AUDIT COMMITTEE

Annual Report to the Board of Governors

for the 2008 financial year
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ANNUAL REPORT TO THE BOARD OF GOVERNORS

For the 2008 financial year

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1. INTRODUCTION

According to the Statute and Rules of Procedure, the EIB’s Audit Committee is responsible for auditing the Bank’s accounts and reports each year to the Board of Governors on the results of its work. In forming an opinion on the financial statements, the Audit Committee reviews the adequacy and effectiveness of the Bank’s risk management systems and internal controls as they affect financial reporting, but also the process for monitoring compliance with relevant standards and procedures, while the detailed audit work is carried out by an external audit firm.

The Audit Committee has issued its Annual Statements on the EIB Group, the Bank, the Investment Facility, the FEMIP Trust Fund and the EU Africa Infrastructure Trust Fund for the financial year 2008, confirming that the financial statements prepared for these entities give a true and fair view of their financial position, on the results of their operations and of their cash flows for the year under review. This report describes the work done by the Committee since the last meeting of the Board of Governors, including the follow-up on prior years’ recommendations, and identifies the key components of the assurance process.

2. ACTIVITIES OF THE AUDIT COMMITTEE

In order to obtain assurances that the operations of the Bank are properly conducted, as stipulated in the Rules of Procedure, the Audit Committee met regularly with management, analysed the documentation received on the Bank activities, including regular management reports, Board documents, internal and external audit reports, summaries of Management Committee and Board minutes and technical papers on relevant issues and discussed the business issues with the Bank’s services, with a particular focus on the global crisis situation. The Audit Committee agenda items are established with the objective of providing it with a good understanding of the Bank activities and enabling it to formulate questions and assess the risk impact of the various developments in the Bank.

2.1 Following the Bank’s developments and new initiatives

The Audit Committee is kept informed of all the new initiatives and strategic developments and considers them from a risk perspective and equally from the point of view of their impact on the financial reporting and from an audit point of view. In connection to new products that the Bank will have to develop to respond to increasing demands for financing, the Committee made a recommendation aimed to ensure that all products that ought to go before the New Products Committee are properly identified and appraised.

The Bank’s reaction to the global crisis. The EIB responded with determination to the credit system crisis and to the deep economic recession incipient in Europe and the other countries of operation. The risk aspects connected with an increased activity and with a rapid reaction to the requests from the EU Member States, as well as with the deterioration in the credit quality of securities in general, were all very well managed by the Bank, as described in more detail in paragraph 2.2 below.

The new Small and Medium Enterprises (SME) strategy. At the last meeting of the Board of Governors the Bank was asked to increase its efforts in support of small and medium enterprises. This was already a priority for the Group, which was well prepared to answer the requests after a pan-European consultation on SME, finalized at the beginning of 2008, which meant to assess whether the product EIB was offering was appropriate for the needs of the beneficiaries. The partnership with the banking sector, which will continue to be the intermediary, was intensified with 3 types of instruments designed to implement the decision: the EIB Loans for SMEs (former Global Loans), where the EIB takes the risk on the intermediary and the intermediary takes the risk on SMEs; the risk sharing schemes and the mezzanine financing – a mandate which was given to EIF. The product diversification will be accompanied by strict but simplified reporting requirements aimed at ensuring that the EIB advantage is transparently passed to the final beneficiaries. The volume of signatures for SMEs in 2008 was EUR 8.5 billion, or 70% more than in 2007 (EUR 5 billion), and exceeded the target by 21%.
The 2008 Corporate Operational Plan (COP) targets. The Audit Committee noted the overachievement of most of the ambitious 2008 targets, such as the overall envelope for SFF/RSFF/LGTT\(^1\) signatures. We requested and obtained assurances that the Bank had the human resources and the competence to manage these products.

The 2009 COP+. The current COP, approved by the Board of Directors in December, aims at a 30% increase in the activity levels maintaining the quality in the Bank’s operations. Priority lending objectives remain Convergence, Knowledge Economy, TENs, Environment, SMEs and Energy. Special lending efforts will be directed towards the EU recovery plan and imply attracting a record volume of funds on the capital markets. The COP identifies specific risks associated with the increased activity in the context of the market turmoil, such as liquidity, operational and financial risks. The Committee notes the measures to support the COP+ contained in a paper issued by a special high-level Task Force. These measures (see also paragraph 2.3 below) cover the need to secure resources and to reinforce the monitoring and mitigation of risks, as well as to streamline processes and increase the focus on priorities.

The Audit Committee highlighted the importance for the Bank’s departments to have the appropriate resources available and will follow the implementation of the respective measures. The Committee is continually analysing the various risk patterns with the responsible Directorates. Thus, the Committee noted the increased difficulty of borrowing and the relatively higher costs already felt by the Bank. In addition, there is a growing mismatch between the lending and borrowing terms. As a result, the Bank could see a growing liquidity/funding gap, unless borrowing maturities are increased or lending maturities will be reduced.

Organizational changes. The Audit Committee is informed about the restructurings in the Bank and in 2008 received presentations on the newly created autonomous departments, in particular the Transactions Management and Restructuring and Human Resources.

External mandates. The Audit Committee is concerned by a case brought by the European Parliament (EP) in front of the Court of Justice against the December 2006 decision of the Council of the European Union in relation to the Community guarantee to the European Investment Bank for operations under the external mandates (for 2007-2013). The EP contests the regularity of the decision, claiming a co-decision procedure should have been followed. Since the Bank is directly concerned, the Audit Committee asked to establish what are the risks and the consequences if a co-decision is not reached and to prepare contingency plans.

