationships, the auditors may be influenced by friendships and/or identification with management and may lose objectivity and professional scepticism. Also, external readers of financial statements interpret the regular auditor rotation as a strong indicator of independence.

Audit efficiency and effectiveness: A fresh view brought by a new EA may give rise to innovative audit methods and improved audit efficiency. The newly appointed auditor may also identify exception or risk areas that a long-standing auditor may not identify due to habit or not report due to reluctance to change a previously expressed view.

Involvement of more audit institutions: Regular change of auditor would ensure the involvement, over time, of a broader range of auditors. This provides opportunity for the organization to benefit from the experience of various external auditors.

However, too frequent rotations of the External Auditor present some serious disadvantages. The most common are:

Increased costs: Frequent change of the external auditor involves significant costs, both for the Agency and for the auditor. The bidding and selection process is time-consuming, costly, and at times, politically sensitive. The investment of management and staff time and other resources in the process of helping the new auditor acquaint himself with the Agency's systems and procedures is significant and may be disruptive to other activities. In addition, a similar investment of resources is required from the auditor.

Increased risk of audit failures: There is evidence that a significant percentage of audit failures occur during the first and second year of any audit engagement, due to the significant time required to develop the necessary knowledge of a client to ensure that the audit approach is fully effective in large and complex organizations.

Reluctance to invest: A very short mandate term may lead an external auditor to be reluctant to invest time and resources in learning about the audited organization and its activities and, as the rotation date approaches, the EA could lose interest in its audit function as it prepares for new clients/projects.

III. **CONCLUSION**

With these factors in mind, the Agency should consider adopting a non-renewable six year term of office for the External Auditor. This would align the term of office of the IAEA External Auditor with that of the UN Headquarters and other UN Programmes, Funds and Specialized Agencies. Alignment with other organizations in the UN system would help to ensure that the Agency remains competitive in attracting proposals from a broad range of qualified audit institutions. It would also improve the efficient use of Secretariat and Member State time by decreasing the frequency with which the appointment of the External Auditor would be considered. A non-renewable six year term would offer greater predictability in costs than is afforded by the requirement for audit organizations to submit new proposals every two years. It would also provide for a more regular rotation of External Auditors than has been the case to date within the IAEA. A non-renewable six-year term would thus provide an optimal balance for ensuring that the Agency is able to get the most out of this audit function.

V. **ACTION**

It is proposed that the Programme and Budget Committee recommend to the Board of Governors that the Board decide to recommend that the General Conference decide that "the appointment of the Agency's External Auditor shall be made through a competitive selection process for a non-renewable six-year term starting from the audit of the financial statements for the financial year 2020, with another appointment possible only after a break of at least one term."

Canada