AUDIT COMMITTEE

Annual Report to the Board of Governors

For the 2009 financial year

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ANNUAL REPORT TO THE BOARD OF GOVERNORS

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1. INTRODUCTION

Following the entry into force of the new Statute under the Lisbon Treaty in December 2009, the Audit Committee was strengthened and new responsibilities were added to its mandate. In addition to its main responsibility for auditing the Bank's accounts, the new Statute requires the Audit Committee to verify that the activities of the Bank conform to best banking practice. At the same time the statutory number of Audit Committee members has been increased from three to six. In addition, the Rules of Procedure permit the appointment of observers to the Audit Committee on the basis of their particular qualifications, especially with regard to banking supervision.

According to the Statute and Rules of Procedure, the EIB's Audit Committee reports each year to the Board of Governors on the results of its work. This report describes the work done by the Committee since the date of our last report, including the follow-up on prior years' recommendations, and identifies the issues of focus for the following period.

The Audit Committee has issued its Annual Statements on the following financial statements for the financial year 2009:

- EIB Group consolidated according to IFRS
- EIB Group consolidated under the general principles of the EU Directives[1]*,
- Bank statutory,
- Investment Facility,
- FEMIP Trust Fund,
- EU Africa Infrastructure Trust Fund,
- Neighbourhood Investment Facility (NIF) Trust Fund*.

In the statements the Committee confirms, to the best of its knowledge and belief that the financial statements prepared for these entities gave 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.

2. COMPLIANCE AND RISK MONITORING

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, but also the process for monitoring compliance with relevant standards and procedures. The day-to-day audit work is delegated to an external audit firm designated by 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 meets regularly with management, analyses and discusses 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 discusses the business issues with the Bank's services. The Audit Committee work plan is established with the objective of providing it with a good understanding of the Bank activities throughout the year. The Audit Committee formulates questions and requests specific analyses in order to assess the risk impact of the various developments in the Bank.

2.1 Compliance with laws and regulations

Contributing to the international efforts to promote integrity in financial markets, the Bank has revised its policy towards offshore financial centres, first adopted in 2005. The revised policy calls for enhanced vigilance and strict behaviour in relation to all activities, i.e. in lending, borrowing and treasury.

The Audit Committee is informed about all cases relating to internal fraud or reputation risk. In 2009 the workload in terms of on-going fraud investigations further increased. The Committee is pleased to note the proactive approach taken by the Bank in the area of fraud investigation; thus a methodology for pro-active integrity reviews has been recently designed to help ensure that EIB funds

[1] Referred to as "EU GAAP" further in this report.
* - issued for the first time in 2009.

are used for the intended purpose. The proactive reviews are expected to identify broader issues, reveal process weaknesses and thereby result in lessons learned which can improve future project preparation and implementation.

The Committee has not been advised of any compliance matters that could have had an impact on the financial statements.

2.2 A framework for the EIB compliance with best banking practice

The new EIB Statute expands the responsibilities of the Audit Committee, as such the Committee will now have to verify that the activities of the Bank conform to best banking practice.

We have outlined the methodological approach of the verification in our last report to the Board of Governors (June 2009). Following a consultation with the Bank's services, we have established a framework of best banking practices applicable to the EIB. The Bank services are now establishing the processes of implementation and verification. The framework was adopted by the Management Committee and the Board of Directors.

Scope. As a basis for establishing the scope we have determined the following hierarchy of legal and regulatory texts.

1) The core EU legislation: a) the EU Treaty, b) the EIB Statute, being an integral part of it, as well as c) the Rules of Procedure;
2) Standards mandatory for the banking industry (e.g. EU Directives, national laws) and which the EIB adopts - to become best banking practice for EIB. As a EU Institution the EIB should follow the relevant EU Directives or rules, wherever EU specific legislation co-exists with international guidance;
3) Further sources of best banking practice for the EIB are supervisory guidelines (such as those issued by national supervisors or Basel Committee) and industry best practices, as developed, for example, by the Institute of International Finance or the European Banking Federation. While these industry best practices are optional, their application, if chosen, has to be consistent with the general corpus of best banking practice.