Information Technology (IT). The Committee follows the new IT system developments and meets regularly with the Head of IT. In 2008, the Committee made inquiries, \textit{inter alia}, about the Business Continuity Plan and was informed about the move of all production applications to external data centers (to be completed in April 2009). The Audit Committee also monitored the upgrade of the major application for borrowings and treasury operations and received assurances that the year end closing was not affected by the inherent problems associated with such a migration (e.g. manual entries). An update on the progress of implementation of a new application for loans was also provided by Internal Audit.

The Audit Committee believes that adding IT expertise to its current mix of skills would enhance the oversight possibilities and would therefore welcome the nomination of an Audit Committee member or observer with an IT background.

Accountability and transparency initiatives. The Audit Committee noted two major developments in this area. On one hand the Committee was informed about the update of the "EIB Statement of Environmental Principles and Standards", which was subject to a full public consultation and which reaffirms the strong commitment of the EIB to environmental sustainability and social welfare. Secondly, the Audit Committee took note of the whistle blowing policy, which is drawing on existing provisions contained in several documents, and of its own role in the policy as instance of last resort for reporting cases of alleged fraud, corruption, money laundering or financing of terrorism.

\(^1\) SFF stands for Structured Finance Facility; RSFF for Risk Sharing Finance Facility and LGTT for Loan Guarantee for TENs Transport.
2.2 Risk management activities

The business environment has changed dramatically, and it is likely that more changes will follow—in the area of regulation, a less leveraged banking and financial sector, continued volatility of markets, and greater expectations for effective oversight. For the Audit Committee, understanding the Bank’s risk profile - and the ways it is improving the governance processes for risk management and oversight – was and will remain a top priority.

The Audit Committee has intensified, in the wake of the 2008 credit crunch and subsequent economic turbulences, its exchanges with Risk Management, a traditional provider of assurance to the Committee, through specific and more detailed inquiries. The Audit Committee was satisfied with the overall quality of the analysis provided and with the responses obtained during the meetings. Key aspects are presented below:

Anti-crisis measures taken by the Bank. Risk Management played a central role in the actions taken by the Bank to avoid any negative impact of the crisis. Thus, special measures were put in place since September 2008 for monitoring counterparts that were not on the watch list and a special task-force was created to cooperate closely with the Finance and Operations Directorates, as the case required. In 2009 Risk Management will continue to focus attention on the corporate sector.

Basel II compliance. The Audit Committee continues to devote special attention to the Bank’s efforts to voluntarily comply with Basel II, a direction in which progress was achieved, albeit at a lower rate than in the previous year. The Committee's analysis is corroborated by the recommendations made by Internal Audit on the subject which were endorsed by the Committee. Thus the Committee hopes that the internal rating of the EIB counterparts will be completed by year end, and that the documentation of internal rating methodologies will be improved and suggested that a methodical follow-up of the recommendations made by the Luxembourg banking supervisor be undertaken.

The EIB is applying the Basel II advanced method, in spite of the insufficient default experience on its loan portfolio; the Committee has therefore asked whether a more straightforward approach could be to use the loss given defaults provided by the foundation approach (i.e. the conservative regulatory parameters) as a floor. However, the Bank is addressing the issue by studying the loss history of operations under mandate outside EU and by pooling the data with the International Finance Corporation (IFC), which should permit it to obtain more meaningful loss given defaults (and probability of defaults).

The Annual Risk Report. The Audit Committee discusses all the quarterly risk reports with Risk Management, while also receiving the monthly operational risk reports. The Committee analysed, together with Risk Management, the portfolio credit quality, the composition of the watch list and the various concentration measures, noting that there were no breaches in the sector limits.

Banking exposures. The Audit Committee requested an analysis of the top bank exposures and asked questions on the policy regarding the limits by groups of banks and countries and by product and recommended a more frequent review of the limits and of the counterpart's own funds, given the current crisis situation.

Risk Management Policies and Procedures. The internal Policy Guidelines are continuously updated in order to keep pace with the changing risk environment. Thus, the “EU – Credit Risk Policy Guidelines” and the “Financial Risk and ALM Policy Guidelines” were both updated in January 2009. The Audit Committee, as a matter of course, follows these developments.

The Audit Committee will continue to rely on RM, by constructively challenging its reports and by maintaining the positive cooperation achieved so far.
2.3 Follow-up on prior years’ issues

The Audit Committee identified eleven recommendations which were formally included in its two previous annual reports, of which five are closed and for the rest the Management Committee has delegated the follow-up task to Internal Audit. In addition, after each meeting, the Audit Committee records action points, most of which were resolved during the period.

A review of the key recommendations from prior years is given below:

Financial Control (FC) reorganization. The Audit Committee was consulted on the reorganization of the financial control function and the succession plans for the Head of financial control and made suggestions regarding the preservation of the FC independence. At the same time, the Audit Committee gave feedback on the wording of a Financial Control Charter. We are satisfied that the arrangements implemented satisfy the requirements of independence and avoid conflicts of interest.

Banking best practice. In its 2006 Annual Report the Audit Committee has proposed to the Bank services to prepare documentation on the potentially relevant industry standards. While some work was done in this respect, the Committee is revisiting the recommendation in the light of the new responsibilities it might acquire once the new Statute is adopted, upon ratification of the Lisbon Treaty (see below).

