

# GENERAL MEETING

## Annual Activity Report of the EIF Audit Board for the 2010 financial year

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# EXECUTIVE SUMMARY

## MANDATE OF THE AUDIT BOARD

The Audit Board has the statutory responsibility to provide a reasonable assurance<sup>1</sup> to the Members of the General Meeting that the balance sheet and the profit and loss account of the European Investment Fund (EIF) give a true and fair view of the financial position of the Fund.

## AUDIT BOARD APPROACH

The Audit Board opinion relies on the work carried out during the nine meetings held in 2010/2011 and in particular the assurance statements received from the following:

- The external auditor appointed by the Audit Board: KPMG has issued an unqualified opinion on the EIF financial statements for 2010;
- The internal audit reports issued in 2010: the internal auditor didn't report any outstanding critical issue;
- 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 them on behalf of the EIF have been executed in line with the Treasury Management Agreement and the Service Level Agreement concluded between EIF and EIB.

Complementary to this primary responsibility, the Audit Board must also give assurances that the operations of the EIF are carried out in compliance with the Statutes and Rules of Procedure. To this end it relies on the management assurance statement on the adequacy of the internal control system, the work carried out by the various EIF functions such as Internal Audit (outsourced to EIB Internal Audit), Risk Management & Monitoring (RMM) and Compliance & Operational Risk (COR) and the assurance received from the External Auditor.

## AUDIT BOARD CONCLUSIONS FOR 2010

**On the basis of the audit work carried out, the unqualified opinion given by the External Auditor, the assurance statement provided by EIF Management and the reporting received from the EIF control functions the Audit Board has issued a positive statement on the financial accounts of the EIF for 2010.**

The Audit Board acknowledges the following improvements in procedures and processes:

- Improvement in the risk management culture in the EIF, demonstrated by the development by the COR function of the EIF Risk and Control Assessment in 2010, which is a significant step forward;
- The implementation performance of EIF Agreed Action Plans (AAPs) standing at 91% at 31 December 2010 which confirms the continued priority placed on the closure of AAPs by EIF Management;

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<sup>1</sup> "Reasonable assurance" is the level of confidence that the financial statements are not materially misstated that an auditor, exercising professional skill and care, is expected to attain from an audit. The Audit Board reviewed and adopted the materiality level defined by KPMG.

- The timely issue of the KPMG Management Letter. The Audit Board appreciates the efforts of the external auditor and EIF staff so that this was achieved;
- The confirmation received from the European Investment Bank (EIB) that services carried out by them on behalf of the EIF have been executed in line with the Treasury Management Agreement and the Service Level Agreement concluded between EIF and EIB;
- In 2010, the Audit Board is happy to note that new mandates and products are fully incorporated into the EIF Risk and Control framework under the guidance of the Mandate Management and Product Development Steering Committee and governed by the relevant procedures put in place;
- The Audit Board wishes to acknowledge the proactive support of the Deputy Chief Executive in driving forward the above improvements in procedures and processes;
- The steps taken by EIF Management to enhance and complement the EIF Rules of Procedure with regard in particular to tacit approvals and the treatment of abstentions in the business approval process;
- In 2010, at the request of the Audit Board, the planning methodology that defines the content of the Internal Audit work programme was redesigned to align the audit risk matrix/audit cycle with the EIF processes/business lines;
- The Audit Board as requested in 2010 welcomes the receipt of an opinion from Internal Audit on the internal control system of EIF based on the work performed during the year. This is a very important step forward which can be developed in the future.

While acknowledging the improvements in the EIF control environment in 2010, the Audit Board would like to highlight the below areas which it will follow in 2011:

- In 2010 the preparation of the Risk Control Matrix was integrated in the EIF operational risk management framework under the coordination of the COR function. The Audit Board as stated earlier acknowledges the progress in the development of this process and the Internal Control Framework document, and will follow its further development in 2011 so that it continues to be an effective and useful management tool;
- The further integration of Management and Internal Audit risk assessments;
- Given the high volume of audit activity in the EIF, the Audit Board emphasises that sufficient staff resources are allocated to the departments implicated;
- The Audit Board welcomes the demonstrated priority in the past years placed by EIF Management on the closure of AAPs, and encourages that resources continue to be allocated to allow the continuation of this in 2011;
- The outstanding issues<sup>2</sup> highlighted by the external auditor (KPMG) will be summarised in a management letter to be addressed to EIF. These issues will have to be included in the AAPs and corrective actions must be taken in 2011;
- The implementation of complemented and enhanced Rules of Procedure in the day to day work of EIF;
- The planned development in 2011 by the Head of Compliance of a more conclusive Compliance Annual Activity report providing facts or clear evidence and assurance as to the implementation and acceptance of compliance rules.

