

GENERAL MEETING

Annual Activity Report of the EIF Audit Board
for the 2011 financial year

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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 members of the Audit Board need to be reasonably assured¹ that the financial statements of the European Investment Fund (EIF) give a true and fair view of the financial position of EIF as regards its assets and liabilities, and of the results of its operations for the financial year under review. The Audit Board opinion relies on the work carried out during the nine meetings held in 2011/2012 and in particular the assurance statements received from the following:

- KPMG, mandated and appointed by the Audit Board to audit the financial statements of the Fund, has issued an unqualified opinion on the EIF financial statements for 2011;
- The internal audit reports issued in 2011 and up to March 2012: the internal auditor did not 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.

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 relies primarily on:

- Minutes of the meetings of the Board of Directors and General Meeting;
- 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), Compliance & Operational Risk (COR);
- The Compliance opinion in the Compliance Annual Activity Report 2011 and
- The assurance received from KPMG.

¹ '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.

In the context of the Audit Board's consideration of the Board of Directors minutes, the members have noted the restructuring of the Board of Directors meeting agendas to manage the increasing number of business proposals and other documents put forward by Management for their decision or for information.

Throughout the year in the course of their work, the Audit Board has discussed and challenged the accounting judgements made by Management and the audit approach adopted by KPMG.

AUDIT BOARD CONCLUSIONS FOR 2011

On the basis of the audit work carried out, the unqualified opinion given by KPMG, the assurance statement provided by EIF Management and the reporting received from the EIF control functions the Audit Board is reasonably assured that the financial statements of the European Investment Fund (EIF) 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 and therefore issues a positive statement on the financial accounts of the EIF for 2011. On the basis of the work carried out and assurances received and disclosed above, the Audit Board confirms to the best of its knowledge and judgement that the operations of the EIF are carried out in compliance with the Statutes and Rules of Procedure.

In the context of the 2011 audit work carried out, the Audit Board has followed closely, has received updates from EIF Management and has discussed the developments in the sovereign debt situation and its impact on the financial statements of EIF.

The Audit Board acknowledges the implementation performance of EIF Agreed Action Plans (AAPs) standing at 88% at 31 December 2011 which confirms the continued priority placed on the closure of AAPs by EIF Management. The Audit Board notes that none of the outstanding items of the AAPs are of a high risk nature or are overdue.

The Audit Board would like to highlight the following areas for focus in 2012:

- The outstanding issues² highlighted by KPMG have been reported in a management letter addressed to EIF. These issues will be included in the AAPs and corrective actions must be taken in 2012;
- A review of the disclosures (wording as well as extent of disclosures) in the financial statements so that the "readability" of the financial statements is enhanced for third parties;
- The establishment of a fraud awareness training programme for EIF staff;
- The Audit Board will continue to follow the further development of the risk and control assessment process;
- The Audit Board will aim at an interim update by the Head of Compliance and Operational Risk (COR) in advance of the annual reporting on the function.

² The issues referred to in KPMG's management letter do not affect the unqualified audit opinion on the financial statements 2011.

FULL REPORT

1 INTRODUCTION

This is the eighth 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 2011 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 Management & Monitoring (RMM) and the Compliance and Operational Risk (COR) function.

Consequently the Audit Board may designate an external auditor; it must: 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 2011 approved the nomination by the European Investment Bank of Mr Gerard Smyth for the standard three year mandate. The mandate for Mr Smyth replaced the mandate held previously by Mr O. Klapper which had concluded on the same day. The Audit Board members are satisfied with the commitment and availability of current members and draw attention to the significant time investment by members to carry out their mandate.

4 REVIEW OF AUDIT WORK PERFORMED IN EIF

Throughout the year in the course of their work, the Audit Board has challenged and discussed the approach and judgements provided by EIF Management and KPMG.

4.1 External Audit

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 2011, 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.

The mandate given by the Audit Board to KPMG is 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 2011, 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.

During the course of the year the Audit Board has held regular meeting sessions with KPMG. During these meetings the Audit Board was updated with regard to their audit approach, the audit progress and developments. The members have used these sessions with KPMG to review their work and to challenge them with regard to their approach and findings. KPMG advised that there were no unadjusted differences to report to the Audit Board. 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.