These texts refer to the areas where best banking practice can be identified and assessed in a structured manner:

- Capital requirements;
- Large exposures;
- Risk management, internal controls & operational risk;
- Corporate Governance;
- Liquidity risk management;
- Anti-Money Laundering and Combating the Financing of Terrorism;
- Accounting / valuation;
- Fair Value and Transparency;
- Business continuity;
- Rogue Trading;
- Market Operations;
- Payment Systems;
- Human Resources;
- IT Security;
- Compliance Function.

For each of these areas the Bank services have identified their respective responsibilities for implementation and follow-up. It is understood that "Best Practice" is a dynamic concept, which will change as regulatory and professional practice develops.

Implementation. The Audit Committee sees compliance with best banking practice as a natural process which is part of the day to day operations of the Bank and hence part of the Internal Control Frameworks (ICF). Although the initial self-assessment shows a high degree of compliance already, a structured and ongoing process is needed to ensure standards applicable to the Bank are taken into account permanently. To achieve this, the Audit Committee suggested that the standards be included in the procedures' manuals by the Bank services by the end of 2010.

Verification. Ownership of the framework by the Bank services is seen as paramount by the Audit Committee, which is why the Committee favours a bottom-up approach to the exercise. Once the procedures' manuals capture the framework of best banking practice, the compliance will become part of the operational processes. In addition, the Internal Control Frameworks (ICF), when updated, will also reflect the controls added where needed. In the light of this, the Audit Committee does not envisage an external validation process but will continue to rely on the assurances obtained on an ongoing basis via the ICFs, the external audit, IA, RM, OCCO and the control structures of the Bank in general.

Maintenance and update. The Bank services will be in charge of monitoring the regulatory and practice developments in their areas of activity and to ensure compliance, by updating the framework and the procedures accordingly. The Audit Committee will review the updated framework throughout the year.

2.3 Risk management activities

According to the Rules of Procedure, the statutory responsibility for risk control oversight rests with the Board of Directors. The Audit Committee also looks at risk management and monitoring activities and gives assurance thereon in the context of its annual statement on the accounts.

In obtaining assurance in relation to risk management activities, the Audit Committee cooperates closely with the various services responsible for specific banking risks, notably Risk Management (RM), Transaction Monitoring and Restructuring (TMR) and Finance Directorates. We aim to meet top management regularly at the Bank and try to focus the agenda topics on specific technical points to address risk management.

Credit risk. In 2009 and at the beginning of 2010, the Bank continued its strategy of taking more risk in a controlled manner for more value-added in support of EU policies. Thus, the main risk indicators showed a deterioration of the portfolio credit quality, coupled with an increase in the watch list and resulting in a corresponding increase in the general loan reserve.

The Audit Committee receives regularly, analyses and discusses with the Bank's management, the various reports on risk, which depict the indicators used to monitor risk, such as large exposures, sector exposure limits, capital adequacy ratios or gearing ratio. The Committee is satisfied that the Bank's management uses these monitoring tools effectively and that in general the reports provide an adequate overview of risk.

Risk Management Policies and Procedures. The Risk Policy Guidelines are continuously updated in order to keep pace with the changing risk environment. Thus, the EU – Credit Risk Policy Guidelines (CRPG) and the Financial Risk and ALM Policy Guidelines (FRPG) were both updated in February 2010 and new Non-EU Credit Risk Policy Guidelines were introduced in 2009, consolidating the previous Investment Facility and Non-EU Resources Credit Risk Policy Guidelines and governing all EIB lending outside EU, candidate and potential candidate countries. The Audit Committee, as a matter of course, follows these developments. In the case of FRPG the updates mainly consisted in changes in derivatives counterparty limits and changes of Treasury limits and exposures for certain instruments as well as the adoption of special measures during the financial crisis.

Monitoring: In order to strengthen monitoring and ensure consistency at the EIB level, the Bank has decided to create a new department dealing with loans monitoring, to be integrated into TMR, which will become a fully fledged directorate. The Committee welcomes the initiative and will follow its implementation. However, the approach to monitoring should be nuanced, depending on the particular regional conditions. As such, the projects located outside the EU would probably need more on the ground monitoring, while desk type reviews may be appropriate for most EU projects.

