



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

Dear Chairperson,

The ESM management acknowledges receipt of the Board of Auditors' Annual Report to the Board of Governors for the year 2023. We recognise the importance of this report as it underscores the robust oversight provided by the Board of Auditors, reinforcing the ESM governance and accountability framework. In response, we are pleased to share the ESM management comments on the observations and recommendations presented, alongside a summary of the audit oversight activities conducted in 2023.

Independent oversight by the Board of Auditors

Throughout 2023, the Board of Auditors engaged in comprehensive discussions with the ESM Managing Director, members of the Management Board, and senior staff, focusing on key areas that impact ESM operations and financial results. The Board's interactions were particularly centred on understanding the risk landscape of the ESM, an area of high importance given the shifting interest rate environment and broader economic developments. At the Board of Auditors' request, ESM management provided detailed presentations on key issues, such as the ESM's funding activities, liquidity buffers, risk management practices, compliance function, and accounting framework. Upon request, the Board of Auditors received timely updates on the progress of the project for the construction of an ESM office building, undertaken jointly with the State of Luxembourg. Lastly, the Board of Auditors was informed of the meetings and decisions of the ESM governing bodies, as well as other relevant ESM policy issues and developments.

In addition to its regular meetings and presentations, the Board of Auditors has conducted an audit on ESM procurement procedures and initiated an audit on ESM's investment strategy. These audits will help us ensure that our practices adhere to the highest standards of governance and compliance.

Regarding the audit on the procurement procedures, ESM management appreciates the general conclusion of the report stating that the ESM has satisfactory procedures in place and acknowledges that there is room for certain improvements.

Specifically, ESM management has already initiated implementing enhancements, where applicable, as detailed in its response to the audit report. These efforts align with the ESM's broader commitment to continuously improve operational efficiency and compliance across all facets of ESM operations, addressing the relevant issues highlighted by the Board of Auditors during their 2023 review.

Additionally, the ESM is dedicated to fully cooperating with the current audit of its investment strategy to guarantee its successful completion.

Furthermore, ESM management closely monitors the progress of the ESM building project, which is currently at the first planning stage. Similar to other large construction projects in the current economic environment, the project is exposed to possible risks of delays and potential cost overruns. The ESM is engaging closely with the Luxembourg authorities to ensure that potential issues are identified and addressed promptly with effective mitigating measures with a view to steering the project in line with the envisaged timeline and budget. The ESM has also considered the recommendations from the recent internal audit report on the project's governance and is in the process of updating its internal procedures and documentation accordingly.

Finally, the Board of Auditors discussed with ESM management and the ESM external auditor the draft ESM financial statements as at 31 December 2023 and related disclosures. In preparation of its report in respect of the ESM 2023 financial statements, on 6 March 2024 the Board of Auditors also exchanged views with the Chairperson of the ESM Board Risk Committee. The Chairperson of the Board of Auditors presented the report on the ESM 2023 financial statements to the Board of Directors on 26 March 2024. A subsequent exchange with the Board of Directors took place on 13 June 2024, followed by the presentation of the Board of Auditors' report on the ESM 2023 financial statements and its annual report to the Board of Governors during the annual meeting of the Board of Governors on 20 June 2024. In line with its mandate, the Board of Auditors regularly monitored and reviewed the external audit processes and their results and performed a review of the working papers of the external auditor, KPMG Luxembourg, ("KPMG"), related to the statutory audit of the ESM 2023 financial statements.

Audit procedures by the internal audit function

The ESM internal audit function, which reports directly to the Managing Director, has continued its effective operation throughout 2023, focusing on enhancing the institution's risk management, internal control, and governance framework. Adhering to international auditing standards, the internal audit function supports the ESM in maintaining transparency and operational integrity, ensuring that we meet our responsibilities with the highest level of oversight and accountability. The regular closed sessions between internal audit and the Board of Auditors have been instrumental in facilitating comprehensive reviews and fostering an environment of rigorous scrutiny.

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 2023.

Audit procedures by the independent external auditor

In 2022, following a competitive public procurement procedure in line with Article 22 (2) of the ESM By-Laws mandating a rotation of the external auditor at least once every six years, the ESM appointed KPMG, as its new external auditor for the 2023–2025 financial years.

The transition to the new external auditor was followed by the Board of Auditors, which reviewed the audit processes and methodologies implemented

by KPMG. KPMG's first audit of the ESM's financial statements for the year ending 31 December 2023 was conducted in compliance with the Council Directive 86/635/EEC and its amendments through Directive 2001/65/EC, Directive 2003/51/EC, and Directive 2006/46/EC.

The external auditor's report confirmed that the financial statements provide a true and fair view of the ESM's financial position as of 31 December 2023. Furthermore, KPMG affirmed that no significant issues were encountered that would necessitate adjustments or disclosures in a Management Letter.

The external auditor's report was presented to the Board of Governors at the annual meeting on 20 June 2024, and is publicly available on the ESM website as part of the *ESM 2023 Annual Report*.

ESM internal control framework

The ESM's internal control framework is integral to its daily operations, reflecting the complex nature of our financial and operational activities, along with their inherent risks. Governed by a robust three lines model, the ESM framework includes management oversight, risk assessment, and robust business and IT controls, ensuring comprehensive coverage across all levels of the institution. This multi-layered approach ensures thorough governance and risk management. In 2023, the Managing Director issued a management report on internal controls, which indicated no material weaknesses and affirmed the effectiveness of the ESM internal controls.

In closing

The ESM management remains dedicated to maintaining an open and constructive engagement with the Board of Auditors. We value the Board's rigorous independent oversight and the insights provided in its annual report, which contribute to the continuous improvement of the ESM's operations.

We are looking forward to continuing our collaboration with the Board of Auditors to further strengthen the ESM's practices and ensure the highest standards of accountability and transparency.

20 June 2024

Pierre Gramegna
Managing Director