

SUBJECT: Draft decision setting up an Audit Committee

SUBMITTED BY: President of the European Patent Office

ADDRESSEES: 1. Administrative Council (for decision)
2. Budget and Finance Committee (for information)

SUMMARY

The present document is based on consultations between the Office and the Board of Auditors and presents a draft decision based on the outlines of the terms of reference for an EPO Audit Committee (cf. CA/32/09) as a subsidiary body of the Administrative Council pursuant to Article 14 of the Rules of Procedure of the Administrative Council of the European Patent Organisation. The document contains explanatory remarks in Part I and a draft decision in Part II. This draft decision is submitted to the Budget and Finance Committee for opinion and to the Administrative Council for decision.

This document replaces CA/33/09 dated 24.04.2009. It contains amendments requested and unanimously agreed by the Budget and Finance Committee, in accordance with the conclusions of its 96th Meeting (Munich 12 and 13 May 2009). The amendments are indicated by grey hatching.

TABLE OF CONTENTS

Subject	Page
PART I	1
I. STRATEGIC / OPERATIONAL	1
II. RECOMMENDATION	1
III. MAJORITY NEEDED	1
IV. CONTEXT	1
V. ARGUMENTS	2
A. GENERAL REMARKS	2
B. COMMENTS ON INDIVIDUAL PROVISIONS	2
VI. ALTERNATIVES	4
VII. FINANCIAL IMPLICATIONS	4
VIII. LEGAL BASIS	4
IX. DOCUMENTS CITED	4
PART II	5
ANNEX 1	11

PART I

I. **STRATEGIC / OPERATIONAL**

1. Strategic.

II. **RECOMMENDATION**

2. To adopt the draft decision contained in Part II.

III. **MAJORITY NEEDED**

3. Simple.

IV. **CONTEXT**

4. The present document follows on from CA/140/08 submitted by the President ("Audit Committee: possible models"), CA/148/08 submitted by the Board of Auditors (Audit Committee: possible models: auditors' comments on CA/140/08) and CA/148/08 Add.1 (Audit committee: possible models - auditors' further comments on CA/140/08).
5. During the discussion within the Budget and Finance Committee in October 2008 the Office was invited to reflect further on the question of an Audit Committee in the light of the BFC's remarks and the Board of Auditors' comments in CA/148/08. Along the same lines, the Council confirmed its position in favour of setting up an Audit Committee and noted the intention of the President and the Board of Auditors to reach a joint solution. In close consultation with the Board of Auditors, CA/32/09 was then presented to the Administrative Council for information during its March 2009 session.
6. In CA/32/09 it was announced that a draft decision setting up an Audit Committee would be presented. The present document is again the result of a close consultation process with the Board of Auditors and takes into account the comments made during the 117th meeting of the Administrative Council.

V. ARGUMENTS

A. GENERAL REMARKS

7. The arguments for setting up an Audit Committee as well as its terms of reference can be found in CA/140/08 and CA/32/09 respectively. The draft decision contained in Part II of this document reflects the contents of these documents, the consultations with the Board of Auditors and the discussions held by the Budget and Finance Committee and the Administrative Council as mentioned in point 5 above.
8. The Committee is a subsidiary body of the Administrative Council established according to its own Rules of Procedure (see Preamble). The Audit Committee advises the Administrative Council, the Budget and Finance Committee and the President in carrying out their overseeing and governance responsibilities in matters relating to risk, internal control and audit process.

B. COMMENTS ON INDIVIDUAL PROVISIONS

9. Article 1 defines, in general terms, the Audit Committee's tasks (cf. CA/32/09, Chapter A,6). The article refers *inter alia* to the notion of "risk management". Risk means here "the possibility that an event will occur and adversely affect the achievement of objectives" (INTERNATIONAL ORGANISATION OF SUPREME AUDIT INSTITUTIONS/INTOSAI). Risk management is consequently "a process to identify, assess, manage and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives" (Institute of Internal Auditors).
10. Article 2 contains the details of the composition of the Audit Committee (cf. CA/32/09, Chapter E). Paragraph 2 foresees the involvement of the President for the appointment of the members since the President is the main addressee.
11. Article 3 contains details as to the meetings to be held (cf. CA/32/09, Chapter F) and specifies who are the attendees. As a subsidiary body of the Administrative Council, the President has the right to attend. Paragraph 11 of Article 3 contains the financial consideration which the Audit Committee members will receive for their work. As a principle, it is proposed that this be aligned with that of the Board of Auditors, for the time being based on grade A6. Nevertheless, an alignment at Vice-President level seems more appropriate in order to ensure a parity of status. Such alignment, which should be extended to the Board of Auditors, would

have a marginal impact of about EUR 50 per day and person. As the fees will be subject to national income tax, the basis proposed is the annual gross salary for grade A7/8 (Germany) divided by the number of days worked per year.