Liquidity Risk management. The Bank maintained sufficient liquidity levels throughout the year. The Committee has noted the implementation of the agreement with the ECB which gives the EIB access to the Eurosystem's short term liquidity. The Committee was also satisfied with the information received in relation to the liquidity contingency plan, which includes, among other aspects, the weekly monitoring of liquidity and various stress test scenarios.

In the period under review we held discussions with the Bank services on collateral management, the monitoring of loan substitutes and the analysis of the internal ratings of transactions insured by monoline insurers, in addition to the regular presentations of the risk reports.

2.4 Follow-up on previous Audit Committee annual reports

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

Differences in the IFRS accounting treatment between the subsidiary and the Group. The Audit Committee highlighted in the past the fact that a certain investment portfolio was classified as available for sale in the EIF financial statements and held to maturity in the Group consolidated financial statements and suggested that the two treatments should be harmonised. The new external auditor has endorsed this view, although it was pointed out that the new standard on financial instruments, when adopted, might smooth out the difference as it will bring simplifications in the classification rules and less categories.

IT expertise. The Committee has suggested, in last year's annual report, 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. The Bank was open to the suggestion and Governors could consider it for the next nomination. The revised Rules of Procedure maintain the possibility of appointing observers, on the basis of their particular qualifications.

Gap risk analysis. In a previous 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, were systematically identified and assessed in terms of their probability and impact. It was agreed this year that a cartography of risk would be developed, under the supervision of the Risk Management Directorate, which would respond to this recommendation and to best banking practice.

Review of counterparty limits. The Audit Committee recommended in last year's report a more frequent review of the limits and of the counterpart's own funds, given the financial and economic crisis. Several action plans were initiated by the Bank during 2009 with a view to improving the measurement and monitoring of limits and large exposures. Thus, Risk Management performed a detailed analysis of the large exposure requirements of the Capital Adequacy Directive versus the EIB internal credit risk guidelines. However, due to subsequent regulatory changes (amendments to the Directive were published last November), this exercise will be re-performed to include the revised requirements and a proposal for necessary amendments to the Credit Risk Policy Guidelines will be submitted before the end of 2010.

At the same time, a new approach to calculate derivative exposures was introduced based on the principle of the Potential Future Exposure, aimed at better risk measurement of derivative instruments. This initiative will bring EIB internal credit risk guidelines closer to best practice and will improve the measurement of limit margins. The Committee took note of the fact that the Bank was applying best practice by using the PFE methodology and encouraged RM to consider, as next steps, the use of trading platforms and clearing houses which are to be created at EU and US levels.

Maturity mismatch between borrowing and lending. The Committee had drawn attention last year to the growing maturity mismatch and associated risks. In 2008 the average borrowing maturity was 5 years, while the average lending terms were 10 years. The situation has changed substantially reverting back to the pre-crisis levels. Thus the average borrowing maturities reached 7.4 years in 2009, with the lending terms remaining constant.

New mandates and products. The Committee wondered whether the audit and discharge arrangements for various new mandates were consistently analysed, in relation the EIB's own involvement in the projects and disbursement decisions. The Bank agreed to perform a review of the audit discharge procedures for all existing mandates. In addition, the Bank has decided to create a New Business Area Committee to screen and pre-approve all Technical Assistance and Partnership-related proposals. Responding to another recommendation made in the previous annual report, the Bank will review in 2010 the role and scope of the existing New Product Committee in order to ensure that all products and initiatives are properly identified and appraised.

3. AUDIT AND ACCOUNTING MATTERS

3.1 Review of Audit Work

In its work, the Audit Committee relies on the external and internal auditors, from which it receives assurance on the accuracy of financial reporting and confirmation of the effectiveness of the internal control mechanisms. In addition, the Audit Committee obtains a representation letter from the President confirming management's responsibility for establishing and maintaining an efficient internal control structure and its responsibility for the preparation and fair presentation of the financial statements. This representation is, in turn, backed by internal letters of support signed by Directors General and other key management personnel.

