

OCCAR Case Study

Auditing procurement of major armament projects
ECA Workshop – May 2019



ECA WS – OCCAR Case Study

Content

Part 1:

1. OCCAR Integrated Business Management Framework
2. OCCAR Internal Control Process

Part 2:

3. The OCCAR Key Accounting policies
4. Accounting Data, Audit and Financial Reporting

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5. The OCCAR Board of Auditors (BoA)
6. Issues raised in the latest BoA audit reports

1. Integrated Business Management Framework

Quality Management versus Quality Management System

Quality Management (QM)

QM is a part of a QMS. It only focusses on a service / product to be built and delivered according to a:

- ⌘ Specification;
- ⌘ On time; and
- ⌘ At the appropriate cost.

Quality Management System (QMS)

A QMS focusses on the *adequate operational and organisational structure* in order to *run successfully the organisation's business* and that the organisation *is prepared for the future*.



OCCAR-EA Quality Management System = *Business Management System of OCCAR-EA*

1. Integrated Business Management Framework

OCCAR Convention – Article 21

The OCCAR-EA Director shall be directly responsible to the BoS for the operation of the EA. His/her detailed responsibilities shall be specified in a document approved by the BoS.



Annex OMP 3-F (OCCAR-EA Director Terms of Reference)

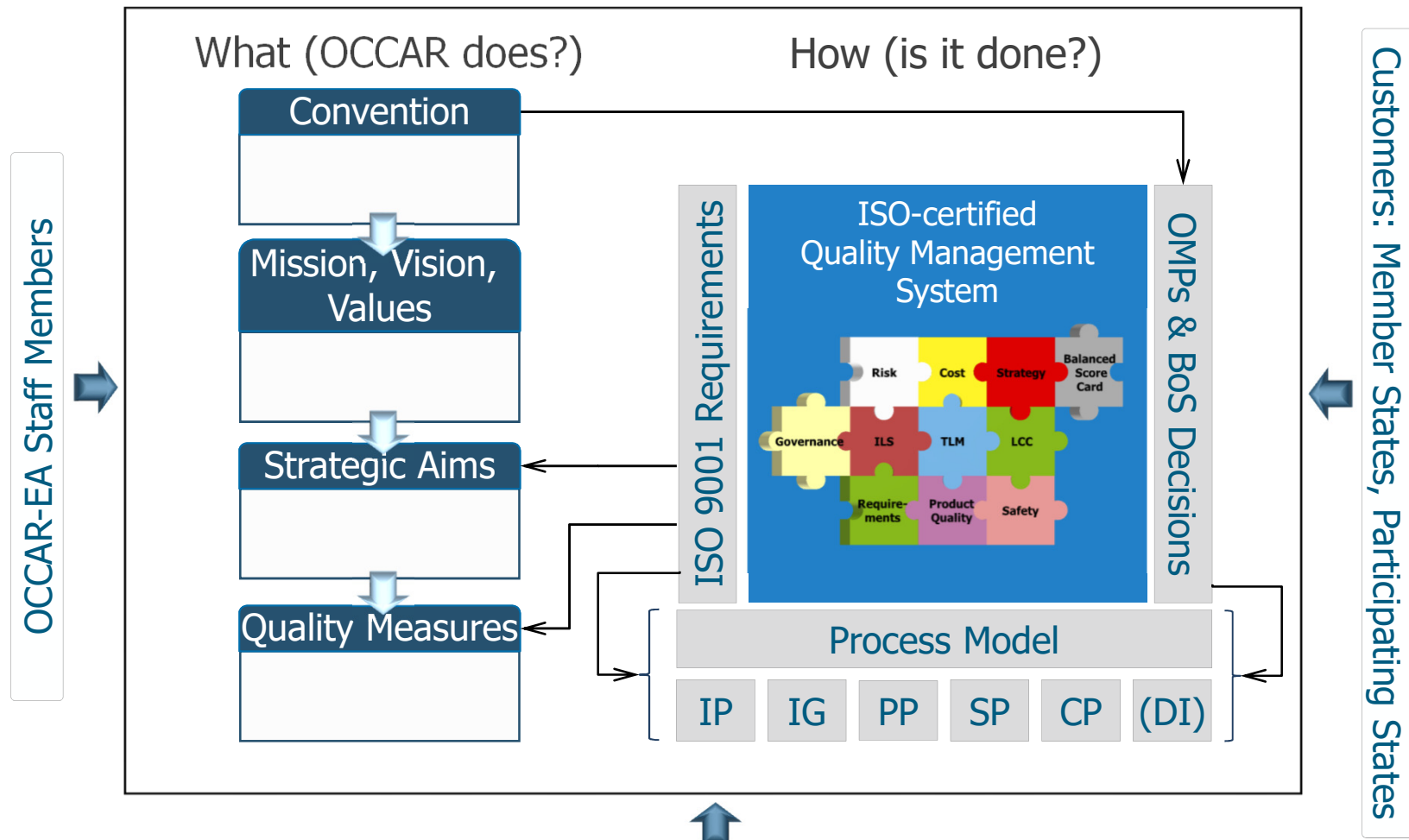
The tasks of the OCCAR-EA Director are inter alia to Manage OCCAR-EA in an efficient, effective and timely manner to meet the objectives specified by the BoS.
This responsibility includes *the implementation of an effective management control system*.