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<sup>2</sup> The issues referred to in KPMG's management letter are not affecting the unqualified audit opinion on the financial statements 2010.

# FULL REPORT

## 1 INTRODUCTION

This is the seventh 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 a summary 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 2010 in a separate statement.

## 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 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 certify 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 (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 Management & Monitoring (RMM) and the Compliance and Operational Risk (COR) function.

Consequently the Audit Board must: designate the external auditors; review the external auditors' proposed audit scope and approach; review the performance of the external auditors; ensure co-ordination of their audit efforts with internal audit; review the independence and effectiveness of the internal audit function; obtain reports on significant findings and recommendations from both audit functions together with Management's responses and ensure that the follow-up process for the implementation of all audit recommendations is adequate.

## 3 APPOINTMENT TO AND MEMBERSHIP OF THE AUDIT BOARD

Pursuant to Article 20 of the Rules of Procedure of the EIF, the General meeting at their Annual Meeting held in May 2010 approved the nomination by the Financial Institutions of Mr Helmut Stermann for the standard three year mandate. The mandate for Mr Stermann replaced the mandate held previously by Ms Gabriela Pantring which had concluded on the same day. The Audit Board Members are satisfied with the commitment and availability of current members.

## 4 REVIEW OF AUDIT WORK PERFORMED IN EIF

### 4.1 External Audit

KPMG have audited the financial statements of the EIF, which comprise the statement of financial position as at 31 December 2010, and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

It is the responsibility of KPMG to express an opinion on the financial statements based on their audit. They 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 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

After the assignment of KPMG in 2009, the Audit Board took the opportunity to emphasise the importance it places on their relationship and co-operation with Internal Audit in order to maximise audit coverage and efficiency. The Audit Board acknowledges that this co-operation has taken place in 2010 in an appropriate manner and encourages that this relationship and co-operation continues to be built upon in 2011.

KPMG has confirmed to the Audit Board that as the auditor of the EIF statutory financial statements, KPMG was not involved in non-audit services with the EIF.

### 4.2 Internal Audit

Internal Audit in EIF is outsourced to the EIB Inspectorate General.

#### 4.2.1 Audit Programme

Internal Audit covers the significant activities and specific tasks undertaken by the EIF on a risk-based three to five year cycle. In 2010, at the request of the Audit Board, the planning methodology that defines the content of the Internal Audit work programme was redesigned to align the audit risk matrix/audit cycle with the EIF processes/business lines. In November 2010, the Audit Board approved the Internal Audit rolling work programme for the period 2011–2013, based on this redesigned methodology.

As stated in the external audit section above, the Audit Board encourages that the relationship and co-operation established between external and internal audit in 2010 continues in 2011.

#### 4.2.2 Internal Audit Reports

The Internal Audit Annual Activity Report became available at the end of February 2011 and 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 will be provided on an annual basis by the Head of Internal Audit. This statement is a

requirement under the International Professional Practises Framework issued by the Institute of Internal Audit Standard 1110- "Organisational Independence".

In total five separate audit assignments have been carried out by Internal Audit in 2010 with seven reports being finalised, received and discussed with the Audit Board up to March 2011 (two assignments were on-going at 31 December 2009 with the reports being issued in 2010). In addition progress reports have been provided on ongoing assignments during Audit Board meetings throughout the year. The Audit Board, as requested in 2010, welcomed the opinion received from Internal Audit on the residual risk of the open issues at year end. This is a very important step forward and should be developed in the future.

The Audit Board acknowledges receipt of the assurance provided by Internal Audit on the general structure of the Internal Control Framework and the specific sections corresponding to its work in 2010.