The cooperation with the European Court of Auditors is regulated by the Tripartite Agreement, signed by the Commission with the Court and the Bank. We were informed that the Court of Auditors was planning to conduct audits of several mandates and facilities managed by the Bank, in addition to the yearly audit of the Guarantee Fund. We will continue to monitor the implementation of the Court's recommendations by the Bank and maintain the open dialogue with it.

3.1.1. External auditors

Following an international call for tender, the Audit Committee in consultation with the Management Committee designated KPMG as the EIB external auditor starting from 2009. The framework agreement is for a period of four years and may be renewed once, for a further three years. KPMG was simultaneously appointed as auditor of the EIF under similar terms. Although two different audit teams are engaged for the audits at the Bank and at the Fund, under two distinct agreements, synergies have been achieved by having a common Group auditor.

The Committee devoted particular attention to the process of hand over from the previous auditor to KPMG in order to ensure a smooth transition and a good understanding, by the new auditor, of the control structure and financial reporting processes, but also to ensure audit support is available at short notice in relation to key borrowing transactions. Despite the large number of audit mandates, some of which have been added this year (e.g. the audits of the EU GAAP consolidated financial statements and of the NIF Trust Fund), and despite the very tight deadlines of the financial statements approval process, the Audit Committee is satisfied that the new auditor displayed a professional approach and successfully met its obligations.

The Audit Committee asked KPMG to focus on the following areas:

- *Lending*: key controls were tested by the auditors, the audit procedures covered inclusion tests, monitoring controls and the initiation and authorization of loans, referring back to the Statute, Rules of Procedure and the CRPG;
- *Fair value calculations*: KPMG recalculated the fair values of a sample selected from the universe of derivatives, structured loans and borrowings and applied specific tests to ensure that transactions are correctly captured in the Bank's systems;.
- *IT audit*: recommendations for improvement were agreed by the Bank in the context of the Management Letter.

The Audit Committee obtained a confirmation of independence from the external auditor and communicated the EIB policy that consultancy engagements are disallowed to the incumbent auditor.

Discussions were held with the auditors at each Audit Committee meeting, during which the Audit Committee was briefed on the audit progress and the audit and accounting issues. A private interview was conducted before the Committee gave its clearance on the various financial statements.

3.1.2. Internal Audit

The Audit Committee meets regularly with the Inspector General and the Head of Internal Audit and relies on the work of Internal Audit (IA), as well as ensuring coordination between the internal and external audit functions. The internal audit efforts are focused in two directions, namely internal audits of functional areas and processes (auditable targets as defined in the IA work plan) and the Internal Control Frameworks (ICFs).

All internal audit reports are sent for information to the Audit Committee and the most significant ones are discussed at the Committee's meetings, together with IA and the auditees. The Committee also receives periodic reports on finalized and ongoing audits and the quarterly report on the implementation of agreed action plans (AAP). We requested that high risk rated AAPs outstanding for long periods be discussed in front of the Committee together with the services responsible for implementation.

The Audit Committee paid particular importance to the audit reports issued in connection with the implementation and testing of a new IT application covering lending operations and appreciates as positive the recommendations of Internal Audit in the project.

The ICFs now cover substantially all the Bank risk processes and several ICFs were updated during the period under review. Following the review of the procedures manuals in relation to best banking practice, the ICFs will be updated to reflect the identified changes in process flows and controls. In addition, the Audit Committee may request IA to perform specific checks as part of their audit work to contribute to the process of best banking practice compliance verification. The audits will follow the existing IA methodology but will be designed to provide more specific assurance to the Audit Committee about the integration and observance of the relevant best practices.

The Audit Committee was consulted in relation to the Internal Audit Work Program (2010-2012) which is based on a risk matrix derived by IA taking into account several factors such as the inherent risk, the control risk and adjusted based on the time since the last audit of the area and the outcome of the last audit. The Audit Committee suggested, as a matter of best practice, that the audit plan make use of the cartography of risk as an input, when this is established.

3.2 The Financial Statements as at 31 December 2009 and the Annual Statements of the Audit Committee

The *Audit Committee* has examined the three sets of accounts issued by the Bank[2] and those of the Investment Facility[3], the FEMIP Trust Fund, the EU-Africa Infrastructure Trust Fund and the NIF Trust Fund for 2009.

