

## **EUROPEAN STABILITY MECHANISM**

### **INTERNAL AUDIT CHARTER**

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#### **Article 1** ***Legal Basis***

1. Pursuant to Article 28 of the Treaty establishing the European Stability Mechanism, an internal audit function shall be established within the European Stability Mechanism (the “ESM”) according to international standards.
2. This Internal Audit Charter (the “Charter”) sets out, in line with international standards, the key objectives and features of the ESM’s internal audit function. This Charter is complemented by the documents referred to in Article 3 below.

#### **Article 2** ***Purpose and Mission***

1. The purpose of ESM’s internal audit is to provide independent, objective assurance and consulting services designed to add value and improve ESM’s operations. The mission of internal audit is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight. It assists the ESM in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness and procedural efficiency of the ESM’s risk management, control and governance processes. All activities, operations and processes of the ESM may be subjected to internal auditing.
2. The internal audit function is an essential component of the three-lines-of-defence governance model at the ESM as described in the High Level Principles of Risk Management established by the Board of Directors during the meeting held on 9 October 2012.

#### **Article 3** ***Standards for the Professional Practice of Internal Auditing***

1. The internal audit function will adhere to the mandatory elements of the Institute of Internal Auditors’ (the “IIA”) International Professional Practices Framework, including the definition of internal auditing, the Core Principles for the Professional Practice of Internal Auditing, the IIA Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing. The Head of Internal Audit will report periodically to the Managing Director and the Board of Auditors on the internal audit’s function conformance to the Code of Ethics and the Standards.
2. In addition, the internal audit function will adhere to the relevant policies and procedures of the ESM, including the ESM Internal Audit Manual established by the Head of Internal Audit.

#### **Article 4** ***Authority***

1. The internal audit function, with strict accountability for confidentiality and safeguarding of records and information, is authorized to have full, free and unrestricted access to any and all of the ESM’s records, physical assets and personnel as pertinent to the implementation of its tasks.
2. All members of staff are required to assist the internal audit function in fulfilling its roles and responsibilities.

3. The internal audit function shall be notified of instructions and decisions of ESM management that may be of relevance to it. The internal audit function shall be notified in due time of any material amendments to the risk management system.
4. The internal audit function has no authority to determine policies, make executive decisions, manage risks or to change staff, systems or methods of work. Its role is to examine, evaluate and make recommendations to the ESM's Management Board and, as relevant, to Heads of division.

#### **Article 5** ***Independence and Objectivity***

1. The Head of Internal Audit reports and is accountable to the Managing Director. The internal audit function shall also have free and unrestricted access to the Board of Auditors without impediment. Beyond regular reporting, the Head of Internal Audit shall have the ability to engage with the Board of Auditors as foreseen in this Charter.
2. In the context of its mandate, the internal audit function shall remain free from interference by any element in the organisation, including with regard to matters of audit selection, scope, procedures, frequency, timing or report content in order to maintain independence and objectivity. If the Head of Internal Audit determines that the independence or objectivity of the internal audit function may be impaired in fact or appearance, the details of such impairment will be disclosed to the Managing Director and the Board of Auditors.
3. The internal audit function shall have no direct operational responsibility or authority over any of the activities audited. Accordingly, the internal audit function will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair the internal audit function's judgment.
4. The internal audit function shall demonstrate the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or processes being examined. The internal audit function shall make a balanced assessment of all relevant circumstances and will not be unduly influenced by its own interests or by others in forming judgments.
5. The Head of Internal Audit shall confirm to the Board of Auditors, at least annually, the independence of the internal audit function.

#### **Article 6** ***Scope of Internal Audit Activities***

1. The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy, procedural efficiency and effectiveness of the ESM's governance, risk management and control processes, and the compliance with the established policies and procedures. For this purpose, the internal audit function examines whether:
  - a. The ESM's resources and assets are properly accounted for and safeguarded;
  - b. Financial, operating, accounting and other data generated within the ESM or by third parties and used for management purposes is accurate and reliable;
  - c. The integrity, reliability, confidentiality and continuous availability of the information systems is secured;
  - d. Risks are properly identified and managed;

- e. The application of risk management procedures and methodologies and the functioning of internal control are effective;
  - f. The ESM's policies, procedures and manuals in relation to the above are adequate and complied with;
  - g. The governance, operations and various functions and activities of the ESM are performed efficiently and effectively; and in consistency with the established goals and objectives.
2. In addition, the internal audit function will:
- a. Report, through the Head of Internal Audit, to the Managing Director and the Management Board as described in article 8.
  - b. Evaluate specific operations at the request of the Managing Director, as appropriate; and,
  - c. Provide recommendations, including consultancy, on matters relating to governance, risk management and control, as raised in its internal audit reports or on an *ad hoc* basis.

