

GENERAL MEETING

Annual Activity Report of the EIF Audit Board

For information

	Chapter	Page
	EXECUTIVE SUMMARY	3
1.	INTRODUCTION	5
2.	AUDIT BOARD RESPONSIBILITIES AND ACTIVITY	5
3.	APPOINTMENT TO AND MEMBERSHIP OF THE AUDIT BOARD	5
4.	REVIEW OF AUDIT WORK PERFORMED IN EIF	6
4.1	Audit of the annual financial statements	6
4.2	Internal Audit	7
4.2.1	Internal Audit Reports and Assessment of Internal Audit Work	7
4.2.2	Status Review of Audit Recommendations and Agreed Action Plans	8
4.3	Investigations	8
4.4	Evaluations	8
5.	INTERNAL CONTROL FRAMEWORK AND OTHER ADDITIONAL ASSURANCE	9
6.	COMPLIANCE AND OPERATIONAL RISK	9
7.	EUROPEAN COURT OF AUDITORS	10

EXECUTIVE SUMMARY

MANDATE OF THE AUDIT BOARD

The Audit Board has the statutory responsibility (Article 22 of the Statutes) to annually confirm to the members of the General Meeting that the balance sheet and profit and loss account of the European Investment Fund ("EIF" or the "Fund") give a true and fair view of the financial position of EIF in respect of its assets and liabilities, and of the results of its operations for the financial year under review.

Complementary to this primary responsibility, the Audit Board also has to confirm (Article 18 of the Rules of Procedure) that the operations of the EIF have been carried out in compliance with the formalities and procedures laid down in the Statutes and the Rules of Procedure.

The Audit Board provides these confirmations to the best of its knowledge and judgement.

AUDIT BOARD APPROACH

In order to comply with its mandate the Audit Board relies on the work carried out during the eight meetings held in 2014/2015 (since the AGM in April 2014 to date) and, in particular, on the following sources of assurance:

- KPMG, mandated and appointed by the Audit Board to audit the financial statements of the Fund, has issued an unqualified audit opinion on the EIF financial statements for 2014;
- The internal audit reports issued in 2014 and up to March 2015 including the 2014 Internal Audit Annual Activity report;
- The unqualified management assurance on the adequacy of EIF's internal control systems included as part of the Internal Control Framework document;
- The confirmation received from the European Investment Bank (EIB) that services carried out by it on behalf of the EIF for 2014 have been executed in line with the Treasury Management Agreement and the Service Level Agreement concluded between EIF and EIB.

In relation to its confirmation, that, to the best of its knowledge and judgement, the operations of the EIF are carried out in compliance with the Statutes and Rules of Procedure, the Audit Board also relies on:

- Minutes of the meetings of the Board of Directors and General Meeting;
- The work carried out by the various EIF functions such as Risk & Portfolio Management (RPM), Compliance & Operational Risk (COR), and
- The Compliance opinion in the Compliance Annual Activity Report 2014.

A target of closing at least 60% of Agreed Action Plans (AAPs) contained in internal audit reports issued in the previous two years has been set. The Audit Board notes that actual performance was 85% at 31 December 2014 which met the target of 60% and is well above the previous year's performance of 62%. This confirms the continued priority placed on the closure of AAPs by EIF Management. The Audit Board notes that, out of the 12 AAPs open at year end, none of the outstanding items of the AAPs are of a high risk nature, two of them being overdue. Those two low risk AAPs initially closed in good faith have been reopened at the end of December 2014 and are expected to be closed by the end of June 2015. The Audit Board will continue to monitor performance in this area.

Throughout the year in the course of its work, the Audit Board has reviewed the accounting judgements made by Management and the audit approach adopted by KPMG so as to satisfy itself that these are

appropriate. During the course of the 2014 audit work, the Audit Board has received regular business updates from EIF Management which provided valuable insight into the EIF business environment.

The Audit Board has evaluated its performance in 2014 and, as in preceding years, can confirm that all responsibilities outlined in the Audit Board Charter have been carried out. The Audit Board continues to strive to improve its own effectiveness and to increase the level of oversight it exercises. It derives its assurance from the work that it carries out throughout the year. It has developed a framework for use on an annual basis which is intended to bring increased rigour to its assessment of whether operations of the EIF have been carried out in compliance with the formalities and procedures laid down in the Statutes and Rules of Procedure.