BoS

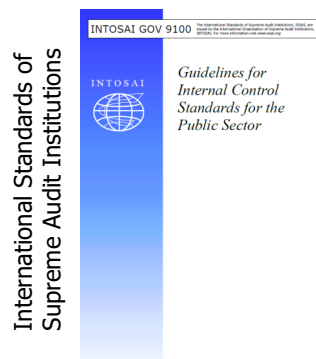
OCCAR Member States decided in 2002/2003 to establish/implement/ maintain an effective management control system within OCCAR-EA based on the *ISO 9001 framework*.

1. Integrated Business Management Framework



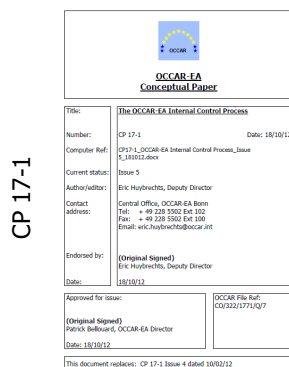
2. Internal Control Process

Definitions



Internal control is an integral process that is effected by an entity's management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission, the following general objectives are being achieved:

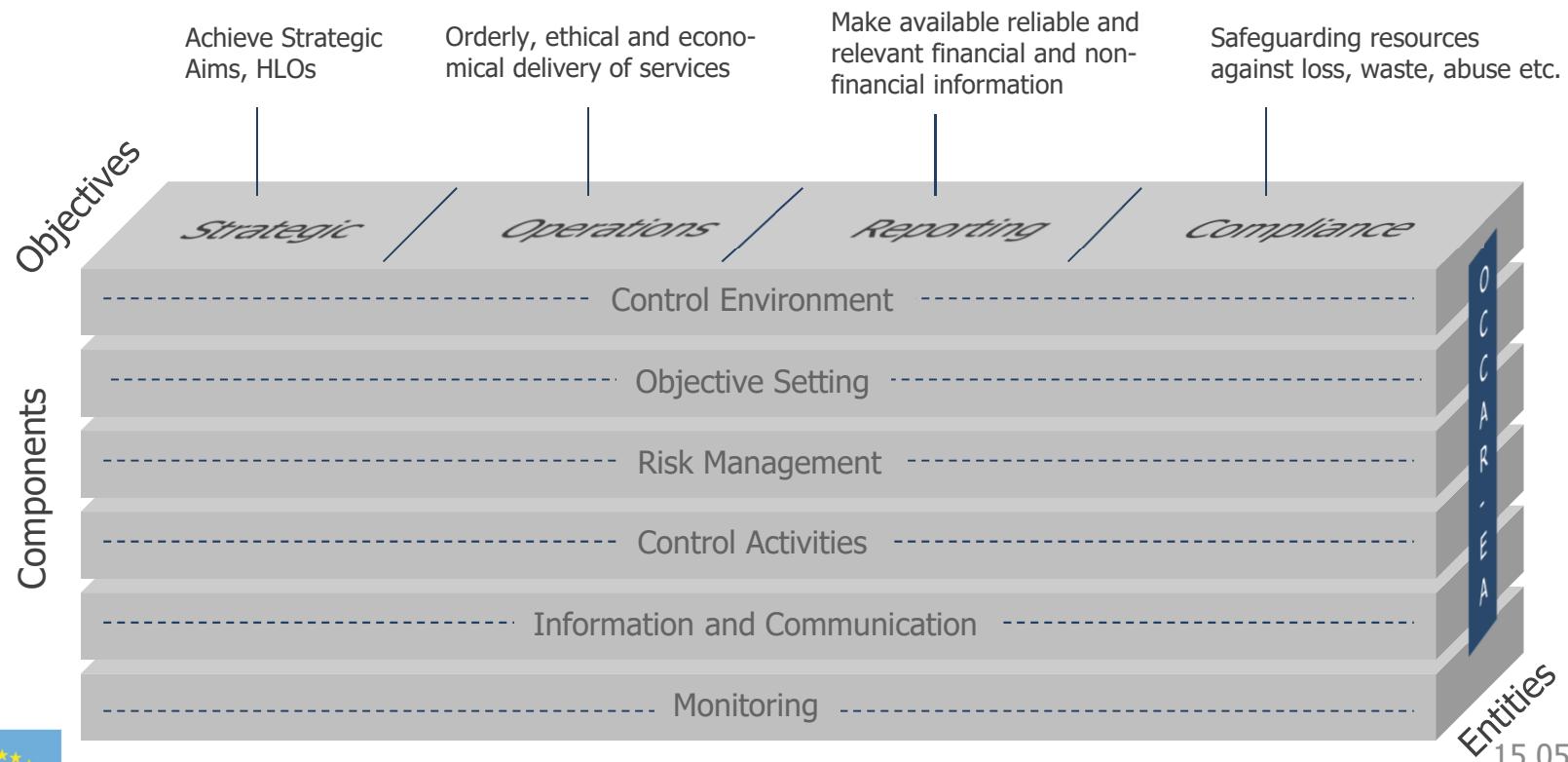
- ⌘ executing orderly, ethical, economical, efficient and effective operations;
- ⌘ fulfilling accountability obligations;
- ⌘ complying with applicable laws and regulations;
- ⌘ safeguarding resources against loss, misuse and damage.



Internal control, as defined in accounting and auditing, is a process for assuring achievement of an organisation's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies.

