

EUROPEAN STABILITY MECHANISM

INTERNAL AUDIT CHARTER

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 the internal audit function is to strengthen the ESM’s ability to create, protect, and sustain value by providing the ESM management, Board of Auditors and governing bodies with independent, risk-based, and objective assurance, advice, insight, and foresight. The internal audit function enhances the ESM’s:
 - a) Successful achievement of its objectives;
 - b) Governance, risk management, and control processes;
 - c) Effectiveness and procedural efficiency;
 - d) Decision-making and oversight;
 - e) Reputation and credibility with its stakeholders; and
 - f) Ability to serve the public interest.
 All activities, operations, and processes of the ESM may be subject to internal auditing.

2. The internal audit function is an essential component of the three-lines governance model at the ESM as described in the High Level Risk Policy established by the Board of Directors

Article 3 ***Commitment to Adhering to the Global Internal Audit Standards***

1. The internal audit function adheres to the mandatory elements of the Institute of Internal Auditors' International Professional Practices Framework, consisting of the Global Internal Audit Standards and the Topical Requirements.
2. The Head of Internal Audit periodically reports to the Managing Director, the Board of Auditors and the Board of Directors on the internal audit function’s conformance to the International Professional Practices Framework.
3. In addition, the internal audit function adheres 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, has 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 is notified of instructions and decisions of the ESM management that may be of relevance to it. The internal audit function is notified in due time of any material amendments to the risk management system.
4. The internal audit function has no authority to determine policies, to make executive decisions, to manage risks, or to change staff, systems, or methods of work. Its role is to examine, evaluate, and make recommendations to the ESM management 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 has also free and unrestricted access to the Board of Auditors without impediment. Beyond regular reporting, the Head of Internal Audit has 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 remains 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 to the Board of Auditors.
3. The internal audit function has no direct operational responsibility or authority over any of the activities audited. Accordingly, the internal audit function must 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 demonstrates the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or processes being examined. The internal audit function makes a balanced assessment of all relevant circumstances and must not be unduly influenced by its own interests or by others in forming judgments.
5. The Head of Internal Audit confirms to the Board of Auditors and to the Board of Directors, 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 internal control processes, and the compliance with the established policies and procedures. For this purpose, the internal audit function examines whether:
 - a. Risks relating to the achievement of ESM's strategic objectives are properly identified and managed;
 - b. The ESM's resources and assets are properly safeguarded and used efficiently as per decisions made by management and governing bodies;

- c. Financial, operating, accounting and other data generated within the ESM or by third parties and used for management purposes is accurate and reliable;
 - d. The integrity, reliability, confidentiality and continuous availability of the information systems is secured;
 - e. The application of risk management procedures and methodologies and the functioning of internal controls are effective;
 - f. The ESM's policies, procedures and manuals in relation to the above are adequate and complied with; and
 - g. The governance, operations and various functions and activities of the ESM are performed efficiently and effectively.
2. In addition, the internal audit function:
- a. Reports, through the Head of Internal Audit, to the Managing Director and the Board of Auditors as described in Article 9;
 - b. Evaluates specific operations at the request of the Managing Director, as appropriate; and,
 - c. Provides recommendations, including advisory, on matters relating to governance, risk management and internal controls, as requested by the Management Board member responsible for the area in scope with approval from the Managing Director and endorsement of the Board of Auditors. The nature and scope of advisory services may be agreed with the requesting party, provided the internal audit function does not assume management responsibility. Opportunities for improving the efficiency of governance, risk management, and control processes may be identified during advisory engagements. These opportunities will be communicated to management.
3. The Head of Internal Audit:
- a. At least annually, develops a risk-based internal audit plan that considers the input of management and discusses the plan with the Managing Director for review and approval, and with the Board of Auditors for review and endorsement;
 - b. Communicates the potential impact of resource limitations on the internal audit plan to the Managing Director and the Board of Auditors;
 - c. Reviews and adjusts the internal audit plan as necessary, and communicates those changes to the Managing Director and the Board of Auditors;
 - d. Ensures that internal audit engagements are performed, documented, and communicated in accordance with the Global Internal Audit Standards;
 - e. Follows up on engagement findings, recommendations and action plans, and communicates results to the Managing Director and the Board of Auditors;
 - f. Ensures the internal audit function collectively possesses and obtains the knowledge, ethics, skills and competencies needed to meet the requirements of the Global Internal Audit Standards and fulfils the internal audit mandate;
 - g. Identifies and considers trends and emerging issues that could impact the ESM and communicates to the Managing Director and the Board of Auditors, as appropriate;
 - h. Coordinates activities and considers relying upon the work of other internal and external providers of assurance and advisory services, as appropriate;
 - i. Ensures that internal auditors comply with the principles of Ethics and Professionalism (integrity, objectivity, competency, due professional care and confidentiality); and
 - j. Encourages and promotes an ethics-based culture at the ESM and reports any organisational behaviour that is inconsistent with the ESM's ethical expectations.

