

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 that inspects the ESM accounts and verifies that the operational accounts and the balance sheet are in order. Furthermore, it monitors and 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 held nine meetings in 2023. From 1 January 2024 to the date of issuance of this report, the Board of Auditors continued its work and has held a further five meetings.

During its meetings, the Board of Auditors was informed about institutional developments and arising issues through regular discussions with ESM management, as part of its oversight role. Furthermore, the ESM Secretary General provided the Board of Auditors with regular updates on the ESM and its governing bodies' activities. The Board of Auditors requested presentations by ESM management and senior staff on specific topics and met regularly with the internal and external auditors to fulfil its mandate. 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 the context of its mandate, the Board of Auditors also exchanged views with the Chairperson of the Board Risk Committee on 6 March 2024. The Board of Auditors also presented its report in respect of the ESM 2023 Financial Statements, to the Board of Directors on 26 March 2024. Furthermore, the

Chairperson of the Board of Auditors met with the Board of Directors on 13 June 2024 and attended the annual meeting of the Board of Governors 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 2023 as drawn-up by the Board of Directors on 26 March 2024.

The Board of Auditors followed the process of the preparation of the ESM 2023 Financial Statements and provided the ESM with its observations in relation to accounting treatments, methodologies, and disclosures. In addition, the Board of Auditors exchanged views on these matters with the Chairperson of the Board Risk Committee on 6 March 2024 and on a regular basis with the external auditor.

In this context, the Board of Auditors acknowledged the shifts in the interest rate environment, which consequently led to a net profit outcome for the year 2023, as opposed to the net losses recorded in 2022. Moreover, considering the inflation and price increases in 2023, the Board of Auditors is reviewing the potential re-evaluation of the financing strategy for the new ESM building project. Additionally, the Board of Auditors sought further clarification on the cost of funding mechanisms and discussed potential consequences should the amended ESM Treaty not come into effect. Finally, the Board of Auditors took note of Croatia's accession to the ESM and the corresponding contributions to the ESM's paid-in capital.

Subsequently, the Board of Auditors issued its report in respect of the ESM 2023 Financial Statements, which is included in the ESM 2023 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 judgement, 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 2023 as part of the *ESM 2023 Annual Report*.

External auditor

In December 2022, the ESM Board of Governors approved KPMG as the ESM's external auditor for the financial years 2023 to 2025, in line with Article 29 of the Treaty and Article 22 (1) of the By-Laws.

In 2023, the Board of Auditors monitored and reviewed the external audit processes performed by KPMG in line with Article 24 (4) of the By-Laws. This included a review of the annual audit plan setting out the audit methodology and approach, as well as the monitoring of its implementation through regular meetings and discussions with the external auditors. Being KPMG's first year as the ESM's external auditor, the Board of Auditors monitored the transition process from the former external auditor, Ernst & Young, *Société Anonyme*, in order to contribute to a smooth handover. The Board of Auditors also performed a review of the external audit working papers. The review was conducted at KPMG premises over two full days, on 20 and 21 February 2024. In this context, the Board of Auditors discussed with KPMG the audit procedures applied for the most material lines of the balance sheet and profit and loss accounts. The Board of Auditors reviewed and challenged the evidence provided, the controls in place, as well as the results of the applied audit procedures. Based on presentations and discussions, the Board of Auditors identified additional matters that merited further investigation. Furthermore, the Board of Auditors reviewed the report prepared and issued by the external auditor which is addressed to the Board of Auditors in compliance with EU Regulation 537/2014 of the European Parliament and of the Council of 16 April 2014 describing the audit process, scope, and its results.

Internal audit

The Board of 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, the external auditor, 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 audit function, as well as the status of implementation of the related agreed actions by the ESM. In addition, the Board of Auditors also endorsed the internal audit plan for 2024, following its approval by the ESM Managing Director.

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. A particular focus was placed on the areas of risk inherent to the ESM operations. Furthermore, at its request, the Board of Auditors received various written presentations from ESM management concerning issues of oversight. During the course of the past year, this included

presentations in relation to ESM funding activities, liquidity buffers, risk management, the compliance function, the accounting framework and the new ESM building project.

In addition, the Board of Auditors received a presentation by the European Court of Auditors (ECA) on the ECA's special report on the EU's financial landscape that was issued on 1 March 2023. The relevant ESM functions also attended the presentation.