12. Articles 4, 5 and 6 describe the core activity of the Audit Committee, i.e. to give advice within its field of competence. In these articles, which are based on the respective terms of reference contained in CA/32/09 (Chapters B and C), it has been defined to whom advice is given and on what issues. The Audit Committee gives its opinions and proposals to the President, and, if this is deemed necessary by the Audit Committee, to the Administrative Council and to the Budget and Finance Committee. The purpose is to contribute to resolving the governance problems highlighted in CA/140/08 Section III. Through Art. 4 the Audit Committee has direct access to the Administrative Council and to the Budget and Finance Committee, by reporting at least annually and forwarding to them significant opinions or proposals already addressed to the President. In case of urgency, a direct link with the Chairman of the Council is foreseen.
13. Article 5 mentions amongst the responsibilities of the Audit Committee the delivery of opinions on the Office's risk profile and risk policy. Risk profile means in this context "an overview or matrix of the key risks facing an entity or sub-unit that includes the level of impact (e.g. high, medium, low) along with the probability or likelihood of the event occurring" (INTOSAI). The risk profile is the basis for an entity to consider an appropriate response. It is expected that the Audit Committee would give its opinions by assessing significant risks emerging from particular events or decisions and the response thereto, by highlighting deficiencies in the internal control system, and by assessing any system which the EPO may have established to maintain and to promote ethics.
14. Article 6 is devoted to proposals on a number of matters, including "efficiency of audit activities". According to CA/32/09 paragraph 9, this implies inter alia the evaluation of the adequacy of Internal Audit's budget and staffing levels. Under point d, the term "issues" includes recommendations.
15. Article 7 explains to which services the Audit Committee has access to be able to accomplish its duties (cf. CA/32/09, Chapter D,15,16).

VI. ALTERNATIVES

16. No alternative is foreseen, since this was already excluded by the Council at its 115th meeting in October 2008 (CA/129/08, point 12.5).

VII. FINANCIAL IMPLICATIONS

17. The expected financial impact is estimated at EUR 80 000 per year without possible translation and interpreting costs.

VIII. LEGAL BASIS

18. Article 33 paragraph 2(e) EPC in conjunction with Article 14(1) Rules of Procedure of the Administrative Council of the European Patent Organisation.

IX. DOCUMENTS CITED

19. CA/129/08, CA/140/08, CA/148/08, CA/148/08 Add. 1, CA/32/09.

PART II

Draft

DECISION OF THE ADMINISTRATIVE COUNCIL
of [date of decision]
establishing an Audit Committee of the
Administrative Council

THE ADMINISTRATIVE COUNCIL OF THE EUROPEAN PATENT ORGANISATION,

Having regard to the European Patent Convention and in particular Article 33(2)(e) thereof,

Having regard to the Rules of Procedure of the Administrative Council of the European Patent Organisation and in particular Article 14(1) thereof,

Having regard to the opinion of the Budget and Finance Committee,

On a proposal from and in agreement with the President of the European Patent Office,

HAS DECIDED AS FOLLOWS:

Article 1 Purpose

An Audit Committee of the Administrative Council of the European Patent Organisation (hereafter "Audit Committee") is hereby established. The Audit Committee shall, on the basis of reports drawn up by the Board of Auditors and Internal Audit, or on request, advise on

(a) Risk management,

- (b) Efficiency of internal audit and synergy with external audit,
- (c) Follow-up of audit activities,

in accordance with this decision and with due regard to the task and independence of the Board of Auditors.

Article 2 Composition

- (1) The Audit Committee shall be composed of four members who shall serve in their individual capacity. There shall be no alternates or deputy members.
- (2) The Audit Committee members shall be appointed by the Administrative Council, after the President of the Office has been consulted, from a list of candidates nominated by the Contracting States.
- (3) The Audit Committee members shall have proven experience in audit matters and preferably knowledge of the practices followed by international organisations. They shall preferably be selected from among the senior officials of the public internal audit services of the Contracting States.
- (4) Audit Committee members shall, in the exercise of their functions in the Audit Committee, carry out their duties and conduct themselves solely with the interests of the European Patent Organisation in mind. They shall neither seek nor take instructions from any government, authority, organisation or person.
- (5) Current or former members of the Office or the Administrative Council and its bodies and those holding a position at a national patent office (or subordinate body) shall not be appointed as members of the Audit Committee.
- (6) The Audit Committee members shall be appointed for a period of three years, which shall be renewable or extensible only once.
- (7) Audit Committee members may not be employed by the Organisation during the five years following the end of their term of office.