The Bank has prepared for the first time Group financial statements consolidated under the principles of the relevant EU Directives (EU GAAP), in addition to the IFRS consolidated financial statements. The Audit Committee supported this initiative, which permits the Group results to be reported on a basis that better reflects the long term nature of its business model.

As the Committee has stated in previous annual reports, it is more reasonable to use the same basis of preparation for the consolidated and non-consolidated accounts. The performance of the Bank, individually, and as a Group can thus be compared more meaningfully. Indeed the statutory and consolidated results are in the same order of magnitude – as expected and as will generally remain the case, whereas in the last several years reporting under IFRS has produced considerable variations in the consolidated financial result.

The key elements of the various financial statements are presented below.

[2] EIB statutory financial statements (non-consolidated), EIB consolidated financial statements under IFRS and EIB consolidated financial statements under EU GAAP.
[3] The Audit Committee submits a separate report to the Board of Governors regarding its work in relation to the Investment Facility.

Key elements of the statutory financial statements: The Audit Committee noted that the profit recorded for the financial year is EUR 1,877 million, increasing by 13.7% compared with 2008. The balance sheet total has increased by 11.1%, from EUR 325.8 billion at the end of 2008 to EUR 361.9 billion at the end of 2009. The annual increase in the volume of loans to final beneficiaries was 14.8%, compared to an increase of 1.1% in the loans to credit institutions. On the liabilities side we noted a reduction in the commercial paper outstanding at the year end, the result of the fact that the commercial paper program was gradually reduced in favour of the more traditional long and medium term borrowing.

Key elements of the IFRS consolidated financial statements. The Audit Committee warned in its previous Annual Report that it was likely that the effects of the application of the Fair Value Option (FVO), permitted by IAS 39 "Financial Instruments: Recognition and Measurement", could reverse and could result in significant negative adjustments in the following years. Indeed, while a positive impact of no less than EUR 4.7 billion on the consolidated financial statements was recorded last year, bringing the consolidated IFRS 2008 result to EUR 6,356 million, a negative impact of some EUR 4.1 billion was recorded in 2009 resulting from similar adjustments. A loss of EUR 2,281 million is consequently recorded for the financial year in the IFRS consolidated financial statements. However, it should be noted that over a period of six years since 2004 when FVO was introduced the cumulative effects of the adjustments are almost completely neutralised. This is explained by the policy of the Group to hold all financial instruments involved until maturity. It is reminded that the Group has elected to use the FVO as an alternative to hedge accounting. Upon transition to IFRS 9 - the Standard which will replace IAS 39, there is a one-off possibility to revoke FVO for current transactions and to revert to simplified Hedge Accounting, which EIB should duly consider.

Key elements of the consolidated financial statements under EU GAAP. The Group result reported under EU GAAP is a profit of EUR 1,865 million, the difference of EUR 12 million compared with the statutory result being explained by the EIF result and consolidation adjustments amounting to roughly EUR 6 million each. The balance sheet total is also very close to the statutory value at EUR 362.5 billion.

FEMIP Trust Fund. The statement of comprehensive income shows a net comprehensive loss of EUR 2.25 million (compared to a net comprehensive loss of EUR 0.57 million in 2008), 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 total comprehensive loss for 2009 is EUR 22.7 million, compared to a comprehensive income for 2008 of EUR 1.27 million, while the balance sheet total increased to EUR 149 million from EUR 94.78 million at 31 December 2008. As with the FEMIP Trust Fund, the increase in the expenditure on projects largely explains the net results.

The NIF Trust Fund was established *within* NIF for the purpose of providing financial support by way of grants to eligible Projects alongside long-term loan finance made available by Eligible Financial Institutions. The agreement is made between the EC, 15 donors (EU Member States) and the EIB as fund manager. The tasks of the EIB, as manager, are to produce the annual report, the financial statements and statistical information (e.g. on contributions and cash-flows). The Trust Fund is governed by an Executive Committee, chaired by the European Commission.

3.3 Issues of focus for the Audit Committee in 2010

The Audit Committee will monitor the implementation of best banking practice framework and will perform verification as outlined above. To do this, the Audit Committee will focus its meetings with the services responsible in each area and will seek confirmation that the Bank is monitoring the regulatory and professional developments, analysing their applicability to EIB in each case and updating the framework accordingly.