Gap risk analysis. In the previous year Annual Report the Audit Committee recommended that the Bank undertake a gap risk analysis to make sure that all possible risks, in particular the risks that do not fall under the Basel II categories, are systematically identified and assessed in terms of their probability and impact. The Committee did not receive a formal report on the implementation of this recommendation. However, the Committee noted that a COP Scenario Task Force was created to investigate the potential impact of the crisis on the Bank. The Task Force issued a paper containing a number of proposals to support the implementation of the COP+. Although not explicitly cross-referenced, the measures proposed address the risks identified in the COP, thus the exercise can be considered an ad-hoc risk/scenario analysis. The benefits of adopting the more systematic approach suggested by the Committee in its last annual report would be a permanent framework for such risk analyses, including possible responses.

Proactive anti-fraud approach. The Committee is pleased to note that the Investigation Unit was reinforced with the creation of new posts and also that fraud red flags training is going to be organized for relevant staff. In the same direction, the Bank is working on a debarment system and is building up a contractors’ data base, which will enable the investigators to use data mining techniques to analyze sector or regional trends. Lastly, a whistle blowing policy was approved and presented to the Committee, which encouraged large dissemination among staff.

Staff morale issues. The Audit Committee noted with satisfaction that the risks identified by the Audit Committee in its 2007 Annual Report with regard to potential staff morale problems were addressed by the Bank and the communication improved. The Committee was pleased to learn that a conciliation procedure initiated last year was successfully completed and a compensation package was agreed, while the Directors General interviewed reported that the staff morale has indeed increased, also due to the new challenges the Bank was facing. The Audit Committee urged the Bank to ensure timely recruitment of additional staff needed for the ambitious 2009-2010 program, as well as the training required for new and potentially more difficult tasks and took note of the additional recruitment approved by the Management Committee for certain Bank services.
3. AUDIT AND ACCOUNTING MATTERS

3.1 Review of Audit Work

In its work, the Audit Committee cooperates with the external and internal auditors, from which it obtains the required level of assurance on the accuracy of financial reporting and on the relevance of internal control mechanisms and the way the controls are implemented. The existence and functioning of an efficient internal control structure is also confirmed by written representation from the Management.

The Audit Committee received continuous and proper support from both audit functions during the period under review, and has been and is working towards harmonising and coordinating the efforts of the two.

The cooperation with the European Court of Auditors (CoA) is regulated by the Tripartite Agreement, which was renewed by mutual accord in July 2007 and was found to be functioning to the satisfaction of the Bank and the CoA in joint meetings. The Audit Committee met with the CoA Member in charge of the audit of banking activities who gave the Committee an overview of planned audit tasks concerning the EIB Group and, at the same time, expressed his satisfaction with the quality of the audit environment offered by the Bank. The Audit Committee confirmed that it took note of the audit findings in as far as the legality and regularity aspects of the audit on banking measures in the Mediterranean area were concerned and did an appropriate follow-up in the Bank.

3.1.1. External auditors

The Audit Committee asked the external auditors to enhance the scope of their audit procedures and sample checks in order to ensure that the effects of the financial crisis are fully covered. The auditors mobilised additional resources, against additional fees, and it was reported that for certain classes of transactions and balance sheet items full audit coverage was achieved.

The Committee had regular meetings with the external auditors and has properly monitored their activity, by requesting oral and written reports, by reviewing the external auditors’ deliverables and making further inquiries and through a formal interview before the sign-off of the accounts.

In addition, the Committee received this year a letter on internal control assessment, specifically requested before the audit started.

In 2008, the points of specific emphasis for external audit, established in agreement with the Audit Committee, were:

- IT Systems Changes planned in 2008, as part of the ISIS program;
- Valuation in the context of Fair Value Option and the financial crisis;
- Monitoring in the context of the crisis;
- Internal Control Framework (ICF) – Follow-up;
- Risk Management organization and guidelines; and
- Compliance with IFRS standards.

The Audit Committee obtained an independence confirmation letter from the external auditor. Also in 2008, the Audit Committee reviewed several potential additional engagements of the external auditor to avoid conflict of interest situations.

In 2008 the Audit Committee conducted a joint tendering procedure for the selection of a new external auditor, together with the EIF Audit Board. KPMG was selected and designated, after consultation with the Management Committee (and the CEO in the EIF respectively), as the new Group external auditor, starting from 2009. KPMG will be engaged independently by the two entities (EIB and EIF), through two separate framework agreements and is asked to provide two independent audit teams. However, significant synergies are expected at Group level in the external audit process.
3.1.2 Internal Audit

The Audit Committee expressed its agreement on the consultation on the Internal Audit work plan, and took note of the planned audit assignments. The Audit Committee will be particularly interested in the audit of new products and mandates.

In 2008, the Audit Committee met regularly with the Inspector General and the Head of Internal Audit.

The Audit Committee noted the progress made in the completion and update of the Internal Control Frameworks (ICF), which are also relied upon by the external auditors. In particular, the Audit Committee took note this year of the ICF for Financial Risk and recommended that the ICF on financial reporting be updated to reflect the new reporting relationships in Financial Control and the provisions of the Financial Control Charter.

3.2 The Financial Statements as at 31 December 2008 and the Annual Statements of the Audit Committee

The Audit Committee has examined the Bank’s consolidated and non-consolidated financial statements, including those of the Investment Facility, the FEMIP Trust Fund and the EU-Africa Infrastructure Trust Fund for 2008.