AUDIT BOARD CONCLUSIONS FOR 2014

The Audit Board confirms, on the basis of the audit work carried out, the unqualified audit opinion given by KPMG, the assurance statement provided by EIF Management and the reporting received from the EIF control functions, that to the best of its knowledge and judgement:

- the operations of the Fund have been carried out in compliance with the formalities and procedures laid down in the Statutes and the Rules of Procedure and,
- the financial statements of EIF, which comprise the statement of financial position as at December 31, 2014, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information,

give a true and fair view of the financial position of the Fund as regards its assets and liabilities, and of the results of its operations for the financial year under review.

The Audit Board would like to highlight the following areas for focus in 2015:

- Given the expected increase in business volumes arising following the capital increase and the Investment Plan for Europe, that the necessary staff and control structures are in place to deal with this appropriately;
- Implementation and monitoring of the tail-end funds plan;
- Progress in the implementation of AAPs.

REPORT

1 INTRODUCTION

This is the eleventh Annual Activity Report of the Audit Board of the European Investment Fund (EIF). The report has been prepared for use by the shareholders' Annual General Meeting and provides an overview of the Audit Board activities during the period since the last Annual General Meeting. The Audit Board has also provided its opinion on the EIF financial statements for the financial year 2014 in a separate statement contained in the EIF Annual Report.

2 AUDIT BOARD RESPONSIBILITIES AND ACTIVITY

Pursuant to Article 22 of the EIF Statutes, the Audit Board audits the accounts of the EIF. In line with the EIF Statutes and amended EIF Rules of Procedure (modified in this respect in February 2009) it is the task of the Audit Board to verify that EIF operations have been carried out in compliance with the Statutes and Rules of Procedure and to annually confirm to the best of its knowledge and judgement that the balance sheet and profit and loss account give a true and fair view of the financial position of the EIF as regard its assets and liabilities, and of the results of its operations for the financial year under review (Rules of Procedure, Articles 17 and 18). To discharge these tasks the Audit Board may have recourse to external auditors, which it designates after consultation with the Chief Executive and the Board of Directors (Rules of Procedure, Article 19). It also relies on the work of Internal Audit, Risk and Portfolio Management (RPM) and the Compliance and Operational Risk (COR) function.

3 APPOINTMENT TO AND MEMBERSHIP OF THE AUDIT BOARD

Pursuant to Article 20 of the Rules of Procedure of the EIF, the General Meeting approved the appointment of Ms Bettina Jakobsen, as a member of the Audit Board on 14 April 2014. Ms Jakobsen has been nominated to the Audit Board by the EIB, and is currently also a serving member of the EIB Audit Committee. This dual EIB and EIF Audit Board membership provides a useful link between both boards. Ms Jakobsen's appointment is for a three year term of office ending on the day of the 2017 Annual General Meeting.

On 30 January 2015, the General Meeting approved by written procedure the appointment of Mr Charles Borg, nominated by the Financial Institutions. Mr Borg succeeds Mr Branimir Berkovic for his remaining term of office, ending on the day of the 2016 Annual General Meeting, following Mr Berkovic's resignation at the end of 2014. The Audit Board appreciates that in this instance the vacancy was dealt with promptly, but recognises the validity of the arrangement made in 2014 to provide for an alternate member who was able to fill automatically the vacancy until the General Meeting appointed a replacement.

With a view to ensuring that its work can be conducted smoothly also in situations where one of the seats of the Audit Board becomes unexpectedly vacant, the General Meeting approved by written procedure in June 2014 the framework for the appointment of an alternate Audit Board member, to be nominated by rotation between the EIB, the EC and the Financial Institutions shareholders. Mr Gerry Smyth was the first

alternate member appointed following EIB's proposal and was able to act as chairman, following Mr Berkovic's resignation, until the General Meeting appointed a replacement.

This new procedure was included in the Audit Board Charter and approved by the General Meeting. The Audit Board took also the opportunity to update its 2006 Charter which has been submitted to this General Meeting for approval having been reviewed by the Board of Directors at its meeting on 11th March 2015. Other main amendments concerned: the duties of an annual review by the Audit Board of the EIF internal control and risk management; the reception by the Audit Board of assurances from the Management, the Internal and External auditors and the alignment of the Audit Board mission with the Statutes and the Rules of procedures.