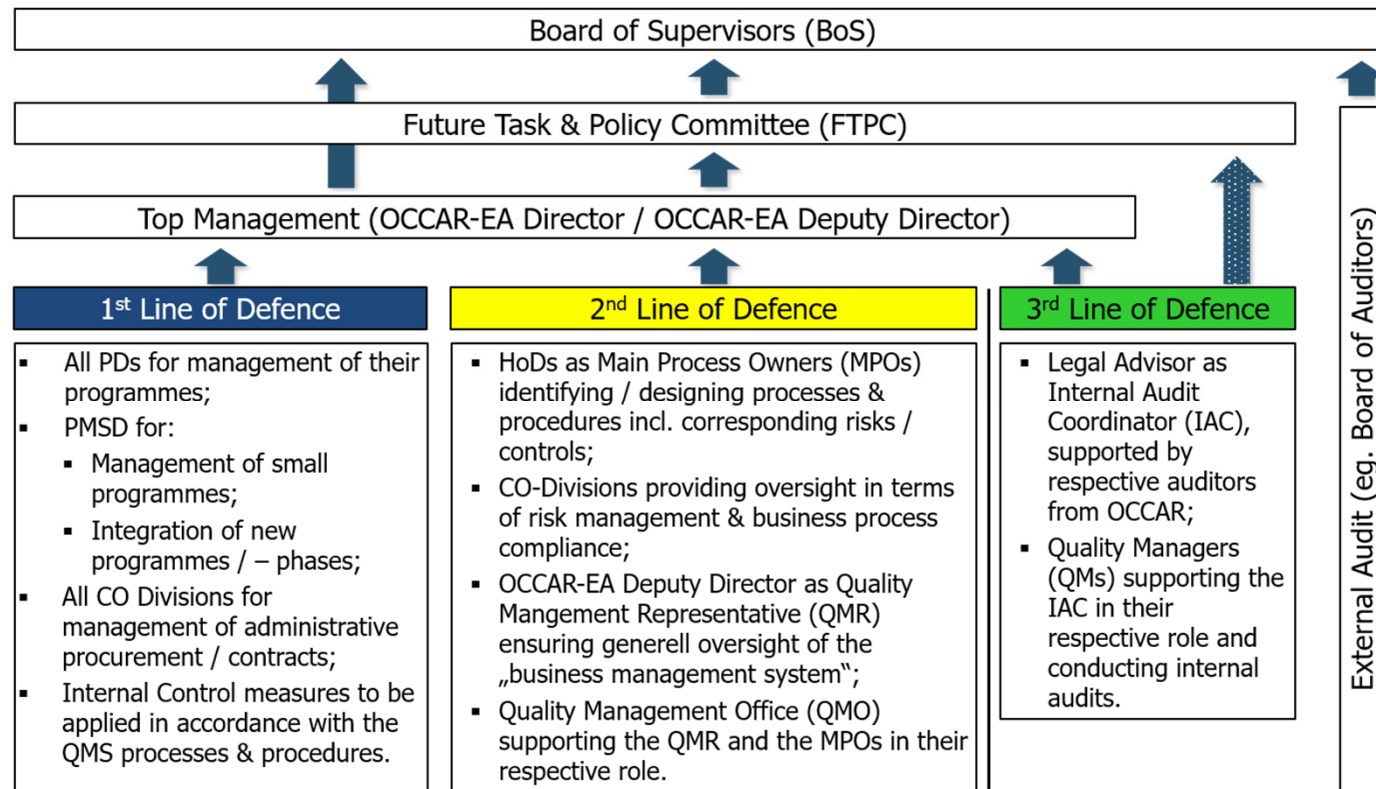
2. Internal Control Process

- ❖ OCCAR-EA Internal Control Process is the ultimate integrator of OCCAR-EA's business management concepts, methodologies, procedures and tools.
- ❖ Internal Control is designed to provide reasonable assurance that the entity's general **objectives** are being achieved.



2. Internal Control Process

“Three Lines of Defence” within OCCAR-EA



2. Internal Control Process

OCCAR-EA Internal Audit

- ⌘ The **Internal Audit strategy** and its corresponding audit results allow the OCCAR-EA Director to provide to the Board of Supervisor (BoS) an opinion on the adequacy, effectiveness and efficiency of the organisation.
- ⌘ The Internal Audit function within OCCAR-EA contributes to the **performance evaluation** of the organisation and the identification of any areas for potential improvement.
- ⌘ It is OCCAR's policy to undertake the management of the internal audit function from **within existing resources** of its functional organisation.
- ⌘ Internal audits will be conducted under the **authority** of the OCCAR-EA **Director**.
- ⌘ **The Legal Advisor as the Internal Audit Coordinator (IAC)** leads the internal audit function, hence represents the "3rd line of defence" within the organization.
- ⌘ **"Integrity"** and **"Transparency"** are some of OCCAR-EA's major values. In case of fraud or suspicion of fraud, the internal auditors shall report to the OCCAR-EA Director.

