

European Stability Mechanism



ESM management comments on the Board of Auditors' Annual Report to the Board of Governors

Dear Chairperson,

Thank you for the Board of Auditors' report to the Board of Governors for the year 2019. It is very reassuring that, despite the unexpected onset of the Covid-19 pandemic and related lockdown measures, all ESM assurance and reporting processes for 2019, including your report on the 2019 ESM financial statements and your annual report to the Board of Governors, were completed as foreseen in the ESM Treaty and By-Laws.

The independent oversight provided by the Board of Auditors and your annual report are essential elements of the ESM governance and accountability framework. The ESM management welcomes your report, its observations, and conclusions.

I would like to use this opportunity to provide you with the ESM management comments on the report as well as with an overview of the key elements of ESM's audit oversight in 2019.

Independent oversight by the Board of Auditors

In 2019, the Board of Governors appointed three new members of the Board of Auditors for non-renewable terms of three years, replacing former members of the Board of Auditors whose terms had expired. The new members were nominated in line with Article 30 (1) of the ESM Treaty and Article 24 (1) of the By-Laws, as follows: Mr Tommaso Fabi, appointed as of 1 April 2019, upon the proposal of the Chairperson of the Board of Governors; Mr Ilias Dimitriadis, appointed as of 8 October 2019, upon nomination by the Supreme Audit Institution of Greece, and Mr Baudilio Tomé Muguruza, appointed as of 17 December 2019, upon nomination by the European Court of Auditors. The new Board of Auditors' members were provided with dedicated introductory sessions offering a broad overview of the key elements of ESM governance, its legal framework, as well as its funding, investment, and financial assistance activities.

As in prior years, the ESM management met regularly with the Board of Auditors, which held seven meetings at the ESM premises in 2019. During these meetings, ESM management and senior staff updated the Board of Auditors on ESM activities, the meetings and decisions of the ESM governing

bodies, and other relevant policy issues and developments. Representatives of the compliance, finance and control, risk management, and internal audit functions informed the Board of Auditors of their work and sought its feedback.

From the beginning of 2020 until the date of the Board of Auditors' annual report, another seven meetings took place - two at the ESM premises and the remainder by teleconference. Since March 2020, the ESM Secretary General has regularly informed the Board of Auditors about the ESM organisational measures implemented for mitigating the Covid-19 health risks to staff while ensuring the continued delivery of the ESM's mandate. The Board of Auditors also had a number of exchanges with ESM management regarding the developments and preparations in relation to the ESM's pandemic crisis support available to ESM Members, based on the Enhanced Conditions Credit Line instrument pursuant to the ESM Treaty.

In line with its mandate, the Board of Auditors discussed with ESM management, staff, and the external auditor the ESM financial statements as at 31 December 2019. As foreseen in the By-Laws, the Board of Auditors also performed a review of the working papers of the external auditor related to the statutory audit of the ESM financial statements. As stated in the Board of Auditors' report in respect of the ESM 2019 financial statements, 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 2019 financial statements. The Board of Auditors' report on the ESM 2019 financial statements, along with the financial statements and the external auditor's audit opinion, are included in the ESM 2019 Annual Report, which will be published on the ESM website following its approval by the Board of Governors on 11 June 2020.

The Board of Auditors also met regularly with the ESM internal audit function in closed sessions. It monitored its work, including among other matters, the annual internal audit plan, the internal audit reports and recommendations, and its quarterly reports on the progress in addressing outstanding audit recommendations.

In addition to the internal audits performed by the ESM internal audit function and the statutory audit of the annual financial statements by the external auditor, the Board of Auditors also periodically carries out audits of the regularity, compliance,

performance, and risk management of ESM. As such, at the beginning of 2020, the Board of Auditors initiated an audit of the ESM internal committees' structure with the support of experts from the Maltese National Audit Office. ESM management and staff have provided a wide range of documents and information and will continue to cooperate fully with the audit team for the effective completion of the audit procedures later in 2020.