#### 4.2.3 Status Review of Audit Recommendations and Agreed Action Plans

Recommendations from internal and external auditors are incorporated to agreed action plans (AAPs), with target dates that are fixed in consultation with EIF Management. 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 with the application of a grading methodology for each AAP. From the review as at 31 December 2010 the Audit Board for a second year acknowledges that the EIF management and services has continued to make significant efforts to address AAPs, and wishes to acknowledge the achievement of a 91% implementation performance of AAPs. This is a very positive signal that the implementation of AAPs is a priority of EIF management. It is noted that, there are:

- 10 open recommendations from internal audit reports as at 31 December 2010, none of which are high risk rated;
- There are no overdue AAPs as at 31 December 2010;
- No high risk rated items were introduced.

During 2011 the progress being made with the implementation of all audit recommendations within appropriately agreed dates will continue to be followed on an on-going basis.

#### 4.2.4 Assessment of Internal Audit Work

In 2010 a number of Internal Audits have been performed on operational processes as well as familiarisation audits on new products. The Audit Board is satisfied with the quality of audit work performed and the reporting received. From their audit work carried out in 2010 there were no significant control issues raised by Internal Audit. We refer here to the previous section which notes that in 2010 no new high risk rated items were introduced. The Audit Board acknowledges the efforts being made by EIF Management to address the issues raised in the AAPs in a timely manner and to work on overdue issues. At year end 2010 there were no overdue items. The implementation of AAPs in 2010 was a priority

for the EIF Management and staff (proactively driven by Internal Audit) and remains a priority moving forward.

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

#### 4.3 Investigations

The Inspector General reports 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 this regard the Audit Board noted in its previous reports that allegations made by staff members have been forwarded to the appropriate authorities in line with the rules and procedures in place. The Audit Board awaits the full results of this procedure, which will be considered when available.

#### 4.4 Evaluations

The evaluation related to the JEREMIE initiative was launched in 2010 according to plan. It assesses EIF's role in and contribution to JEREMIE's Evaluation Phase. The scope of the analysis comprises both the *Gap Analysis* studies and their outcomes, and the different complementary activities carried out by the EIF during JEREMIE's Evaluation Phase. The evaluation comprises: desk preparation, field work and the analysis and synthesis of findings from the previous stages. The final report is expected to be presented to the EIF Board of Directors in June 2011. No other EIF evaluation is programmed for 2011.

### 5 INTERNAL CONTROL FRAMEWORK AND OTHER ADDITIONAL ASSURANCE

Since the year ended 31 December 2009 the Internal Control Framework (ICF) exercise is effectively a management risk assessment exercise with the ownership and responsibility for undertaking the exercise resting with EIF Management. The role of the Internal Audit is restricted to a review of the document based on the results of the audit assignments conducted during the year. In 2010 the preparation of the Risk Control Matrix was integrated in the EIF operational risk management framework under the coordination of the Compliance and Operational Risk function (COR). The ICF for year-end 2010, together with its letters of representation and assurance, has been issued at the end of February 2011. The principal objectives of the Risk Control Matrix included in the ICF are to identify the key 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.

In line with established practice the Audit Board has sought and received assurance from the Chief Executive (representation letter) that the ICF mitigates against 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 that the controls designed to achieve these objectives are in place and are operating effectively. In 2010, as requested by the Audit Board, Internal Audit has provided an opinion on the internal control system. Based on their work carried out in 2010 the opinion states that the controls outlined in the ICF were achieved except for the matters raised as AAPs. The Audit Board warmly welcomes this improvement and expects



that through additional coverage of the audit universe in the coming years, Internal audit will provide EIF management with an overall opinion on the internal control system.

The updated Service Level Agreement (SLA) between the EIB and the EIF was signed in December 2009 and more clearly outlines and reflects services performed. As proposed by the Audit Board in their activity report for 2009, the Audit Board is satisfied to note that annual assurance letters have been introduced with respects to the SLA and Treasury Management Agreement between the EIF and the EIB. In these letters the EIB confirmed to the EIF that the defined service had been carried out appropriately. With the objective to support the annual management assurance these letters also support the EIF Management representation letter to the Audit Board.

## 6 COMPLIANCE

The Audit Board has reviewed the fifth annual report issued by the Compliance function. It welcomes the confirmation of the day-to-day implementation of the compliance procedural framework. This had been developed over the previous reporting period with the implementation of all of the AAPs of the 2008 Internal Audit report on the Compliance function in the EIF.

The Audit Board notes the activities carried out by the function in 2010. The Audit Board welcomes the co-operation and regular contact between the EIF Head of the Compliance function and the EIB Group Chief Compliance Officer (GCCO) in 2010.