4 REVIEW OF AUDIT WORK PERFORMED IN EIF

In December 2014 the EIF Board of Directors approved an increase in the decision-making authority which it delegates to the Chief Executive. As a result, EIF is now in a position to have certain new transactions, and certain amendments to existing transactions, validated by executive management, under a delegation which revokes authority previously granted by the Board in January 2003 and June 2007.

The communication of information between the Audit Board and the Board was enhanced through the creation of a Board Portal which enables the Audit Board members and alternate to receive directly Board-related documents, to send comments to the Board and to consult the archive related to past Board meetings.

4.1 Audit of the Annual Financial Statements

Under the mandate of the Audit Board, KPMG have audited the financial statements of the EIF, which comprise the statement of financial position as at 31 December 2014, the statement of comprehensive income, statement of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

The mandate given by the Audit Board to KPMG is to express an opinion on the financial statements based on their audit. KPMG believe that the audit evidence they have obtained is sufficient and appropriate to provide a basis for their audit opinion. In their opinion, the financial statements give a true and fair view of the financial position of EIF as of 31 December 2014, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

During the course of the year the Audit Board has held regular meetings with KPMG. During these meetings the Audit Board was updated with regard to the audit approach, the audit progress and developments. The Audit Board has used these sessions with KPMG to review their work and to satisfy themselves that the audit approach was acceptable. In addition, private sessions have also been held with the Audit Partner. The Audit Board has been assured by KPMG that the audit process went as planned with the full support of EIF staff. The Audit Board is satisfied with the quality of external audit work performed and has used the results of this work to formulate its own opinion.

The Audit Board notes that for 2014 co-operation has taken place between KPMG and EIF Internal Audit in an appropriate manner.

KPMG has confirmed to the Audit Board its independence and that KPMG did not provide non-audit services to the EIF.

4.2 Internal Audit

Internal Audit in EIF is outsourced to the EIB Inspectorate General. Internal Audit covers the significant activities and specific tasks undertaken by the EIF on a risk-based three year cycle. In November 2014, the Audit Board approved the Internal Audit rolling work programme for the period 2015–2017.

4.2.1 Internal Audit Reports and Assessment of Internal Audit Work

The Internal Audit Annual Activity Report was made available in February 2015. This includes an opinion on controls in place (included also in the Internal Control Framework) which has been taken into consideration in preparing the present report. The Audit Board has also noted the declaration of independence contained in the report which is provided on an annual basis by the Head of Internal Audit as required under the International Professional Practices Framework (issued by the Institute of Internal Auditors, Standard 1110 - "Organizational Independence").

In total six audit assignments were completed by Internal Audit in 2014 and up to 9 March 2015 with six reports being finalised, received and discussed with the Audit Board up to March 2015 (one assignment was on-going at 31 December 2014 with the report being issued in February 2015). In addition, progress reports have been provided on on-going assignments during Audit Board meetings throughout the year. The Audit Board is satisfied with the quality of audit work performed and the reporting received. The need to maintain an appropriate level of EIF internal audit work has been addressed through a dialogue between EIF Management and the Inspector General resulting in an extension of the Internal Audit resource allocation from 1.5 to 2.5 person-year.

In line with the International Standards for the Professional Practice of Internal Auditing (the Standards), in 2012 an external Quality Assessment Review (QAR) was carried out on the Internal Audit function. The Audit Board was reassured to have external validation that the function operates professionally with similar working practices to functions at comparable organisations and that the function "Generally Conforms" to all the IIA Standards. One recommendation resulting from the review was the completion of a yearly internal Quality Review. In 2014, for the second consecutive year, an internal Quality Assurance Review (QAR) was conducted by a Senior Internal Auditor. The overall conclusion is that the Internal Audit function operates professionally and "Generally Conforms" to the selected IIA Standards falling within the scope of the 2014 QAR. Minor areas of improvement were identified in relation to the enhancement of internal audit working processes and tools.

The work carried out by Internal Audit on the EIF Internal Control Framework is covered in section 5 of the report.