With the objective of improving its own performance, the Audit Committee intends to use external expertise to advise, and possibly validate, the Audit Committee's self assessment, an exercise which has been undertaken already for several years.

Streamlining of Audit Committee processes. Given the increasing volume and complexity of tasks the Committee has to deal with, including the more numerous financial statements on which the

Committee has to provide assurance, the Committee will seek to improve the processes whereby it monitors the critical path for reporting deadlines and organizes its own meetings.

With the adoption of the new Statute and Rules of Procedure, the Audit Committee will also review its own Charter, and will update its internal procedures, with a view to aligning them to the new requirements.

The Audit Committee will continue to monitor the IFRS developments and in particular IFRS 9, the standard expected to replace IAS 39 in order to identify the potential impact on the consolidated financial statements and ensure adequate implementation and disclosure.

In addition, we will continue to devote significant attention to:

- Understanding and monitoring the impact of the financial crisis;
- Overseeing the effective management of risks;
- Ensuring clear and accurate financial reporting.

4. CONCLUSIONS

The Audit Committee was able to carry out its work to fulfil its statutory mandate under normal, unrestricted conditions. The Audit Committee is satisfied that the audit assurance obtained during the meetings, corroborated with the review of the documentation presented, and its own analyses sustain its conclusions. On this basis, the Audit Committee issued 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 2009 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 2009 the Audit Committee received the expected support from the Bank, which enabled it properly to discharge its responsibilities.

In relation to the compliance with best banking practice, we believe that the Bank is reasonably well positioned and that the preparations accomplished to date will enable us to complete a full verification by the date of our next report.

Based on work undertaken and the information received (including an unqualified opinion from the external auditors 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 2009 results and financial status according to the accounting principles applicable in each case.

The Audit Committee is able to extend the same conclusion to the financial statements of the Investment Facility, the FEMIP Trust Fund, the EU-Africa Infrastructure Trust Fund and the Neighbourhood Investment Facility 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, 14 April 2010

O. KLAPPER, Chairman	**G. SMYTH, Member**	**E. MATHAY, Member**
J. RODRIGUES DE JESUS, Member	**D. NOUY, Member**	**J. GALEA, Member**

European Investment Bank

AUDIT COMMITTEE

ANNUAL REPORT TO THE BOARD OF GOVERNORS

INVESTMENT FACILITY

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ANNUAL REPORT TO THE BOARD OF GOVERNORS

ON THE INVESTMENT FACILITY

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1. INTRODUCTION

Since 2003, the EIB's operations in the ACP and OCT regions are carried out under the ACP-EC Cotonou Partnership Agreement and the Overseas Association Decision. The Bank manages the EUR 3.5 billion Investment Facility (funded from EDF resources), which meets the financing needs of investment projects in the region with a broad range of flexible risk-bearing instruments such as junior loans, equity, quasi-capital, guarantees and, in particular cases, interest rate subsidies. For the period 2008-2013, the Bank can also lend up to EUR 2 billion from its own resources, with a specific guarantee from EU Member States. The Bank's product range in the region is usefully complemented by technical assistance grants, which can be used to support or improve projects.

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.

The Audit Committee issues a statement each year confirming, to the best of its knowledge and belief that the financial statements prepared for the Investment Facility gave a true and fair view of its financial position, on the results of its operations and of its cash flows for the year under review.

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 annual report date.

2. AUDIT COMMITTEE WORK

The assurance expressed by the Audit Committee is based primarily on the external audit performed by KPMG, but also 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. The Risk Report for the Investment Facility prepared by the Bank services was also consulted by the Committee. The Audit Committee also obtains an understanding of the activities and risks associated with the various developments by reviewing regular management reports and by interacting with the relevant bank services involved in the IF activities, and mainly in the preparation of the financial statements.