As mentioned in section 5 in 2010 the preparation of the Risk Control Matrix was integrated in the EIF operational risk management framework under the coordination of the Compliance and Operational Risk function. The Audit Board will continue to follow the development of this risk and control assessment process and the Compliance and Operational Risk function in 2010.

The Audit Board welcomes the planned development in 2011 by the Head of Compliance of a more conclusive Compliance Annual Activity report providing facts or clear evidence and assurance as to the implementation and acceptance of compliance rules. In addition a detailed list of training carried out during the reported period with the number of staff members reached should be annexed to the report.

In 2010 and to date no incidents of non-compliance have been communicated to the Audit Board.

An additional activity for the Head of the COR function is that of Data Protection Officer (DPO) for EIF. This follows the 2007 decision to separate the responsibilities for data protection issues respectively between EIB and EIF. EIF management approved the implementing rules of the EU Regulation 45/2001 on 3 December 2010. The implementing rules detail the appointment, the position and the tasks of the EIF DPO as well as the rights of data subjects and procedural matters. The implementing rules were communicated to the European Data Protection Supervisor (EDPS) and published on the EIF website. With effect as of 8 July 2010, EIB and EIF entered into a memorandum of understanding on the mutual replacement of the respective DPOs in case of absence. On 12 October 2010, EIF transmitted the transactional data base in EIF to the EDPS for prior checking. This corresponds to the data processing which had been indicated to the EDPS for authorised "ex-post prior checking" procedures, which allow the ex-post notification of existing data processing which would have been subject to prior checking.

The DPO has advised that a separate report on data protection matters will be received for the reporting period ending 31 December 2010.

In 2011 the Audit Board will continue to monitor actions taken regarding data protection.

## 7 EUROPEAN COURT OF AUDITORS

The Audit Board has not carried out any audit in co-operation with the European Court of Auditors (ECA) under the Tripartite Agreement in 2010. The Audit Board at the end of 2010 was informed that the ECA had carried out two audit assignments during the year on financial programmes managed by EIF for the Commission: the SME Guarantee Facility and a performance audit on European Regional Development Fund (ERDF) and access to finance for SME, with JEREMIE being the focus for EIF. The Audit Board looks forward to an update with regard to the results of this audit work when available. The Audit Board is not aware as yet of the ECA planning with regard to the Private Equity programme although it is expected planning meetings could take place in 2011.

The Audit Board foresees in its work plan a meeting in 2011 with the ECA to achieve a better understanding of their audit efforts with regard to EIF.

## 8 PROCEDURES WITHIN EIF

The Audit Board has placed emphasis on procedural questions during the reporting period ended 31 December 2010. The Audit Board explicitly welcomes the inclusion of the enhancement and complement of the Rules of Procedures to the Follow-up programme of the Board of Directors following the Board of Directors meeting on 14 July 2010. The Audit Board further appreciates the subsequent steps taken by management of EIF to make proposals for a review of the Rules of Procedure of EIF by the General Assembly.

The Audit Board will follow in 2011 the implementation of complemented and enhanced Rules of Procedure in the day to day work of EIF.

The Audit Board has noted the increasing number of business proposals and other documents put forward by management to the Board of Directors for decision or for information purposes. In close collaboration with the Board of Directors the Audit Board will monitor the development in the workload of the Board of Directors in order to maintain the quality of the decision making process. The Audit Board would be in favour of an increase in their cooperation with the Board of Directors.

## 9 ISSUES TO BE FOLLOWED IN THE FUTURE BY THE AUDIT BOARD

In addition to monitoring the progress of issues raised in the main body of the report and highlighted in the Executive Summary, the Audit Board will also in the coming year:

- Monitor the evolution and changes in the international accounting and professional standards, as well as industry practise and agreement that could arise;
- Monitor and have regular discussions with EIF and external auditors regarding fair value, impairments and EIF assumptions underlying critical accounting estimates;
- Be proactive in focussing the Audit Board meeting agendas on key issues;
- Continue to search for opportunities to improve the Audit Board's own effectiveness given the increased expectation for good governance and effective oversight as we move forward to face the challenges of 2011 and beyond.

## 10 CONCLUSION

In conclusion, on the basis of the audit work carried out and the unqualified opinion given by the External Auditor, the assurance statement provided by EIF Management and the reporting received from the EIF control functions the Audit Board has issued a positive statement on the financial accounts of the EIF for 2010.