4.2.2 Status Review of Audit Recommendations and Agreed Action Plans

Recommendations from internal auditors and from KPMG which have been accepted by Management are recorded as agreed action plans (AAPs), with target dates that are fixed in consultation with EIF Management. The matters giving rise to the AAPs are graded as high, medium or low risk. The follow up and monitoring of control issues and their corrective actions is a fundamental part of the audit cycle.

On the basis of quarterly Internal Audit updates, the Audit Board reviews the status of audit recommendations. A target implementation performance of at least 60% has been set, as a ratio between

the number of AAPs open at the quarter-end and the total AAPs issued during the last two years. From the review as at 31 December 2014 the Audit Board notes the EIF implementation performance of AAPs of 85% which surpassed the target of 60% and was up on the previous year's performance of 62%. This confirms the continued priority placed on the closure of AAPs by EIF Management. The Audit Board notes that two low-risk audit points were re-opened at the end of December 2014. These AAPs relate to the need for EIF to formalise data classification and retention policies. The relevant documents had been prepared in 2013 but had not been finalised. Actions are underway to close these AAPs by the end of June 2015.

The two high risks AAPs raised in the Equity post-signature events audit issued in December 2013 were closed in 2014. Both AAPs related to the need to establish an exit management strategy for "tail-end funds" (TEF). This led to the creation, as from 1st January 2015, of a dedicated Division within the Middle, Information and Back Office (MIBO) department dedicated to the management of the portfolio of TEF.

There are no outstanding High Risk action plans as at 31 December 2014. The 12 remaining open AAPs are graded as medium or low risk which includes the two low risk AAPs re-opened in December 2014 with action under way to close them by June 2015.

In the view of Internal Audit, based on the year-end situation, the overall residual risk to the EIF from outstanding AAPs is medium.

4.3 Investigations

The Inspector General and the Head of Investigations report regularly to the Audit Board on the status of investigations on cases of alleged fraud, misappropriations etc. with an assessment of the reputational risks for the EIF. In February, September and December 2014, the Head of Investigations presented to the Audit Board the 2013 Annual Report of Investigations and the quarterly Investigations reports.

In the context of fraud prevention within the EIB Group, EIF Compliance advised that the EIF anti-fraud policy was in line with the EIF whistle-blowing policy and also with the EIB anti-fraud policy, while respecting the specific business requirements of the EIF.

4.4 Evaluations

In December 2013, the Evaluation Division (which is under the responsibility of the Inspector General) launched a study entitled "Leveraging and disseminating the knowledge from the evaluations of four EIB Group/EC Joint Initiatives". This study aimed to consolidate into one document the good practices that have been observed within the four joint EIB Group/EC initiatives that have been subject to an evaluation i.e. JASPERS, JEREMIE, Loan Guarantee Instrument for Trans-European Transport Network (LGTT) and Risk Sharing Finance Facility (RSFF). The study was issued in April 2014 and outlined several good practices for the Group mainly on the improvement of internal procedures and enhancement of synergies between the EIB and the EIF.

In January 2014, an evaluation on the EIB Group Contribution to European Knowledge Economy was launched. This evaluation will assess the contribution of the EIB Group to the strengthening of the European knowledge-based economy over the period 2007-2013 with suggested recommendations to optimise it. This evaluation is expected to be completed in early 2015.

In September 2014, the Evaluation department started a stocktaking exercise to review the development and performance of EIF microfinance activities. The main objectives are to learn from past experience, to

capitalise on knowledge gathered in existing evaluation reports and to highlight areas for improvement. This exercise should be finalized in June 2015.

5 INTERNAL CONTROL FRAMEWORK AND OTHER ADDITIONAL ASSURANCE

The Internal Control Framework (ICF) exercise reflects the results of the Management risk assessment exercise which results in the preparation of a risk control matrix. The principal objectives of the risk control matrix included in the ICF are to identify the key operational risks relating to the business activities undertaken by EIF and to identify and review, at a macro level, the internal control processes implemented to ensure that risks are mitigated and/or minimised to an acceptable level. The preparation of the risk control matrix has been integrated in the EIF operational risk management framework under the coordination of the Compliance and Operational Risk division (COR).