For 2008 the non-consolidated financial statements have been prepared in accordance with the general principles of the European Directive applicable while the consolidated, the FEMIP Trust Fund and the EU-Africa Infrastructure Trust Fund financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS). The Audit Committee noted that the Bank is up to date with the developments in the accounting world and is maintaining a high level of IFRS expertise among staff. In respect of the financial statements of the Bank and the EIB Group, the audit Committee noted the following matters:

Key elements of the statutory financial statements: The Audit Committee noted that the profit recorded for the financial year is EUR 1 651 million, increasing by 1.1% compared with 2007. The balance sheet total has increased by almost EUR 24 billion, from EUR 301.9 billion at the end of 2007 to EUR 325.8 billion at the end of 2008. EUR 6 billion of the increase in the balance sheet total is due to the increase in the commercial paper program, matched on the assets side by a similar increase in the operational money market portfolio. The remainder EUR 18 billion are attributed to an increase in the loans to final beneficiaries (from EUR 155 to EUR 173 billion), while the loans to financial institutions stagnated. The liabilities correspondent is in debts evidenced by certificates (which increased from EUR 253 to EUR 266 billion), other liabilities and the increase in the SFF reserve (under own funds) of EUR 1.5 billion, approved by the Board of Governors in June 2008.

Impact of IFRS adjustments on the consolidated financial statements. The Audit Committee notes a large net positive IFRS impact of EUR 4.7 billion on the EIB Group Consolidated Income Statement for 2008, which brings the consolidated result to EUR 6 356 million. The increase is largely due to the application of the Fair Value Option (FVO), permitted by IAS 39 “Financial Instruments: Recognition and Measurement”, in relation to borrowings which are hedged by derivatives – mainly interest rate swaps and cross-currency interest rate swaps. The application of the FVO had a negative effect, but for a lower amount, at the previous year end (2007). The Group has elected to use the FVO because not to do so would result in a fundamental accounting mismatch with the hedged borrowings being accounted for at amortised cost and the derivatives at fair value.

Under IFRS, the Group measures borrowings at market prices, which are very sensitive to market situation, while the related swaps are measured using internal valuation models, as they are not traded on a market. The net result of the variation of the value of the borrowings and the hedging items results in an unrealised accounting profit. As it is the intention of the Group to hold all financial instruments involved until maturity, it is expected that this unrealised accounting profit will be completely neutralised once the cash flows of the bonds and the hedging swaps are received. The opposite phenomenon was observed last year reducing the EIB Group profit to EUR 843 million compared to a statutory profit of EUR 1 633 million; it is possible that it will reverse again in future years.

The Audit Committee submits a separate report to the Board of Governors regarding its work in relation to the Investment Facility.
The Committee will continue to monitor the international debate and future developments on the subject of international financial reporting of financial instruments, including the application of fair value.

**FEMIP Trust Fund.** The income statement shows a net loss of EUR 566 thousand (compared to a net profit of EUR 904 thousand in 2007), which is mainly due to an increase in the number of projects financed, while the income remains at a comparable level, being largely generated by the remuneration on the balance of EC / Member States contributions.

**EU-Africa Infrastructure Trust Fund.** The operating profit for the year 2008 was EUR 1265 thousand, while the balance sheet total at 31 December 2008 was EUR 94,779 thousand. The Committee met the Fund’s Secretariat at the Bank and discussed the financial statements, including the operations financed and the level of contributions, and also about the Fund governance aspects.

### 3.3 Issues of focus for 2009

The Audit Committee will follow-up the hand-over to the new external auditor (KPMG), aiming to ensure that full support is available to the new auditor and that the latter understands the Bank’s expectations in terms of deadlines, deliverables and availability. An open relationship based on trust and transparency is essential for a good start in the new audit mandate.

Should the Lisbon Treaty be ratified, then the new Statute of the Bank would take effect, which would reinforce the Audit Committee, while also giving it enhanced responsibilities, namely to verify that the activities of the Bank conform to best banking practice. The EIB Rules of Procedure and the Audit Committee’s own Manual will have to be revised in consequence.

In this respect, the Audit Committee is working on a best banking practice reference document intended to be the starting point for a strategy of obtaining and giving assurance in this area. The main areas of banking best practice identified so far are:

- Capital requirements;
- Large exposures;
- Risk management;
- Internal control;
- Corporate Governance;
- Liquidity;
- Anti-money laundering;
- Accounting / valuation;
- Transparency;
- Business continuity; and
- Operational risk.

The document will be shared with the Bank services which will be required to review it and to indicate to what extent the Bank is already complying with the referenced standards. The compliance checklist will then be validated annually. The Board of Governors is asked to endorse the proposed approach setting out the main areas of best banking practice on which the Audit Committee will give assurances on compliance.
4. CONCLUSIONS

The Audit Committee is concerned about the effects that the application of IAS 39 has on the Group financial statements and warns that it is possible that significant unrealised losses could be booked in future years, following this rule, which could have an important impact on the actual result.

The Audit Committee draws attention to the growing maturity mismatch between borrowing and lending and the associated risks. The Audit Committee took note of the important steps already taken by the Bank to address the issue and will continue to monitor the situation.

The Audit Committee is of the opinion that it was able to carry out its work to fulfil its statutory mission under normal, unrestricted conditions. The Audit Committee is satisfied that the evidence obtained during the meetings, including the review of the documentation presented, and its own analyses sustain its conclusions. On this basis, the Audit Committee provided approval of its annual statements as of the date of signature of the audit report by the external auditors and of the adoption by the Board of Directors.

The Audit Committee has concluded that it met its responsibilities during 2008 and that its work was balanced in terms of focus, issues handled and means utilised to obtain the necessary assurance. The Committee believes that it has retained appropriate standing within the Bank, and that it has maintained appropriate relations with management and Bank staff. In 2008 the Audit Committee received the expected support from the Bank, which enabled it properly to discharge its responsibilities.

