

ESM Confidential

Board of Auditors’ Annual Report to the Board of Governors

Board of Auditors

European Stability Mechanism

1. Introduction

The Board of Auditors of the European Stability Mechanism (the "ESM") is established pursuant to Article 30 of the Treaty establishing the ESM (the "Treaty") and Article 24 of the ESM By-Laws ("By-Laws"). The members of the Board of Auditors are appointed by the Board of Governors, on the basis of Article 30 (1) of the Treaty and Article 24 (1) of the By-Laws.

The Board of Auditors is an independent body. It inspects the ESM accounts and verifies that the operational accounts and the balance sheet are in order. Furthermore, it monitors as well as reviews the ESM's internal and external audit processes and

their results. In addition, it carries out independent audits in relation to the regularity, compliance, performance, and risk management of the ESM.

This report is addressed to the Board of Governors in accordance with Article 30 (4) of the Treaty and Article 24 (6) of the By-Laws and provides details on the audit work of the Board of Auditors, its work in relation to the financial statements of the ESM and its conclusions. This report will be made available also to the national parliaments and supreme audit institutions of the ESM Members, the European Court of Auditors and the European Parliament.

2. Activities of the Board of Auditors

2.1. Meetings of the Board of Auditors

The Board of Auditors met on seven occasions in 2019, during which it held regular discussions with the ESM Management in relation to institutional developments and oversight issues. From 1 January 2020 to the date of the issuance of this report, the Board of Auditors continued its work and has held a further seven meetings.

During these meetings the Board of Auditors was provided with regular updates on the activities of the ESM and the ESM governing bodies, received presentations by the ESM management on specific topics requested by the Board of Auditors and, met regularly with the internal and external auditors. It also held its own discussions in connection with the Board of Auditors' core mandate to:

- review the integrity and adequacy of the financial statements and the related control frameworks,
- perform selective efficiency and effectiveness audits in relation to the regularity, compliance, performance and risk management of the ESM in accordance with international auditing standards, and
- monitor and review the ESM's internal and external audit processes and their results.

In addition, the Chairperson of the Board of Auditors met with the Board of Directors on 3 June 2019. Subsequently, the Chairperson of the Board of Auditors attended the annual meeting of the Board of Governors and met with the Chairperson of the Board of Governors to give briefings on the work and conclusions of the Board of Auditors.

In preparation of the Board of Auditors' report in respect of the ESM 2019 Financial Statements, the Board of Auditors also exchanged views with the Chairperson of the Board Risk Committee on 13 March 2020. Furthermore, the Chairperson of the Board of Auditors is foreseen to meet with the Board of Directors, Board of Governors as well as the Chairperson of the Board of Governors during the course of June 2020 to discuss the conclusions of this report.

2.2. Main activities

In line with its mandate, the Board of Auditors performed the following activities:

ESM Financial Statements

The Board of Auditors reviewed the ESM Financial Statements for the period ended 31 December 2019 as drawn up by the Board of Directors on 30 March 2020.

The ESM Financial Statements were prepared and presented in accordance with the Directive 86/635/EEC of the Council of the European Communities of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions, as amended by Directive 2001/65/EC of 27 September 2001, by Directive 2003/51/EC of 18 June 2003 and by Directive 2006/46/EC of 14 June 2006.

In this context, the Board of Auditors discussed the process of the preparation of the ESM 2019 Financial Statements, as well as its observations in relation to accounting treatments, methodologies and disclosures. In addition, the Board of Auditors exchanged on these matters with the Chairperson of the Board Risk Committee on 13 March 2020. Subsequently, the Board of Auditors issued its report in respect of the ESM 2019 Financial Statements, which is included in the ESM 2019 Annual Report. Based on the work undertaken and the information obtained, including the unqualified audit opinion of the external auditors the Board of

Auditors concluded that to the best of its judgment, no material matters have come to its attention that would prevent it from recommending that the Board of Governors approve the ESM financial statements for the year ended 31 December 2019 as part of the ESM 2019 Annual Report.

The Board of Auditors takes particular note of the events after the reporting period. The ESM received on 11 February 2020, EUR 131.7 million from the Federal Republic of Germany, following a political commitment to compensate the ESM for negative interest paid on the cash balances held with its national central bank during 2019. This amount is expected to be recorded as extraordinary income in 2020. In addition, the Board of Auditors also took note of the reference to the coronavirus global pandemic and the uncertainties at the time of the drawing up of the ESM 2019 Financial Statements, in relation to its duration, magnitude and speed of subsequent recovery. The Board of Auditors discussed the need and content of such disclosures with the ESM Management.

External auditors

The Board of Auditors monitored and reviewed the external audit processes performed by Ernst & Young Société anonyme. This included a review of their risk assessments, audit working papers and documentation with the assistance of three subject matter experts from the European Court of Auditors and an external subject matter expert. Furthermore, the Board of Auditors reviewed the report addressed to the Board of Auditors issued by the external auditor in compliance with EU Regulation 537/2014 and describing the audit process, scope and its results.

