



INTERNATIONAL TROPICAL TIMBER COUNCIL

COMMITTEE ON FINANCE AND ADMINISTRATION

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PROPOSED AMENDMENTS TO THE FINANCIAL RULES OF THE INTERNATIONAL TROPICAL TIMBER ORGANIZATION

1. The Committee on Finance and Administration at its Thirty-third Session recommended to consider, at the next Council session, amending the financial rules to extend the audit term to match best practices in the market. Furthermore, the Secretariat had conducted a systems appraisal, which is required at least once every 3 years under the Financial Rules, to assess the appropriateness of systems and the proper functioning of internal controls and to make improvements if necessary.
2. Accordingly, this document is prepared with the proposed changes to the ITTO's Financial Rules to reflect the recommended changes based on the assessment below. This document only lists those which need revisions or amendments since most of the Regulations and Rules need no revisions.

Mandatory Audit Firm Rotation

3. Currently, ITTO has in place a mandatory audit firm rotation policy of 3 years. Mandatory audit firm rotation policies are intended to avoid excessively long relationships between the client and the auditor, which is believed to negatively impact the quality of the audit. However, it is also argued that changing auditors has adverse effects which result in start-up costs, organizational disruptions, loss of client-specific knowledge and the ability to negotiate audit fees, which may impact the quality of the service of the auditors.
4. According to resources published by EY Global Financial Services Institute (The audit mandatory rotation rule: the state of the art, Cameran et al., 2015), only a few countries have this policy in place, namely being the E.U. which adopted the audit firm rotation rule in mid-2016 to limit the appointment of an independent external auditor to a maximum of 10 years. On the other hand, many other countries such as the U.S. and Japan do not have mandatory firm rotation policies in place. While firm rotation is not widely adopted, the idea of partner rotation is supported by many countries with the term varying from 5-7 years. The research also concluded that, "investigations into the impact of the [audit firm rotation] rule at corporate and market level have not been able to prove that the benefits outweigh the costs."
5. Additionally, ITTO's financial statements are prepared based on the International Public Sector Accounting Standards (IPSAS) which require specific expertise and experience for an effective audit to take place. Even if the audit firm has the adequate capacity to audit financial statements prepared with IPSAS, the audit firm would need to spend significant time on-site to gain a better understanding of ITTO specific applications of the accounting policies. Therefore, the quality of audit may suffer from frequent changes in audit firms due to loss of client-specific knowledge.
6. Considering the above points, the Secretariat proposes that the term of the auditor should be extended from three years to five years. The mandatory audit firm rotation policy should be abolished by allowing firms to submit proposals and be reappointed, allowing for competition and for ITTO to retain the same firm if other firms do not meet desirable standards. However, if reappointed, the lead audit engagement partner should rotate off an engagement after a maximum of five years in his/her capacity and, upon rotation, is off the audit team for at least five years, in order to minimize any threat to independence.

This change should be applied retroactively to the current audit firm, extending their term from three years to five years.

Financial Delegations

7. Annex 6 of the Financial Rules lays out the financial delegations and disbursements procedures for the Organization. While the rules on required signatories for approving specific payments/commitments have improved governance, some rules tend to put an excessive burden on senior management by requiring their approval of volumes of relatively low risk transactions.

8. Specifically, it is proposed that the threshold for payments and travel requests that require the Executive Director's signature be set to \$10,000 or more, which is in line with the current rules for Purchase Orders. Payments less than \$1,000 should not require a signature from a Director level and can be processed at the Finance Officer's level. Additionally, the current delegation rules allows only for management to delegate approving authorities to higher officials. This in practice would only allow, in the absence of a Director, the approving authority to be delegated to the Executive Director. By adding the option to delegate one's approving authority to an officer acting in a similar capacity, the amount of Director level approvals submitted to the Executive Director can be reduced.

9. In summary, the proposed amendments to the financial delegation rules would improve the efficiency and cost benefit of the internal controls of the Organization by effectively assigning approvals to the appropriate positions based on the transaction's risk level.

