

Ortssektion München . Local Section Munich . Section locale de Munich

20.09.2011
ex11082cp - 0.2.1

Interview with Paul Ernst

Director of Internal Oversight (ret'd)
Ministerialrat als Mitglied des Bundesrechnungshofes a.D.

“... the absence of an established anti-fraud policy, an agreed code of conduct and investigation guidelines – as it is the case of the EPO – constitutes a significant risk.”

“The role of an Audit Committee strengthens accountability and transparency. Today one can say that, at least in international organisations, Audit Committees are an essential part of good governance.”

Mr. Ernst, in 2009 the European Patent Organisation created an Audit Committee, only to abolish it again less than two years later. You were a Member of the EPO Audit Committee.

In general, what is the purpose of an audit committee?

Paul Ernst: The decision to abolish the Audit Committee was in fact taken one year after the first meeting of the Audit Committee. In principle, an Audit Committee provides independent assurance to the governing body that the organisation's internal and external controls and its audit functions are adequate and operating as intended and whether or not audit recommendations are followed up. The Committee accomplishes this by reviewing the plans, progress and results of related activities performed by the External Auditors, the Internal Audit and the administration and management of the Organisation. The Committee may also advise the CEO or President on matters of policy requiring corrective action or on improvements with respect to controls, including, evaluation, audit, investigation and risk management. There are differences between Audit Committees according to the organisation concerned. Of course there is a difference between whether it is a subcommittee of an Executive Board of an American private company or whether it is a consultative body to the governing body of an international organisation. Furthermore the composition can be very different. It can be composed of directors of the

organisation, members of the governing body, independent external experts or a mixture of these options. The composition can also have an impact on the role of the Committee.

The dissolution of the Audit Committee at EPO was justified with the argument that the Audit Committee's tasks are already carried out by Internal Audit and the Board of Auditors (BOA). What is your view on this?

Paul Ernst: The reasoning behind the decision reveals a lamentable ignorance of the fundamental role of an Audit Committee. The Audit Committee can be seen as an answer to the famous question „who audits the auditor?“ The Audit Committee reports directly to the Administrative Council, whereas Internal Audit reports to the President and has no right to address the Administrative Council directly. The Audit Committee protects the independence of both audit functions and observes the coordination between Internal Audit and External Audit, and the follow-up given to audit recommendations. The Audit Committee should also raise its voice if a significant conflict of interest is discovered, e.g. a close relationship between a member of the BOA or the Internal Auditor or the Chair of the governing body and the chief executive. There is no other institution that plays a similar role. These are significant differences that demonstrate that the Audit Committee does not duplicate the work of the Internal Auditor nor the Board of Auditors.

Is the existence of an Audit Committee today considered an essential part of good governance?

Paul Ernst: The response to this depends on cultural factors. As a consequence of scandals at Enron, WorldCom, Flowtex and Comroad the discussion about adequate Corporate Governance was intensified and the role of an Audit Committee was part of this discussion. Audit Committees are more easily accepted in the Anglo-Saxon environment, whereas Mediterranean countries have been slow in introducing Audit Committees. However, in particular in the international public sector Audit Committees are seen as an essential part of good governance. The Audit Committee is a key component of the governance triangle comprising the External Auditors, Internal Audit and Audit Committee. This is because the control environment in the international public sector is often less strong than in the national sector. For example, the absence of an established anti-fraud policy, an agreed code of conduct and investigation guidelines – as it is the case of the EPO – constitutes a significant risk. Nowadays, the member states of international organisations are usually interested in establishing Audit committees. At present the following organisations, inter alia, benefit from the existence of an Audit Committee: European Union, many Organisations of the UN family, OSCE, OECD, Council of Europe and the Global Fund is soon to follow. The role of an Audit Committee strengthens accountability and transparency. Today one can say that, at least in international organisations, Audit Committees are an essential part of good governance.

The decision of the Administrative Council of the EPO to abolish its recently created Audit Committee is therefore without precedent. Moreover it is contrary to the efforts of most member states to establish Audit Committees in other international organisations. Who had an interest in reducing accountability and transparency in the EPO? A propos transparency: it is remarkable that important documents in this context were never distributed to the members of the Administrative Council.

Against this background and in view of the fact that the financial situation of the EPO shows a negative equity and that undoubtedly there is a need to realise savings, it is amazing that the decision to abolish the Audit Committee was taken. Regarding transparency: the decision to *establish* an Audit Committee was very transparent. The rationale for that decision was explained in detail in document CA/140/08¹. On the other hand document CA/55/11² proposing a repeal of the Administrative Council's decision to establish an Audit Committee does not make any reference to the reasons listed in CA/140/08 even though they were recognised by all parties concerned: the Office, the Board of Auditors, the Budget and Finance Committee and the Council. As regards risk management, an anti-fraud policy or a code of ethics, no substantial progress has been made for several years. The EPO still has no established policies or guidelines in these areas. This was one of the reasons that led to the creation of an Audit Committee. The Audit Committee addressed these issues in its last report, CA/24/11³. One year was of course not enough to achieve visible results. Is it realistic to expect that the situation will improve without an Audit Committee?

At least it would have been logical to postpone the decision until the mandate of the members of the first Audit Committee came to an end.

How can the gap in internal control created by the abolishment of the Audit Committee be addressed?

Paul Ernst: The answer to this question will be crucial to the Organisation. First of all the independence of the internal audit function needs to be strengthened significantly and protected. There are good examples. In the Council of Europe (CoE) the appointment and the removal of the Internal Auditor requires the consent of the governing body. The Secretary General cannot prevent the Internal Auditor from carrying out an audit that he/she deems necessary. Although the right of the Internal Auditor of the CoE to report directly to the governing body is not cast in stone, it was never questioned by anybody.. The situation is similar in many other international organisations, for instance in WIPO. The internal audit function in the EPO should be given the same level of powers and the same protection.

It will be interesting to see the comments of the BOA and their initiatives to protect an independent internal audit function in the EPO. In addition the structure of the external audit function could also be reconsidered. Other, even smaller, organisations considered that a BOA composed of three distinguished and very experienced experts was adequate decades ago, when the organisation was created. But since then times and good governance standards have changed completely. Therefore, many organisations have opted for a system whereby a supreme audit institution of a member state assumes the role of the external auditor. This concept has many advantages. Additionally the Council could ask the President to sign a Statement on Internal Control every year together with the financial statements declaring that all is in order. Last but not least the EPO should develop a robust investigation function and introduce a while-blower policy.

I hope recent events will lead to an open and in all aspects transparent, interesting and constructive discussion.

¹ [CA/140/08](#); see also www.suepo.org/public/news, entry of 17.06.2011

² [CA/55/11](#)

³ [CA/24/11](#)