The Audit Committee confirms that the Bank has appropriate procedures and policies in place to identify and manage risk. The Bank has raised awareness and stepped up mechanisms to control and contain risks in view of the crisis.

Based on work undertaken and the information received (including an unqualified opinion from Ernst & Young on the financial statements and a representation letter from the Management of the Bank), the Audit Committee concludes that the Bank’s consolidated and non-consolidated financial statements have been drawn up correctly and that they give a true and fair view of the 2008 results and financial status according to the accounting principles applicable to the Bank.

The Audit Committee is able to extend the same conclusion to the financial statements of the Investment Facility, the FEMIP Trust Fund and the EU-Africa Infrastructure Trust Fund, as these are covered to a large extent by the EIB’s own risk control systems and internal and external audit arrangements.

Date, 8 April 2009

C. KARMIOS, Chairman  O. KLAPPER, Member  G. SMYTH, Member

Having participated in the work of the Audit Committee as Observers, we concur with the above report.

E. MATHAY  J. RODRIGUES DE JESUS  D. NOUY
AUDIT COMMITTEE

Annual Report to the Board of Governors

Investment Facility

for the 2008 financial year

9 June 2009
AUDIT COMMITTEE

ANNUAL REPORT TO THE BOARD OF GOVERNORS
ON THE INVESTMENT FACILITY
For the 2008 financial year

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1. INTRODUCTION

Under the Cotonou Agreement, the financing of lending operations in ACP (African, Caribbean and Pacific) countries are allocated from, *inter alia*, a EUR 3 137 million Investment Facility whose funds are provided from Member States’ budgetary resources. The operations carried out under the Investment Facility are accounted for in separate financial statements. In addition to the Investment Facility, the EIB can lend up to a further EUR 2 000 million from its own resources (OR) in the ACP countries over the period 2008-2013. Operations carried out under the Bank’s own resources are covered by a specific guarantee from EU Member States.

The role of the Audit Committee

The statutory role of the EIB’s Audit Committee is to verify that the Bank’s operations have been conducted and its books kept in a proper manner, as defined in the Statute and Rules of Procedure. The Financial Regulation of the Cotonou Agreement provides for the audit and discharge procedures of the Investment Facility to be the same as those defined for the Bank.

This report from the Audit Committee to the Board of Governors provides a summary of the Committee’s work focused more specifically on the Investment Facility during the period since the last Board of Governors’ meeting in June 2008.

2. AUDIT COMMITTEE WORK

2.1. Review of Investment Facility’s activities

The assurance expressed by the Audit Committee is based on the fact that the Investment Facility (IF) shares a number of systems with the Bank, notably those involved in risk management, human resources management, treasury management and financial reporting. In addition, the Investment Facility is subject to the internal and external audit procedures of the Bank. The Risk Report for the Investment Facility prepared by the Bank services was also relied upon by the Committee.

Salient points noted by the Audit Committee in relation to the Investment Facility in 2008/2009 are shown below.

Cotonou Agreement: Following the completion of ratification process, the revised Cotonou Partnership Agreement, Cotonou II, and its related financial protocol, the 10th European Development Fund, entered into force on 1st July 2008. The protocol covers the period 2008-2013.

Operational context: Activity levels for 2008 were somewhat below the business plan projections, achieving 75% of the planned approvals and signatures and 57% of the target disbursement volume. Although the direct effect of ongoing volatility on financial markets has so far been limited in ACP countries – as a consequence of their limited integration into the world economy and the modest development of local capital markets, the ongoing financial problems are now expected to result in a knock-on slowdown effect in ACP countries, mainly given significantly reduced global demand leading to lower commodity prices and a shortage of foreign investments.

Interaction with Management: The Audit Committee met on several occasions with the Management of the Investment Facility, who explained some of the difficulties in meeting the 2008 targets. The causes for the 2008 underachievement cited were diverse, such as institutional causes (the uncertainty about when Cotonou II would be ratified and would come into force), the impact of the crisis in some parts of the world, the increasing complexity of the operations, notably project finance, PPPs, or structured finance operations which tend to be more difficult to finalize; development of the technical assistance portfolio (which has so far not been accounted for in terms of achievement of COP targets but is proving to be very labour intensive).

Monitoring Aspects: Following up on issues raised in its previous reports, the Audit Committee took note of progress made in this direction. Thus, the EIB’s Management Committee approved a
financial monitoring plan for the ACP portfolio at the end of September 2008, in response to the Internal Audit Report on “ACP Risk Capital Operations”.

The Audit Committee also took note of the ongoing effort to balance resources with current tasks, including, in particular, monitoring. We understand that the review will have to take into account the increasing complexity of the operations (e.g. project and structured financing, including PPP) which require sometimes very specific knowledge.

Notwithstanding the above, the Audit Committee understands that all IF operations are subject to the usual monitoring procedures, including review and validation of annual reviews by the Credit Risk Department.

2.2. Review of Audit Work

External auditors: The Audit Committee met regularly with the external auditors, who are designated by the Committee and report to it. In order to be able to rely on the work performed by the external auditors, the Audit Committee has properly monitored their activity, by requesting oral and written reports, by reviewing the external auditor’s deliverables and making further inquiries and through a formal interview before the sign-off of the accounts.