Ex-post Evaluation Pooled Funds

10. Rules related to Ex-post Evaluation Pooled Funds are currently contained in Decision 3(XXVIII), Annex II issued in May 2000. It is proposed that these rules be moved into the Financial Rules under the section on the Special Account. Slight amendments to the text are also proposed in order to allow funds to be automatically transferred to the ex-post evaluation pooled fund after a certain time passes.

11. The Committee on Finance and Administration may wish to consider the proposed changes documented below and recommend to the Council for their adoption and immediate implementation in accordance with Rule 28 of the ITTO Financial Rules which stipulates that amendments must be approved by the Council.

ORIGINAL TEXT

PROPOSED AMENDMENTS

PROPOSED FINAL TEXT

**Financial Rules and Rules Relating to Projects of
the International Tropical Timber Organization**

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International Tropical Timber Organization**

Rule 10 : Ex-post Evaluation Pooled Funds

Rule 10 : Ex-post Evaluation Pooled Funds

N/A

Inclusion of rules on the financial procedures for the ex-post evaluation pooled fund which is currently only contained under Decision 3(XXVIII).

1. Within the Special Account, three sub-accounts shall be created, one for each Committee (CEM, CFI and CRF) to fund ex-post evaluations carried out under the supervision of the respective Committee, in accordance with the decision of the Council. Committees shall specify the source of funds to be used for the ex-post evaluation work such as remaining ITTO Monitoring and Evaluation funds, specially budgeted Ex-post evaluation funds or the funds placed in the sub-account of the Special Account for ex-post evaluations.

2. The budget prepared for the ex-post evaluation should include the fee and travel costs of the mission, preparation of the report, translation costs and costs associated with the dissemination of the results and any other costs as required.

3. Funds remaining in completed projects, under ITTO's budget item for monitoring and evaluation, and for ex-post evaluation, will be transferred to the appropriate sub-account of the Special Account after receipt and acceptance of the project's audited financial report and after the project has been declared closed according to the Organization's financial procedures and after agreement by the contributor(s) to transfer funds in accordance with Article 20, paragraph 8 of ITTA (2006). If a donor fails to respond to the notification from the Secretariat regarding monitoring and evaluation and ex-post evaluation funds in completed projects within 6 months, then such funds shall automatically be transferred to the appropriate pooled ex-post evaluation sub-account.

ORIGINAL TEXT

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Rule 19 : Appointment of Auditor

1. In accordance with Article 23 of the Agreement and following the procedures and guidelines as described in ITTO's Auditing Standards (Annex 4) the Council shall appoint an independent external auditor of recognized standing for a term of three consecutive years, subject to satisfactory performance. The process for identifying qualified firms for Council consideration and selecting an auditor is described in ITTO's Auditing Standards. This auditor shall be selected from among firms incorporated in a member country of the Organization that are qualified to conduct audits in Japan. The same auditor shall not be appointed for the successive three years after the most recent appointment. Notwithstanding that the appointment is made for a maximum of three (3) years the tenure of the engagement will be subject to an annual performance review by Council, which may in the event of unsatisfactory performance, result in termination of the appointment prior to the elapse of three (3) years.

Annex 4, Paragraph 1.2

At the conclusion of the evaluation and selection process the successful firm will be required to execute a contract of services specifying the key contractual terms of services rendered during the 3-year contractual duration. Contractual terms may contain, but not be limited to the following;

Annex 6, Paragraph 1

Assignment of delegations can be transferred if an officer is acting in a higher position.

Extension of audit appointment to five years and allowing reappointment of audit firms given that the lead audit engagement partner rotates off an engagement after a maximum of five years in his/her capacity and, upon rotation, is off the audit team for at least five years.

Extension of audit appointment to five years.

Allowing for the delegation of authority to officers with similar capacity.