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3. OCCAR Key Accounting policies

⌘ OCCAR-EA Director

⌘ The Director exercises his authority to manage all financial operations as have been delegated to him by the BoS, under Chapter V Article 21 of the OCCAR Convention and the Director's ToR defined in OMP 3-F

- In particular, the Director holds overall responsibility for financial planning, budgeting, in year management and accounting. In fulfilling his responsibilities to the BoS, the Director is entitled to formally sub-delegate, to the fullest extent possible, authority further within OCCAR-EA.

⌘ Head of Finance Division

⌘ As indicated in the OCCAR Financial Rules (OMP 10), the Head of FD shall maintain the accuracy, reliability and relevancy of the financial information produced and ensures the identification of OCCAR's financial risks. He is responsible to the Director and is his primary source of advice on OCCAR's financial issues.

3. OCCAR Key Accounting policies

- ⌘ Internal Control (OCCAR Financial Rules – OMP 10)
 - ⌘ The Director, and the Head of FD as delegated representative, shall establish internal controls as necessary to enable proper checks and authorisations of all financial transactions, ensure correct and effective use of OCCAR-EA's funds, assets and property and, consequently, minimise the risk of error or fraud.
 - To this end the Director shall ensure that financial responsibilities and functions are attributed following a clear policy of segregation of duties.