- (8) The members of the Audit Committee shall select a chairperson from among the membership.
- (9) Each member of the Audit Committee shall sign a declaration of independence, the text of which is defined in Annex 1 to this decision.

Article 3 Meetings

- (1) Meetings of the Audit Committee shall be convened by the Chairperson.
- (2) Each member of the Audit Committee shall have a vote. The Chairperson shall have a casting vote.
- (3) The quorum necessary for the validity of meetings shall be three members.
- (4) Decisions shall be taken by simple majority.
- (5) The Audit Committee shall hold meetings at least twice a year.
- (6) The meetings shall be held on Office premises.
- (7) The President of the Office has the right to attend meetings.
- (8) The Board of Auditors may attend meetings as observers.
- (9) The Head of Internal Audit shall attend meetings, unless the Audit Committee decides otherwise.
- (10) The provisions relating to the reimbursement of travel expenses and the payment of a subsistence allowance as defined in the Rules of Procedure of the Administrative Council shall apply.
- (11) In addition, the members of the Audit Committee shall be paid a daily fee calculated on the basis of 1/220th of the annual salary foreseen in the gross salary table for Germany, grade A7, step 8 as indicated in the EPO's Service Regulations. For each meeting, each member shall receive an additional daily fee for preparation purposes.

Article 4
Responsibilities

- (1) Within its area of competence as defined in Article 1, the Audit Committee shall submit opinions and proposals, as defined in Articles 5 and 6, to the President, and if deemed necessary by the Audit Committee, to the Administrative Council, as well as to the Budget and Finance Committee if the latter's responsibilities are affected.
- (2) The Audit Committee shall submit a report on its activities at least annually to the Administrative Council and the Budget and Finance Committee, including an assessment of the Office's approach to risk and mentioning any specific issues which have not been resolved.
- (3) The reports, opinions and proposals of the Audit Committee shall be in writing and shall be delivered as quickly as possible.
- (4) In urgent cases, the Chairperson of the Audit Committee may inform the Chairperson of the Administrative Council.

Article 5
Opinions

- (1) The Audit Committee shall give its opinion on:
 - (a) the Office's risk profile and risk policy;
 - (b) the risks related to particular events or decisions;
 - (c) the impact of major changes in the regulatory framework of the Organisation;
 - (d) the Internal Audit's medium term plan and annual programme, as well as any related change;
 - (e) the Internal Audit Charter issued by the President of the Office, and any intended changes;

- (f) the appointment of the Head of Internal Audit and the transfer or dismissal of the Head of Internal Audit and the staff members employed as internal auditors, as well as any disciplinary measures relating to them, without prejudice to the President's authority under Article 10(2)(f), (g) and (h) EPC.

(2) ~~The Audit Committee is entitled to give its opinion on:~~

- (a) ~~The Audit Committee is entitled to give its opinion on~~ specific Internal Audit reports or recommendations;
- (b) ~~The Audit Committee shall give its opinion on~~ particular issues raised by the Administrative Council, the Budget and Finance Committee, the President of the Office, the Board of Auditors or the Head of Internal Audit.

Article 6 Proposals

The Audit Committee is entitled to submit proposals aimed at improving:

- (a) risk management and the anti-fraud policy of the Office;
- (b) the organisation of internal controls;
- (c) the efficiency of audit activities;
- (d) the Office management's response to issues raised by Internal Audit and/or the Board of Auditors.

Article 7 Authority

Within its area of competence as defined in Article 1, the Audit Committee is entitled to:

- (a) invite any EPO senior employee of grade A6 or A7 to discuss a particular issue, ~~subject to prior authorisation by~~ accompanied by the President of the Office if the latter deems it fit.

- (b) have access to reports drawn up by Internal Audit or the Board of Auditors,
- (c) request any relevant information within its mandate.

This decision shall enter into force on [date of decision].

Done at Munich, [date of decision]

For the Administrative Council
The Chairman

Benoît BATTISTELLI

ANNEX 1

CONFLICTS OF INTEREST

I undertake to act as a member of the Audit Committee solely in the interests of the European Patent Organisation. If, in the case of a specific issue, the state and/or administration and/or organisation from which I originate has a particular interest which is different from that of the European Patent Organisation, I will inform the Chairperson of the Administrative Council and abstain from any participation in the Audit Committee's deliberations on that issue.