In the context of the 2011 audit work carried out, the Audit Board has followed closely the developments in the sovereign debt crisis and has received updates on this subject from KPMG and EIF Management.

During 2012, the Audit Board will work with KPMG to further enhance their reporting to the Audit Board.

The Audit Board notes that for 2011 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 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. Internal Audit covers the significant activities and specific tasks undertaken by the EIF on a risk-based three year cycle. In November 2011, the Audit Board approved the Internal Audit rolling work programme for the period 2012–2014. As stated in the external audit section above, the Audit Board notes the communication and co-operation between Internal Audit and KPMG in 2011.

4.2.1 Internal Audit Reports and Assessment of Internal Audit Work

The Internal Audit Annual Activity Report became available at the end of February 2012 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 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 four new audit assignments have been carried out by Internal Audit in 2011 with six reports being finalised, received and discussed with the Audit Board up to March 2012 (two assignments were on-going at 31 December 2010 with the reports being issued in 2011). 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 Inspector General and the Head of Internal Audit have confirmed to the Audit Board that the present allocation of audit efforts is sufficient to maintain an effective level of Internal Audit work at EIF; they have agreed to advise the Audit Board members should additional staff resources be required to carry out their work.

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 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 2011 the Audit Board notes the EIF achievement of an 88% implementation performance of AAPs. It is noted that, there are no overdue AAPs or high risk rated plans outstanding.

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 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 report on the Evaluation launched in 2010 related to the JEREMIE initiative, was presented to the EIF Board of Directors in summer 2011. There were no new EIF evaluations programmed for 2011.

5 INTERNAL CONTROL FRAMEWORK AND OTHER ADDITIONAL ASSURANCE

The Internal Control Framework (ICF) exercise reflects the results of the Management risk assessment exercise. 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 2011, together with its letters of representation and assurance, has been issued at the end of February 2012. 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 2011 Internal Audit has provided an opinion on the internal control system. Based on their work carried out in 2011 the opinion states that the controls outlined in the ICF were achieved except for the matters raised as AAPs.

The updated Service Level Agreement (SLA) between the EIB and the EIF was signed in December 2009 and more precisely outlines and reflects services performed. In their respective annual assurance letters the EIB confirmed to the EIF that the defined services 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 sixth annual report issued by the Compliance function.

The Audit Board took note of the activities carried out by the function in 2011 and the integration for the first time of Compliance awareness events in the overall training programme developed by EIF Human Resources. The Audit Board noted the continued co-operation and regular contact between the EIF Head of the Compliance function and the EIB Group Chief Compliance Officer (GCCO) in 2011.

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 recognises the development in this area in 2011 and will continue to follow the further development of this risk and control assessment process and the Compliance and Operational Risk function in 2012. In 2012, the Audit Board will schedule an intermediary session with the Head of Compliance and Operational Risk (COR) to provide an interim Compliance specific update in advance of the annual reporting on the function.

In 2011 and to date no incidents of non-compliance have been communicated to the Audit Board. As confirmed in the Compliance Activity report 2011, "overall, and on the basis of its on-going assessment, EIF COR has not identified any compliance risk of a systemic nature or which would otherwise substantially affect the reputation of EIF".

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 2011. The Audit Board in 2011 received an update from EIF services with regard to the results of the audit of the SME Guarantee Facility. The Audit Board has been advised that the performance audit on European Regional Development Fund (ERDF) and access to finance for SMEs, with JEREMIE being the focus for EIF should be issued at the end March 2012. The Audit Board is not aware as yet of audit work planned in 2012 by the ECA.

The Audit Board held a meeting in 2011 with the ECA which helped to achieve a better understanding of their respective mandates and audit efforts with regard to EIF. It was agreed that these useful meetings for the exchange and sharing of information regarding the work being carried out by the ECA and EIF Audit Board would continue on a regular basis in the future.

8 OTHER 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 auditing standards and industry practice;
- Monitor and have regular discussions with EIF and KPMG regarding fair value, impairments and EIF assumptions underlying critical accounting estimates;
- 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 2012 and beyond.

9 CONCLUSION

In conclusion, on the basis of the audit work carried out and the information received, including the unqualified opinion given by KPMG, the assurance statement provided by EIF Management and the reporting received from the EIF control functions the Audit Board concludes to the best of its knowledge and judgement that the EIF financial statements 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, and confirms 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.