- ⌘ Financial Statements (FS) responsibility and submission
 - ⌘ The Director is responsible for producing the FS through FD.
 - He shall submit the Annual FS to the Board of Auditors (BoA) appointed by the BoS in accordance with Chapter IX Article 36 of the OCCAR Convention no later than 31st of March following the close of the FY.

3. OCCAR Key Accounting policies

- ⌘ Accounting procedures
 - ⌘ The OCCAR-EA accounting procedures shall comply with the relevant subset of International Public Sector Accounting Standard and with the fact that OCCAR-EA is acting as an Agent in respect of the Operational domain and as a Principal in respect of the Administrative domain.

- ⌘ Financial Statements (FS) requirement
 - ⌘ Specifically, the FS are to be consistent with the IPSAS guidance for financial reporting under the accrual basis of accounting (IPSAS 1) for Section I (Administrative). The Programme Operational transactions under Section II are disclosed and compiled using a modified cash basis.
 - The OCCAR Convention stipulates that all assets acquired by OCCAR under the Administrative section are the property of OCCAR (Article 32), while those acquired or created under the Operational section remain the property of the Member States which fund them (Article 33).

4. Accounting Data, Audit and Financial Reporting

- ⌘ Data, Financial Accounting and Financial Reporting
 - ⌘ Confidentiality (evidence & reporting)
 - Starting point: data security classification (necessity for the Programme Operational data)
 - Outcome: segregation between streamlined and detailed information, in line with the split between Financial Accounting and Management Reporting areas
 - Outputs: separate FS and PFM Reports documents, but prepared consistently (OMP 10), i.e. same set of data.
 - Different reporting channels: Corporate (can be public) vs Programme Committees (remain internal, at Programme level).
 - Non cash data added, useful for procurement management. Look at accurate effort to produce and maintain data.

4. Accounting Data, Audit and Financial Reporting

- ⌘ Data accessible to Audit
 - ⌘ Audit mandate prerequisites, rather than limits (BoA ToRs)
 - “Members of the Board may nominate individuals to carry out audit work of the Board. Both the Board Member and any nominated individuals must possess an appropriate national security clearance.”
 - “OCCAR-EA to ensure it is provided with an appropriate level of access to all premises, persons and relevant records required to conduct the audit.”
 - “The BoA shall organize itself in order to respect OCCAR’s policies and procedures ensuring that access to sensitive programme information is limited to Participating States.”

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5. The OCCAR Board of Auditors

- ∴ An external auditor for OCCAR is required by Article 36 of the OCCAR Convention, which stipulates : “The annual accounts shall be submitted to the audit authorities appointed by the BoS.”
- ∴ This is the legal basis for the BoA **Financial audits**.
- ∴ **Performance audits** are covered by Article 47 of the OCCAR Convention: “The BoS may order any inspection or audit which it considers necessary to improve the functioning of the Organisation and the conduct of the Programmes.”

To note: Clear distinction between recurrent audit activities and punctual insights in the OCCAR-EA performance, subject to a request from the BoS.

However, based on a clause of the ToR (that enable the BoA to possibly cover the effective, efficient and economic use of resources), the BoA decided to address performance issues as well, with prior communication to the BoS. This was the case for a special report on the OCCAR Internal Audit Arrangements (2016) and for a Management Letter on the new ERP (2017), issued by the BoA.

5. The OCCAR Board of Auditors

- ❖ Membership of the Board comprises one representative from each Member State, proposed by its Supreme Audit Institution.
- ❖ Audit of the OCCAR activity can also be performed by national auditors [on a national basis](#).

These auditors are different from the “audit authority” referred to in Article 36.

Article 44 stipulates that, in the context of their duties as regards their national administrations, and with a view to reporting to the respective parliaments, national auditors may obtain all information and examine all documents held by the EA which relate to the programmes in which their Member States are participating, and to the operation of the Central Office. The practical aspects of those audits need to be coordinated with the Director (article 45).

A recent example was the report issued by the French colleagues of the Cour des comptes on the “Bilan industriel des coopérations européennes”, which compared the OCCAR activity as a delegated contracting authority and other collaborative defence acquisition programmes.