The statutory audit was conducted in accordance with the requirements of Regulation No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities, the Luxembourg Law of 23 July 2016 concerning the audit profession, and the International Standards on Auditing as adopted for Luxembourg by the Commission de Surveillance du Secteur Financier.

Internal audit

The Board Auditors met regularly with the internal audit function in closed sessions to monitor internal audit processes and their results. The internal audit function is an independent assurance function designed to add value and improve the operations of the ESM. It assists the ESM in fulfilling its mandate by bringing a systematic and disciplined approach to evaluating and improving the effectiveness and procedural efficiency of the ESM's risk management, control and governance processes. As part of its responsibilities, it also evaluates the adequacy, effectiveness and timeliness of actions taken by management on findings and recommendations issued by the internal audit function, as well as the external auditors and the Board of Auditors. The internal audit function reports directly to the ESM Managing Director and is under the oversight of the Board of Auditors.

The Board of Auditors examined and discussed the reports issued by the internal auditor, as well as the status of implementation of the related agreed actions by the ESM. In addition, the Board of Auditors also discussed the internal audit plan for 2020, following its approval by the ESM Managing Director. The Board of Auditors notes that the timely implementation of audit recommendations is a feature of an effective control environment. The dedication of appropriate resources to ensure the timely implementation of audit recommendations should therefore remain a priority for the ESM.

Evaluation

The Board of Auditors met on two occasions with the ESM High-Level Independent Evaluator to discuss

the progress of the ongoing evaluation exercise in relation to the financial assistance granted to Greece. Furthermore, the Board of Auditors was informed about the preliminary conclusions of the evaluation report.

Covid-19 impact

In light of the unfolding Covid-19 pandemic, the Board of Auditors held several meetings with the ESM Managing Director, the Secretary General and senior staff in order to obtain updates on the evolving situation, its implications on the institution and its future. The focus of these exchanges was both the operational response of the institution, as well as the wider ESM role in the context of the comprehensive European economic policy response to the Covid-19 pandemic. The Board of Auditors is appreciative of the information provided so far and will continue to monitor the developments in this regard.

Exchanges with the ESM Management

The Board of Auditors met with the ESM Managing Director, members of the Management Board and senior staff, to discuss and review relevant issues and developments. Particular focus was placed on the areas of risk inherent to the operations of the ESM. Furthermore, the Board of Auditors received at its request, various written representations from the ESM Management concerning issues of oversight.

2.3. Ongoing audits of the Board of Auditors

The Board of Auditors began its audit of the ESM internal committee structure with the support of subject matter experts from the Maltese National Audit Office. The main objective of the audit is to establish whether the governance arrangements linked to the ESM internal committees facilitate the fulfilment of their tasks. The audit approach

focuses on benchmarking the ESM committee structure against existing governance best practice standards. A scoping exercise within the context of the audit fieldwork was conducted in January 2020. The audit will be finalised during the second half of 2020.

In addition, the Board of Auditors has begun with its preparations of an audit on ESM recruitment procedures. The audit will be performed with the assistance of subject matter experts of the European Court of Auditors.

In Closing

In the period under review, the ESM was in its seventh year of full operation.

The Board of Auditors considers that during the year it adopted a balanced work plan in terms of focus, objectives and means utilised to obtain the necessary assurance required for the discharge of its mandate. The Board of Auditors also confirms that it received the expected full support from the ESM Management.

The Board of Auditors will continue to monitor the implementation of its audit recommendations and those of the internal audit division.

Luxembourg, 11 June 2020

Appendix - composition of the Board of Auditors

According to Article 30 (1) of the Treaty, the Board of Auditors is to have five members, appointed by the Board of Governors. In line with Article 30 (1) of the Treaty and Article 24 (1) of the By-Laws two members are appointed upon proposal of the Chairperson of the Board of Governors, two members upon nomination by the supreme audit institutions of the ESM Members based on a rotation system and one upon nomination by the European Court of Auditors. The members of the Board of Auditors are as follows:

- Ms Irena Petruškevičienė, appointed upon proposal of the Chairperson of the Board of Governors (from 8 October 2018). Ms Petruškevičienė has been serving as Vice-Chairperson of the Board of Auditors since 9 December 2019.
- Mr Noel Camilleri, appointed upon nomination by the Supreme Audit Institution of Malta (from 8 October 2018).
- Mr Tommaso Fabi, appointed upon proposal of the Chairperson of the Board of Governors (from 1 April 2019), replacing Mr Günter Borgel whose non-renewable term had come to an end.
- Mr Ilias Dimitriadis appointed upon nomination by the Supreme Audit Institution of Greece (from 8 October 2019), replacing Mr François-Roger Cazala whose non-renewable term had come to an end.
- Mr Baudilio Tomé Muguruza, nominated by the European Court of Auditors (from 17 December 2019), replacing Mr Kevin Cardiff whose non-renewable term had come to an end. Mr Tomé Muguruza has been serving as Chairperson of the Board of Auditors since 22 January 2020.