### **Article 7** **Resources**

1. The internal audit function shall have adequate resources (e.g. financial, staff, and IT).
2. The quantity and quality of the internal audit staff shall be commensurate, in particular, with the needs of the internal audit function. This will also apply to the use of temporary staff. The internal auditors should have sufficient qualifications and skills to effectively deliver on their mandate and to audit in line with the international standards. Internal auditors collectively should be competent to examine all areas in which the ESM operates.
3. The internal audit staff are expected to possess the expertise and experience needed for their tasks, competencies and responsibilities. Appropriate measures must be taken to ensure that staff are suitably qualified (e.g. through ongoing training). The absence or resignation of staff should not lead to a persistent operational disruption.
4. The internal audit function shall be led by a person with sufficient qualification, integrity and stature. This person is expected to demonstrate appropriate leadership and have the necessary skills to fulfil his/her responsibility for maintaining the function's independence and objectivity.

### **Article 8** **Annual Audit Plan**

1. The internal audit function shall prepare an annual audit plan and shall report semi-annually to the Managing Director and the Board of Auditors. The annual audit plan shall consist of a work schedule for the next calendar year. The plan shall be based on a risk-assessment methodology and will be finalised following consultation with, amongst others, the heads of the relevant divisions, the members of the Management Board, the Managing Director and the Board of Auditors.
2. The annual audit plan shall be approved by the Managing Director and be endorsed by the Board of Auditors. Any subsequent changes to the approved plan shall be submitted to and approved by the Managing Director.
3. Any significant deviations from the approved plan shall be reported to the Board of Auditors.

## **Article 9 Reporting**

1. The internal audit reports, which will take the form of a written report, will be prepared and issued by the internal audit function following the conclusion of each internal audit engagement.
2. A draft of the internal audit report will be submitted to the heads of the relevant divisions and to the respective members of the Management Board for review and comments.
3. The internal audit report will include the response and corrective action taken or to be taken with regards to the specific findings and recommendations as provided by the persons mentioned in paragraph 2 above.
4. The internal audit report will also include significant risk exposures and control issues, including fraud risks, governance issues and other matters needed or requested by the Managing Director.
5. The internal audit report will subsequently be distributed to the Managing Director, the Board of Auditors, the members of the Management Board, the heads of the divisions concerned and the Chief Risk Officer.
6. The internal audit function will be responsible for independent follow-up on the implementation of all significant audit findings and recommendations. A quarterly report on the status of the audit findings will be distributed to the Managing Director and the Board of Auditors.

The Head of Internal Audit will report to the Board of Auditors on the status of the audit findings that have not been rectified by management.

7. The internal audit function shall issue an annual report to the Board of Auditors containing a summary of the work performed during the past year and the activities planned for the coming year.
8. The Head of Internal Audit shall report periodically to the Managing Director and the Board of Auditors regarding: the internal audit's purpose, authority, and responsibility, the status of the internal audit plan, the internal audit's conformance to the IIA Code of Ethics and Standards and any action plans to address any significant conformance issues.
9. The Head of Internal Audit shall report on an ad hoc basis to the Managing Director and the Board of Auditors any significant and urgent risk exposures and control issues, including fraud risk, governance issues, and other matters requiring attention as well as any response to risk that may be unacceptable.

## **Article 10**

### ***Relationship with the Board of Auditors and the independent external auditor***

1. Pursuant to Article 24(4) of the ESM By-Laws, the Board of Auditors shall monitor and review the ESM's internal audit processes and their results.
2. The internal audit function will coordinate its work with the Board of Auditors and the independent external auditor appointed by the Board of Governors in order to avoid duplication of effort and to provide maximum coverage of activities.

**Article 11**  
***Quality Assurance***

The internal audit function will maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity. The programme will include an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the *Standards* and an evaluation of whether internal auditors apply the Code of Ethics. The programme will also assess the efficiency and effectiveness of the internal audit activity and will identify opportunities for improvement. The Head of Internal Audit shall communicate to the Managing Director and the Board of Auditors on the internal audit activity's quality assurance and improvement programme, including the results of any internal assessments and external assessments, which will be conducted at least once every five years.

**Article 12**  
***Conflicts of interests***

1. The internal auditors shall avoid conflicts of interest. Internally recruited internal auditors shall not engage in auditing activities for which they have had previous responsibility before a sufficiently long period has elapsed.
2. Compensation arrangements shall not provide incentives for internal auditors to act contrary to the attributes and objectives of the internal audit function.

**Article 13**  
***Entry into Force and Review***

This Internal Audit Charter will enter into force on the day it is approved by the Managing Director. It will be subject to review as and when it is deemed necessary but not later than five years from the date on which it first enters into force.