In line with established practice, the Audit Board has sought and received assurance from the Chief Executive by way of a representation letter that the ICF mitigates operational risks in all significant activities and that the ICF has been updated according to changes in business activities and as new application systems are implemented. The Audit Board has also been assured in this letter from the Chief Executive that the controls designed to achieve these objectives are in place and are operating effectively. On 11 February 2015, Internal Audit has provided an opinion on the internal control system. Based on their work carried out in 2014 the opinion concludes that the controls outlined in the ICF were achieved except for the matters raised as AAPs.

There is a Service Level Agreement (SLA) and a Treasury Management Agreement between the EIB and the EIF governing the provision of certain services by the EIB to the Fund. In their respective annual assurance letters the EIB confirmed to the EIF that the defined services had been carried out on the behalf of the EIF appropriately. With the objective to support the annual management assurance these letters also support the EIF Management representation letter to the Audit Board.

The Audit Board took note of work in progress between the EIF and EIB risk functions to develop a Group Risk Management Charter which will be presented to the EIF BoD in 2015.

In 2014, the Audit Board performed an assessment of the effectiveness of EIF internal control and risk management as well as its systems for monitoring compliance with relevant laws and regulations and the measures taken by Management as a result of its investigation of material incidents of non-compliance as outlined in the Audit Board Charter. The assessment process refers to the guidance outlined by the Financial Reporting Council Guidance on Risk Management, Internal Control and the Going Concern Basis of Accounting.

6 COMPLIANCE AND OPERATIONAL RISK (COR)

The Audit Board has reviewed the comprehensive 2014 annual report issued by Compliance and Operational Risk (COR). The Audit Board took note of the activities carried out by the division in 2014. The Audit Board welcomed the increase of the average attendance rate at awareness training courses following the installation of the new EIF management. The Audit Board noted the annual private meeting held between COR and the Board of Directors. It also noted the increase in the number of meetings held between the Head of COR and the EIB Group Chief Compliance Officer (GCCO) in 2014 for the

purpose of exchanging views on the assessment of transactional compliance risk within the respective institutions.

The Audit Board recognises the development in the area of risk management in recent years and will continue to follow the further development of the risk and control assessment process and the Compliance and Operational Risk function in 2015, particularly in the light of EIF business development and the expected increase in business volumes.

In 2014, the Audit Board scheduled an intermediary session with the Head of Compliance and Operational Risk (COR) to provide an interim update in advance of the annual reporting on the function. The Audit Boards plans in 2015 to increase further its activity updates with COR.

The Audit Board noted the COR contribution to the internal consultation process leading to an assessment of new products and mandates at the Product and Mandate Committee through the issuance of compliance and operational risk opinions in relation to new products and mandates. The Audit Board welcomes the strengthening in 2015 of the ex-ante operational risk assessment for new business initiatives with a coordinated and integrated process involving all relevant business units.

The Audit Board welcomes the testing by COR of a data mining system to allow an automatic verification of compliance risk indicators, in particular, individual or corporate names against external data bases to identify compliance risk. Following this testing phase, COR will launch a public tender for a compliance system.

The Audit Board notes that following internal re-organisation, the Enterprise Risk Committee was replaced by quarterly reporting on operational risks, monthly reporting on treasury management and monthly reporting on on-going audits and related agreed action plans.

In 2015, developments in international taxation may require a review of the EIF Policy on Offshore Financial Centres and Governance Transparency.

The Audit Board will follow in 2015 the continued increase in EIF transactional volumes and complexity and any potential impact this could have on compliance risk concerns. The Audit Board in the light of EIF business developments in recent years would encourage the continuous effort by EIF Management to reflect on its governance and organization structures in line with best practices.

In 2014 and to date no incidents of non-compliance have been communicated to the Audit Board. As confirmed in the Compliance Activity report 2014, EIF COR has not identified substantial risks of integrity, reputation or otherwise compliance related nature.

7 EUROPEAN COURT OF AUDITORS

The EIF, the European Court of Auditors (ECA) and European Commission are parties to the Tripartite Agreement governing the procedures for providing the Court of Auditors with the documents and information relating to its audit of the value of the European Community's subscription to the capital of the EIF. The Audit Board has not carried out any audit in co-operation with the ECA under the Tripartite Agreement in 2014.

Building on the foundation of their previous meetings, the Audit Board expects to hold a meeting with the ECA in 2015, in order to exchange and to share information regarding the work being carried out by the ECA and EIF Audit Board.