The Audit Committee took note the specific comments made by the external auditors in their Executive Summary Memorandum and the unqualified audit opinion. The Audit Committee assesses regularly the external auditor’s independence, including the absence of any conflicts of interests. The Audit Committee noted that one recommendation issued by the external auditor in its 2007 Management Letter, which was relevant for the Investment Facility accounting, has been implemented.

Internal audit: The Inspector General, who reports to the President, is responsible for three functions which are key contributors to the assurance obtained by the Committee, namely Internal Audit, Fraud Investigations and Operations Evaluation. The Inspector General has free access to the Audit Committee and met regularly with the Committee during 2008/2009, together with the Head of Internal Audit, including in private sessions.

No new external or internal audit recommendations directed at the activities of the Investment Facility were brought to the attention of the Audit Committee during the period under review. We are aware that Internal Audit is finalizing, together with the Directorate concerned, an Internal Control Framework (ICF) for IF. This will identify and review existing controls and will make recommendations for improvement. The Audit Committee will analyze the ICF and will follow-up on the recommendations.

The Audit Committee is permanently informed about the alleged cases of wrongdoing and the ongoing investigations relating to Bank projects, including Investment Facility operations. It welcomed the strengthening of the pro-active approach (pro-active investigations, red flag training for staff) in the bank’s policies, as decided this year.

European Court of Auditors: The Audit Committee noted that the Court did not carry out any Investment Facility related audits in 2008.


The Audit Committee examined the 2008 financial statements of the Investment Facility prepared in accordance with the International Financial Reporting Standards (IFRS), and with the general principles of the European Directive applicable.

The Committee noted, in relation to the 2008 financial statements:
Income statement: The Investment Facility recorded a loss of EUR 26 million in 2008 compared to a profit of EUR 36 million in 2007, mainly due to the impairment charge, (see below), while the increase in interest and similar income was compensated by a reduction in the Member States contribution to general administrative expenses.

Balance Sheet: The Balance Sheet total increased during 2008 from EUR 1 077 million to EUR 1 145 million.

Credit and interest rate risk: The Investment Facility had disbursed exposure totalling EUR 765 million at the end of 2008, increasing from EUR 671 million at the end of 2007.

Impairment: The impairment losses on loans and receivables considerably increased, from EUR 2.7 million in 2007 to EUR 52.7 million. The Investment Facility reviews its problem loans and receivables at each reporting date to assess whether an allowance for impairment should be recorded in the income statement. In principle, a loan is considered as non-performing when payment of interest and principal are past due by 90 days or more and, at the same time, management considers that payment will be completely unlikely.

IFRS valuation: The Audit Committee noted that all the assets of the Investment Facility are measured in accordance with IFRS principles; notably equity investments are measured at fair value, loans originated by the Facility are measured at amortised cost, using the effective yield method, less any provision for impairment or uncollectibility and derivatives are measured at fair value through income statement.

4. CONCLUSION

The Audit Committee has concluded that it met its responsibilities during 2008 and that its work was balanced in terms of focus, issues handled and means utilised to obtain the necessary assurance. The Audit Committee is of the opinion that it has been able to carry out its work to fulfil its statutory mission under normal, unrestrictive conditions.

Based on the work undertaken and the information it has received (including the unqualified opinion from Ernst & Young on the financial statements and a representation letter from the Management of the Bank), the Audit Committee concludes that the 2008 financial statements of the Investment Facility have been drawn up correctly and that they give a true and fair view of the 2008 results and financial status according to the accounting principles applicable to the Investment Facility.

On this basis, the Audit Committee signed its annual statement as of 12 March 2009.

Date, 8 April 2009

C. KARMIOS, Chairman          O. KLAPPER, Member          G. SMYTH, Member

Having participated in the work of the Audit Committee as Observers, we concur with the above report.

E. MATHAY              J. RODRIGUES DE JESUS              D. NOUY
Response of the Management Committee
to the Annual Reports of the Audit Committee
for the year 2008
RESPONSE OF THE MANAGEMENT COMMITTEE TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE FOR THE YEAR 2008

1. Audit and control structures in the EIB

1. The Management Committee took measures to enhance the audit and internal control structures for the EIB Group and Investment Facility (collectively referred to as the “Bank”) on the background of the global credit crisis. Key control functions, notably Risk Management and Transaction Monitoring and Restructuring were further strengthened with particular focus on supporting a rapid reaction mechanism. The Management Committee remains satisfied that the overall internal controls and procedures of the Bank are effectively designed and operated to provide reasonable assurance on the integrity, legality and timeliness of the underlying transactions and processes.

2. The Bank continues to foster mutually constructive, yet appropriately independent, relationships between the Management Committee, Audit Committee, the internal auditors and external auditors. In addition to an annual external audit of the financial statements under the discharge rules of the Statute, the Management Committee fully collaborates with the European Court of Auditors in the audit of operations, or funds, implemented or managed by the Bank which engage EU budgetary resources. A number of the Bank’s activities under partnership agreements are also subject to separate external audit scrutiny. The various audit procedures required in connection with some bond issues and the periodic interaction of the Audit Committee with the external auditors effectively mean that the Bank is subject to significant independent review during the year, as well as at the year end.

3. The Bank has promptly responded to the Audit Committee’s requests on various topics, but mainly related to risk management issues, and the Bank services maintained a collaborative approach in supporting the work of the Committee.

4. The Bank is committed to the identification and implementation of relevant accepted “best practice” within the banking sector and continues to submit itself voluntarily to the core requirements of EU banking regulations and related EU Policies. The Bank will need to pay attention to its responsibilities vis-à-vis banking best practice if the Lisbon Treaty is ratified. The Management Committee looks forward to receiving the Audit Committee’s associated reference document.