Rule 20 : Appointment of Auditor

1. In accordance with Article 23 of the Agreement and following the procedures and guidelines as described in ITTO's Auditing Standards (Annex 4) the Council shall appoint an independent external auditor of recognized standing for a term of five consecutive years, subject to satisfactory performance. The process for identifying qualified firms for Council consideration and selecting an auditor is described in ITTO's Auditing Standards. This auditor shall be selected from among firms incorporated in a member country of the Organization that are qualified to conduct audits in Japan. The same audit firm may be reappointed provided that the lead audit engagement partner rotates off an engagement after a maximum of five years in his/her capacity and, upon rotation, is off the audit team for at least five years. The tenure of the engagement will be subject to an annual performance review by Council, which may in the event of unsatisfactory performance, result in termination of the appointment prior to the elapse of five (5) years.

Annex 4, Paragraph 1.2

At the conclusion of the evaluation and selection process the successful firm will be required to execute a contract of services specifying the key contractual terms of services rendered during the 5-year contractual duration. Contractual terms may contain, but not be limited to the following;

Annex 6, Paragraph 1

Assignment of delegations can be transferred if an officer is acting in a higher position or in a similar capacity.

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Annex 6, Paragraph 3.1

- i) Approving of Purchase Order under existing CFA and Council approved budget are as follows:
- For amounts less than \$50,000, Assistant Director Division of Operations;
 - For amounts greater than \$50,000 Executive Director;
 - Payments greater than \$100,000 are subject to Bid and Tender processes as prescribed by Section 6 of the ITTO Procurement and Tender Manual and require that the Executive Director report such procurements to the CFA.
- j) Air travel for all operational and centre administrative purposes will be at the most economical cost unless approval for deviation to this requirement is obtained prior to the travel being taken. Due regard must always be given to budgetary constraints and will be approved as follows:
- International travel for all staff and consultants will be subject to approval by the Executive Director;
 - All domestic travel will be approved as per financial delegations' levels defined in 3.0 i) Financial Delegations above.

Amendment of approval thresholds to be consistent with amounts set in Annex 7, paragraph 4.3.4 defining authorized personnel of approving purchase orders.

Amendment of approval thresholds to be consistent with amounts for Purchase Orders.

Annex 6, Paragraph 3.1

- i) Approving of Purchase Order under existing CFA and Council approved budget are as follows:
- For amounts less than \$10,000, Director Division of Operations;
 - For amounts \$10,000 or greater, Executive Director;
 - Payments greater than \$100,000 are subject to Bid and Tender processes as prescribed by Section 6 of the ITTO Procurement and Tender Manual and require that the Executive Director report such procurements to the CFA.
- j) Air travel for all operational and central administrative purposes will be at the most economical cost unless approval for deviation to this requirement is obtained prior to the travel being taken. Due regard must always be given to budgetary constraints and will be approved as per financial delegation levels defined in 3.1 i) Financial Delegations above, after authorization for travel is granted by the Executive Director in accordance with Rule 605 of the ITTO Staff Regulations and Rules.

ORIGINAL TEXT

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- l) Payments will be made by EFT wherever possible under the following delegations:
- o Where less than \$5,000, two signatories consisting of the Finance and Administrative Services Officer and the Assistant Director Division of Operations;
 - o Where payments are greater than \$5,000 they will be required to be signed by the Executive Director and one other Assistant Director (normally the Assistant Director Operations);
 - o Where payments exceed \$100,000 they must be signed by the Executive Director, the Assistant Director Division of Operations and one other Assistant Director.

Amendment of approval thresholds to be consistent with amounts for Purchase Orders. Addition of approval by only Finance Officer if payment is less than \$1,000 to reduce burden on senior management.

- l) Payments will be made by EFT wherever possible under the following delegations:
- o Where less than \$1,000, one signature by the Finance and Administrative Services Officer;
 - o Where less than \$10,000 but \$1,000 or greater, two signatories consisting of the Finance and Administrative Services Officer and the Director Division of Operations;
 - o Where payments are \$10,000 or greater, approval is required by the Executive Director and one other Director (normally the Director Operations);
 - o Where payments exceed \$100,000 they must be approved by the Executive Director, the Director Division of Operations and one other Director.