Last year, the Board of Auditors recommended a review of the ESM accounting manual and policies, taking into account the ESM's needs and best practices. During the year, the Board of Auditors followed up on this recommendation and was assured that the review will be finalised in the first half of 2024.

Furthermore, the Board of Auditors had intensive exchanges on the progress of the internal audits that continued in 2023 in relation to the ESM's new building project and had discussions with the external service provider supporting the audit, as well as with the ESM's relevant functions. In this context, the Board of Auditors expressed its concerns about the timeline, the potential cost overruns, and the project governance related to the new building project, which were confirmed by a relevant internal audit report.

Finally, the Board of Auditors was regularly informed about the progress of the ratification of the amended ESM Treaty and noted that as of the date of this report the amended ESM Treaty had not yet come into effect. In this context, the Board of Auditors requested further clarity on possible implications stemming from the preliminary work that had already been executed in preparation of the enhanced ESM mandate.

2.3. Ongoing audits of the Board of Auditors

In addition to the annual statutory audit by the independent external auditor and the audits performed by the internal audit function, the Board of Auditors may carry out audit procedures in accordance with Article 30 (3) of the Treaty and Article 24 (4) of the By-Laws.

In this context, in November 2023 the Board of Auditors concluded its audit on the ESM's procurement procedures and contracts with third parties, which was conducted with the support of subject matter experts from the Audit Office of the Republic of Cyprus.

The main objectives of the audit were to:

- Assess the legal framework applied in contracts signed with third parties;
- Review relevant public procurement policies, to identify any significant changes since the last benchmarking exercise carried out in 2017;
- Examine the implementation stage of the recommendations of the previous Board of Auditors' reports related to procurement procedures and contracts with third parties; and
- Identify possible gaps or weaknesses and make recommendations for further improvement.

Overall, the Board of Auditors concluded that, the ESM has in place satisfactory procurement procedures. However, there is room for improvement to enhance transparency, accountability, and value for money. More specifically the audit found that:

- The ESM's initiative to discuss contract terms with leading candidates shows an effort to improve procurement procedures outcomes, but there is a need for a clearer description

of such negotiation procedures in the relevant documentation to ensure transparency and the alignment of the procurement process with policy objectives for achieving the best value for money solution;

- The ESM should consider strengthening its procurement procedures, especially with regards to the areas of contract value estimations and negotiations with candidates. In addition, there should be a clearer link between contract value estimations and specific budget allocations; and
- In the case of significant contracts, the procedures to assess the need to either procure a new contract or renew the existing should be initiated in a timelier fashion, so that considering an alternative would be a realistic option for the ESM.

Recommendations included in the audit report were agreed with ESM management. The Board of Auditors notes that ESM management confirmed its commitment to implement the issued recommendations.

Furthermore, in October 2023, the Board of Auditors launched an audit on the ESM's investment strategy, with the support of subject matter experts from the German Federal Court of Auditors. This audit is focused on:

- The decision-making processes concerning the ESM's investment strategy;
- The objectives of the decision to rebalance the portfolio since 2022 and their subsequent review and evaluation; and
- The implementation of the rebalancing decision and the restructuring of the portfolio, done by the executing divisions.

The audit is expected to be finalised within the third quarter of 2024.

3. In Closing

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 ESM management.

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

Luxembourg, 20 June 2024

Appendix - composition of the Board of Auditors

According to Article 30 (1) of the Treaty, the Board of Auditors shall have five members, appointed by the Board of Governors for a non-renewable term of three years. 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 Helga Berger, nominated by the European Court of Auditors (from 17 December 2022). Ms Berger has been serving as Chairperson of the Board of Auditors since 17 January 2023;
- Mr Jochen Wenz, appointed upon proposal of the Chairperson of the Board of Governors (from 8 October 2021). Mr Wenz has been serving as Vice-Chairperson of the Board of Auditors since 20 October 2023;
- Mr Akis Kikas, appointed upon nomination by the Audit Office of the Republic of Cyprus (from 8 October 2021). Mr Kikas has been serving as Vice-Chairperson of the Board of Auditors from 20 October 2022 to 19 October 2023;
- Ms Lucia Kašiarová, appointed upon proposal of the Chairperson of the Board of Governors (from 25 April 2022); and
- Mr Giovanni Coppola, appointed upon nomination by the Italian Court of Auditors (from 8 October 2022).