2. Developments within the Bank and within the Investment Facility in 2008-2009

2.1 Operational Activities

The Corporate Operational Plan (COP) 2009-2011 - response to the global crisis

5. The year 2008 ended with a global credit system in a state of paralysis and a deep economic recession in the making in Europe as everywhere else in the world. In drawing up the COP 2009-2011 and responding to the EU Recovery Plan defined by ECOFIN in December 2008, the EIB committed to meet the expectations and demands of its Governors reflecting the needs of the Member States and wider society. In doing so, the Bank will have an unprecedented increase in borrowings, loan signatures and disbursements whilst needing to maintain at least the same quality and value-added in all activities.

6. The Bank is not complacent regarding its position and is addressing the challenges and increased risks inherent to the implementation of the COP through plans prepared and monitored by a Task Force representing all directorates. The objectives pursued by the plans are to systematically:

- increase the focus of all Directorates on priorities;
- secure resources in critical areas;
- streamline processes, namely those which have a critical impact on the implementation of COP, such as the lending process and decision-making; and
- reinforce the monitoring of several risks (exposure, liquidity and capital).

7. Fast action has been taken to set up other relevant cross-Bank sub-groups with a view to facilitating communication and rapid reaction at times of financial market instability.

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1 The COP 2009-2011 and a EUR 67 billion capital increase were approved by the Board of Directors in December 2008.
8. The Bank was able to raise record level of funds during the first 4 months of 2009, albeit a higher cost than in the past. At the beginning of May, issuance on capital markets amounted to EUR 50 bn. However, current market perspectives give absolutely no assurance of sustained satisfactory access to funding; the evolution of cost conditions also remains very uncertain.

9. One of the major challenges faced since the beginning of the year has been the management of the maturity gap between new lending and funding, since the demand of investors in financial securities has been strongly focused on short term maturities. Funding was deliberately and progressively redirected towards longer maturity as soon as some investors’ risk appetite returned, putting EIB very much at the forefront of the restart of longer term issuance on European markets.

10. The European Central Bank (ECB) announced on May 7 that EIB had been accepted as a counterparty eligible for access to Eurosystem’s liquidity, in relation to EIB’s role in supporting Europe’s economy. This announcement was well received by markets. The agreement will become operational in July; work on the implementation framework and tools is in progress.

11. The specific arrangements for credit risk management have included, but are not limited to:
   - suspension of the riskiest investments and greater selectivity in the choice of investments;
   - closer analysis of the underlying assets in securitisation products (Asset Backed Securities, Asset Backed Commercial Paper or Mortgaged Backed Securities for example) without over reliance on the external assessments of rating agencies;
   - monitoring the performance of markets; and
   - reducing the maturity of investments.

12. The Bank is also continuing to streamline its processes and procedures, which will lead to resource efficiency; and is seeking to optimise internal mobility in order to ensure resources are available in critical areas. Speedier recruitment and appropriate training is helping to meet the needs of the departments to cope with an increased workload and potentially new products.

13. With approaches such as noted above, the Management Committee is confident that the EIB Group can strengthen its support to the real economy through meeting EU priority projects with (i) ensuring fund availability to allow fast and increased and/or innovative lending to priority and/or particularly vulnerable sectors and regions, (ii) the development of new financial instruments; (iii) appropriate risk management; (iv) a socially responsible approach (see §22); and (v) effective systems and use of resources. The Bank will also continue to seek risk and resource-sharing opportunities through enhanced cooperation with the Commission and EU long-term finance investors.

14. The various exercises also respond to a previous recommendation made by the Audit Committee for systematic risk analyses to be performed. Regular updates on the various analyses made by the Bank and the concrete measures taken to avert a negative impact of the crisis on its activities have been provided to the Audit Committee.

Achievement of 2008 targets as set in COP 2008-2010

15. In this difficult context, practically all COP targets for 2008 were achieved in particular loan signatures increased by 21% to EUR 57.6 billion in 2008 compared to EUR 47.8 billion the previous year. This increase was accompanied by a marked rise in disbursements (12%) from EUR 43.4 billion in 2007 to a record EUR 48.6 billion in 2008.

External Mandates

16. A recent Court of Justice judgement annulled the Council decision on the EIB external lending mandate. Therefore while maintaining the effects of the original Council decision for a period of 12 months (to 6 November 2009), a consensus between the Presidents of the European Parliament, the Commission and the Council is for the following: While a new “co-decision” is planned to be taken before April 2009 on the new “dual” legal base required by the Court’s judgement, the substantial debate regarding the mandate itself will now take place in the framework of the mid-term review to be concluded by 30 April 2010. when the Commission will submit a new proposal for ‘co-decision’ to the European Parliament and the Council. The Bank’s services will carefully follow the evolution of this dossier between the Commission, Council and Parliament and, in the meantime, will continue its activities as usual whilst being prepared to implement the new orientations agreed for the external mandate by the co-deciding institutions.

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2 All new product development is overseen by the New Products Committee
**New SME strategy**

17. The EIB Group has adopted a series of reforms to simplify its SME finance products as well as offer a substantial development of its loans to its banking partners, both in quantitative and qualitative terms. In order to improve SME access to EIB financing, the new initiative involves the streamlining of the intermediation process at partner bank level to allow intermediating banks to reduce their costs and pass more of EIB’s financial value-added to SMEs. A similar and complementary approach is being developed for the so-called “mid-caps” companies i.e. the ones of a size and development stage between SMEs according to the Community definition of less than 250 employees and larger companies. Simplification, modernisation, risk sharing and transparency are the four aspects of the new EIB product line for SMEs that are being taken forward also for mid-caps.