Article 7

Resources

1. The internal audit function has adequate resources (e.g. financial, staff, and IT).
2. The quantity and quality of the internal auditors is commensurate, in particular, with the needs of the internal audit function. This also applies to the use of temporary staff. The internal auditors has sufficient qualifications and skills to effectively deliver on their mandate and to audit in line with the Global Internal Audit Standards. Internal auditors collectively are competent to examine all areas in which the ESM operates.
3. Internal auditors possess the expertise and experience needed for their tasks, competencies and responsibilities. Appropriate measures are taken to ensure that internal auditors are suitably qualified (e.g. through ongoing training). The absence or resignation of internal auditors must not lead to a persistent operational disruption.
4. The internal audit function is 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 prepares an annual audit plan and reports at least semi-annually to the Managing Director and the Board of Auditors on the status of the audit plan. The annual audit plan consists of a work schedule for the next calendar year. The plan is based on a risk-assessment methodology and is finalised following consultation with, amongst others, the heads of the relevant divisions, the Management Board, the Managing Director, and the Board of Auditors.
2. The annual audit plan is approved by the Managing Director and endorsed by the Board of Auditors. Any subsequent changes to the approved audit plan are submitted to and approved by the Managing Director.
3. Any significant deviations from the approved audit plan are reported to the Board of Auditors.

Article 9

Reporting

1. The internal audit reports, which take the form of a written report, are prepared and issued by the internal audit function following the conclusion of each internal audit engagement.
2. A draft of the internal audit report is 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 includes 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 also includes 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 is subsequently distributed to the Managing Director, the Board of Auditors, the Management Board, and the heads of the divisions concerned.
6. The internal audit function is 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 is distributed to the Managing Director and the Board of Auditors.

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

7. The internal audit function issues 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 reports periodically to the Managing Director and the Board of Auditors regarding the internal audit function's purpose, authority, and responsibility, the status of the internal audit plan, the internal audit function's conformance to the Global Internal Audit Standards and any action plans to address any significant conformance issues.
9. The Head of Internal Audit reports 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.
10. The Head of Internal Audit reports on an annual basis to the Board of Directors on the work performed by the internal audit function and on the work plan for the upcoming year.

Article 10

Relationship with the Board of Auditors and the independent external auditor

1. Pursuant to Article 24(4) of the By-Laws, the Board of Auditors shall monitor and review the ESM's internal audit processes and their results.
2. The internal audit function coordinates 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.
3. The internal audit function follows up on audit findings raised by the Board of Auditors.

Article 11

Quality Assurance and Improvement Programme

The internal audit function develops, implements, and maintains a quality assurance and improvement programme that covers all aspects of the internal audit activity. The programme includes external and internal assessments on the internal audit function's conformance to the Global Internal Audit Standards, as well as performance measurement to assess the internal audit function's progress toward the achievement of its objectives and promotion of continuous improvement. The Head of Internal Audit communicates 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. External assessments are conducted at least once every five years by a qualified, independent assessor or an assessment team from outside the ESM; qualifications must include at least one assessor holding an active Certified Internal Auditor credential.

Article 12

Conflicts of interests

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

Article 13
Role beyond internal audit

The Head of Internal Audit is responsible for internal investigations as described in the Whistleblowing Policy, the Dignity at Work Policy and the Investigations Procedures.

No other operational role should be performed by internal audit.

Article 14
Entry into Force and Review

This Internal Audit Charter enters into force on the day it is approved by the Board of Directors and is revised as and when it is deemed necessary, and in any case not later than every five years.