Audit procedures by the internal audit function

In 2019, the ESM internal audit function performed nine audits and reported that the 2019 audit plan was completed. The annual audit plans reflect the main audit risks faced by the institution and foresee internal audit review of all areas of activity over time.

As part of each audit, the internal audit function tested the design and operating effectiveness of the internal controls for the activities in scope. In addition, the internal audit function performed an annual review of the ESM entity-level controls and information technology application controls.

The internal audit function had full, unrestricted and confidential access to the Board of Auditors and confirmed that there were no impairments to its independence and objectivity in 2019.

Audit procedures conducted by the independent external auditor

The Board of Governors appointed Ernst & Young Societe anonyme, Luxembourg ("Ernst & Young") as independent external auditor of the ESM on 15 June 2017 for a term of three years, renewable once for an additional three years. On 11 June 2020, the Board of Governors will decide on extending the term of Ernst & Young as external auditor of ESM for an additional period of three years until 15 June 2023, when it would expire and a new external auditor would be appointed.

Ernst & Young carried out the statutory audit of the ESM 2019 financial statements and on 30 March 2020 presented its report to the Board of Directors. In its report, Ernst & Young confirmed that the financial

statements gave a true and fair view of the financial position of the ESM as of 31 December 2019. Furthermore, Ernst & Young confirmed that no matter came to its attention that would require comment in a Management Letter and therefore no such letter was issued to the attention of ESM management in 2019.

The external auditor also confirmed that 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, and in compliance with the relevant ethical requirements regarding its independence. Lastly, the external auditor noted that it was granted unlimited access to documents and ESM staff and had good cooperation by the ESM management. The external auditors' report will be presented to the Board of Governors at its annual meeting on 11 June 2020 and then will be publicly available on the ESM website as part of the *ESM 2019 Annual Report*.

In addition to the statutory audit of the annual financial statements, in 2019 Ernst & Young also performed limited review procedures of the ESM accounts and issued a comfort letter in connection with the ESM issuance of US-dollar denominated bonds.

ESM Internal Control Framework

The extensive audit oversight of the ESM is complemented by a comprehensive system of internal controls, which are embedded in the daily operations of the ESM. The ESM internal controls, comprising entity-level, process-level, and information technology controls, are consistent with the nature, complexity and risks inherent in ESM activities. The internal controls are subject to scrutiny by ESM management and regular independent review by the ESM internal audit function, the external auditor, and the Board of Auditors. In addition, the Board of Directors, directly and through the Board Risk Committee, holds periodic discussions with the ESM management on the status of the internal control framework.

Management comments on the Board of Auditors' annual report

Lastly, I would like to confirm that the ESM management is fully committed to continue actively engaging with and supporting the work of the Board of Auditors, including by facilitating its periodic exchanges with the ESM governing bodies, the High-Level Independent Evaluator, and the audit committees of peer organisations. Furthermore, in 2020, ESM management will continue its efforts to allocate staff resources for the timely completion of the outstanding audit recommendations issued by the Board of Auditors and the internal audit function.

At the same time, it could be expected that the strong focus of ESM on ensuring swift and effective delivery of the ESM response to the Covid-19 economic crisis as well as the challenges related to long-term remote working arrangements, may lead to delays in the implementation of some audit recommendations. In such cases, the ESM management will present and discuss with the Board of Auditors appropriate alternative timelines and action plans for addressing the outstanding items.

In closing

Having regard to the public mandate of the ESM, the ESM management attributes great importance to the independent oversight provided by the Board of Auditors. The Board of Auditors' annual report to the Board of Governors provides important observations and conclusions, which are appreciated and welcomed by ESM management.

We look forward to continuing our constructive engagement with the Board of Auditors in 2020 and beyond for the benefit of the ESM and its Members.

11 June 2020

Klaus Regling
Managing Director