18. The success of the new SME strategy, already proven in the second part of 2008, is also due to the increased transparency displayed by the Bank, which is leading to more effective communication and increased media coverage of its initiatives.

**2.2 Other Risk Management Activities**

19. The Bank took note of the Audit Committee’s recommendations in the area of compliance with Basel II and has allocated enhanced staff resources, to be made available before the year end, to complete the internal ratings for guaranteed transactions and public sector, while the more risky transactions are already covered. At the same time, the Bank maintains the cooperation with the Luxembourgish banking supervisor and follows up on its recommendations, in cooperation with the Audit Committee.

20. The Bank welcomed the dialogue with the Audit Committee on the issue of top banking exposures and will implement the recommendations of the Audit Committee in this area, notably those related to the contextual analysis and more frequent review of the limits and the review of counterparts own funds.

21. In April 2008, following a full public-consultation process, the Board of Directors approved a new policy for Preventing and Deterring Corruption, Fraud, Collusion, Coercion, Money Laundering and the Financing of Terrorism. The policy will be updated every 3 years and has led to a Memorandum of Understanding (MoU) being signed with the Luxembourg Financial Intelligence unit to inform of suspected money laundering or terrorist financing activities. In July 2008, an MoU related to the EIB complaints mechanism was signed with the European Ombudsman. At the beginning of 2009, a Whistle-Blowing Policy was also introduced and on this, the Management Committee thanks the Audit Committee for accepting a role as reporting authority of last resort.

**2.3 Other activities**

*Environmental and Social Standards*

22. A public consultation process concluded in 2008 with the revision of the EIB Statement of Environmental and Social Principles and Standards which increases the sense of urgency on problems of climate change, expands the social dimensions of sustainable development and recognises also the importance of biodiversity.

*Human Resources*

23. To ensure appropriate staff resources for the increased activity volumes and complexity (a concern highlighted by the Audit Committee and shared by the Management Committee), HR will focus its efforts on initiatives oriented, inter alia, to: (a) anticipate better the resource needs through the use of a three-year plan linked to the business planning cycle; (b) promote diversity in recruitment and internal mobility; (c) develop alternative channels such as “Graduate” programmes and local recruitment in external offices; and (d) streamline the recruitment processes, improve the assessment tools and increase support to managers in their selection of staff.

24. In March 2009, HR reached an agreement with the staff representatives in terms of the salary and pension reforms.

*Communication*
25. At a time when European citizens are questioning the solidity of the financial system itself, the emphasis is on stability, on the human benefits reaped from EIB Group funding and on the concrete actions the Bank is taking (such as improved and reinforced support for SMEs) in response to the credit crunch. In the last year it is therefore not surprising that the Bank has handled a dramatic rise in media, civil society organisations and public interest.

26. The current Communication Strategy and Action Plan has been updated and augmented for 2009 to continue upgrading external communications at all appropriate levels, safeguard the reputation of the EIB Group and ensure a solid legal footing in terms of disclosure requirements. The plan will also be communicated to the Audit Committee.

**Information Technology**

27. The organisation of IT resources and systems is being adapted in order to be able to react to the increasing complexity and frequency of new mandates and initiatives that the Bank is undertaking and also because whilst the Bank's IT systems offer reliability, operating costs have consumed an increasing proportion of IT spending in recent years compared to direct investment in business applications.

28. The Management Committee fully appreciate that new and existing business applications need to be responsive to strategic evolution and enable process efficiency improvements to add-value to the business. In relation to the upgrade of one of the major software applications during 2008, the measures taken ensured that the integrity of the financial reporting was maintained.

29. In 2008, a new IT Strategy was developed which focuses on linkage with the Bank's strategic objectives and associated operational activities; fine-tuning of the IT Governance Structure; IT synergies for the EIB Group as a whole; use of cost-efficient, industry standards in areas where the Bank does not need to be innovative; and optimisation of IT staff resources to ensure adequate internal controls.

30. The implications of the new IT Strategy will be reflected in relative levels of staff, capital and current expenses dedicated to IT in the period 2009-2011.

**2.4 Investment Facility (IF)**

31. Following entry in force of the revised Cotonou Agreement and related financial protocol on 1st July 2008, an additional EUR 1.1 billion capital endowment is available under the IF while the Bank is authorised to lend up to EUR 2 billion from its own resources in the period 2008-2013.

32. The Bank will consolidate its current strategy of concentrating on infrastructure and financial sector development as the key drivers for sustained economic growth in the region and for the development of the private sector, which are both core elements of the Cotonou mandate. With regard to the infrastructure sector, a strong focus will be maintained on projects with a high developmental impact, notably major energy and transport infrastructure as well as climate change and environmental initiatives. Deployment of new financial instruments under the IF will continue to be pursued. Overall, the Bank will concentrate on projects that foster cooperation with bilateral and multilateral donors, growth and sustainable development.

33. The availability of resources for technical assistance (TA) provided for under the revised Cotonou Agreement adds significant value to the Bank’s activities in the ACP regions by enabling the Bank to take a more proactive role in the preparation of projects, either in the financial sector (such as microfinance) or for larger infrastructure projects, thereby helping to build up a stronger pipeline of quality projects.

34. Overall, the challenge for the Bank during 2009-2010 will be to strike an adequate balance between lending volume, factoring in both the impact of the current financial crisis in developing countries and the emphasis put on the developmental quality of the projects.