5. The OCCAR Board of Auditors

- ❖ **A risk-based Audit strategy.** We plan our audit of the financial statements to respond to the risks of material misstatement and material irregularity. In our Audit Strategy report (October each year), we set out how we have built our assessment of risk, what we base materiality on, those risks we expect to be significant and how we will respond to these risks.
- ❖ **Methods.** Assurance is obtained from the review and testing of controls and substantive testing of sample transactions. We also use analytical procedures to assess the reasonableness of the figures presented for audit and the effectiveness of key internal controls (and, if need arises, to increase the level of sample testing to be subsequently performed).
- ❖ **Regular follow-up.** OCCAR-EA produces an action list monitoring progress made in implementation of BOA's recommendations. We provide our view on the implementation of these recommendations on an annual basis, when we issue our Audit Report.

5. The OCCAR Board of Auditors

∞ Structure of the Audit opinion

- ❖ Under the ToR, “The Board shall be responsible to the BoS to carry out an annual audit of the Financial Statements of OCCAR, and to render annual audit opinion and long form report detailing audit observations and recommendations”.
- ❖ From January 2015, OCCAR has prepared its financial statements in accordance with IPSAS on an accrual basis. OCCAR’s financial statements (Section I) will be subject to the BoA’s audit opinion.
- ❖ In order to be compliant with IPSAS, receipts and payments related to the Operational budget are not included within OCCAR’s financial statements and therefore are not subject to the IPSAS audit opinion. This is based on OCCAR’s assessment that the transactions undertaken have the features of an agent relationship. OCCAR include cash-based disclosures within an Annex to the financial statements (Section II). These disclosures are subject to agreed assurance procedures (in line with testing performed in previous years) and a separate opinion is provided. The opinion on Section II covers the Cash Receipts and Payments, the Cash flow by Nation, the Cash flow by Programme and the Operational Budgets versus Payments by Nation.

6. Issues raised in the latest audit reports

- ⌘ Limited flexibility in the budgetary approval process (audit report for 2016)
 - ⌘ This results in a tendency for Programmes to overstate budgets to avoid future approvals and limits OCCAR's ability to implement effective financial management
 - Realistic budgets should be set and updated to reflect new business information throughout the year. The reasons for significant changes in budgets should be reviewed, challenged and documented centrally.
- ⌘ Management of Call for Funds (audit report for 2016)
 - ⌘ CFFs often raised in advance of need (resulting in OCCAR holding significant bank balances on behalf of Nations)
 - ⌘ While there have been no CFFs that exceed the approved budget, there have been instances of Nations increasing their budgets at year end to enable the CFFs to be raised. FD to strengthen the process for the Finance Officers to review their CFFs. The BoA recognizes that OCCAR has limited power to refuse the requests of Nations in this respect, but it is not within the remit of OCCAR to hold and invest surplus cash balances on behalf of Nations.

6. Issues raised in the latest BoA audit reports

:: Internal Audit Arrangements (audit report for 2017)

- Further to the Internal Audit Management Letter issued in 2016, the BoA continues to emphasise the importance of focussing Internal Audit on the organization key risks, particularly within the Programme Divisions where the significant element of OCCAR's activity takes place. The BoA acknowledges that OCCAR has proceeded to update the framework of its internal procedures ruling Internal Audit, which improves the consideration of Internal Audit standards, practices and principles.

:: Reconciliation of Bank accounts (audit report for 2017)

- In 2016, FD has set up a Cash Pooling mechanism to address the issue of negative rates. This mechanism allows the bank to move funds between accounts, as they see necessary. This has resulted in an additional layer of bank accounts called Master Accounts.
- Our year-end cash testing checks identified a number of variances between the cash balance on the bank confirmation letters and the balance disclosed by OCCAR, indicating that the pooling arrangements are complex and there is lack of visibility for OCCAR of the reconciliation. FD to take into account this aspect in future tenders for bank services.

6. Issues raised in the latest BoA audit reports

A new Enterprise Resource Planning system is planned to be implemented very soon.

- ⌘ To help drive improvement, in a Management Letter to the BoS (2017) we raised some concerns about the implementation and management's governance of the project.
- ⌘ The key areas requiring management attention included:
 - A lack of a sufficiently detailed business case to support the business need, the need for a clear timeline for the project, identifying success criteria and benefits, business transformation/impact on processes, lack of lessons learnt from the previous system implementation, risk of discontinuity).

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