2.1. Operational context

The Bank's activity in the ACP countries picked-up in 2009 both in terms of loan approvals and signatures and this applies also to the Investment Facility. 2010 will be the year of the mid-term review of the IF. It follows on the review of EIB operations outside the EU (the latter excluding the ACPs) and the presentation of the report of the Wise Persons Committee, chaired by Mr Camdessus in the following month, with recommendations on the future of the Bank's external mandates. The year ahead is likely to be challenging, also considering the overall sustainability of the IF. IF capital contributions are capped at EUR 3.5 billion which should ensure a lending volume of EUR 400-450 million per year over the timeframe of the Cotonou Agreement. Member States who provide the budgetary funds constituting the capital endowment of the IF insist that reflows are used first for financing, rather than calling on cash contributions to be paid in. Thus, in 2009 the IF managed to finance its needs without drawing on the 3-rd (and last) annual installment from the MS.

2.2. Meetings with Management

The Audit Committee met on several occasions with the Management of the Investment Facility, who provided an overview of the 2009 activity and insights into the Business plan approved for 2010-2012. The Committee was informed about several organizational changes, including a reinforcement of the regional offices, which would indirectly benefit the Investment Facility.

Monitoring Aspects

Acting on various recommendations, including from the Audit Committee, monitoring will be strengthened with the creation of a special task force and the approval of five additional posts, to be filled in 2010. The Committee noted a rather irregular pattern of disbursements in 2009, due to the numerous conditions attached and which are difficult to confirm on the ground. Increased monitoring, including via the regional offices, could help to increase the level of disbursements in addition to providing strengthened control and early warning in case the projects encounter any difficulties.

Notwithstanding the above, the EIB is always represented in one of the levels of governance (e.g. the Investment Committee) in the case of investments and also the financial intermediaries are subject to reporting obligations on the use of Global Loans, allowing the Bank to monitor these.

2.3. Review of Audit Work

External auditors

The Audit Committee has designated KPMG as the new external auditor in 2009, following an international call for tender. The external auditors report to the Committee, which delegated to them the day-to-day work concerning the audit of the financial statements. 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 assesses regularly the external auditor's independence, including the absence of any conflicts of interests.

Inspector General

Internal Audit finalized, together with the Bank services concerned, the Internal Control Framework (ICF) for "ACP-EU Cotonou Partnership Operations", including the Investment Facility. An ICF identifies and charts the existing controls in a particular area of activity and at the same time provides a critical review of the existing controls, from the point of view of sufficiency, providing recommendations for improvement. Internal Audit also tests key controls identified. The Audit Committee will follow-up on the recommendations made by Internal Audit, in relation to the above mentioned ICF.

The Audit Committee is permanently informed about the alleged cases of wrongdoing and the ongoing investigations relating to Bank projects, including Investment Facility operations. The Committee is pleased to note the proactive approach taken by the Bank in the area of fraud investigation; thus a methodology for pro-active integrity reviews has been recently designed to help ensure that EIB funds are used for the intended purpose. The proactive reviews are expected to identify broader systematic issues, reveal process weaknesses and thereby result in lessons learned which can improve future project preparation and implementation.

European Court of Auditors

The Audit Committee noted that the Court has not issued any audit reports related to the Investment Facility in 2009.

3. THE FINANCIAL STATEMENTS AS AT 31 DECEMBER 2009 AND THE ANNUAL STATEMENT OF THE AUDIT COMMITTEE

The Audit Committee examined the 2009 financial statements of the Investment Facility prepared in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union. The Committee noted, in relation to the 2009 financial statements:

- Income statement: The Investment Facility recorded a loss of EUR 22 million in 2009 compared to a loss of EUR 26 million in 2008. In comparing the results it should be noted that the level of general and administrative expenses is similar to the previous year, while a special contribution to general and administrative expenses was not requested from the Member States in 2009 (in 2008 this amounted to EUR 18 million) following entry into force on 1 July 2008 of the second financial protocol of the Cotonou Agreement and in line with the relevant provisions thereof. Furthermore, the IF recorded a positive net result from financial operations (EUR 9 million) compared to a negative contribution of EUR 18 million in the previous year. Lastly, the net interest and similar income decreased from EUR 61 million in 2008 to EUR 48 million in 2009, but the impairment charge was smaller (EUR 44 million in 2009 compared to EUR 54 million in 2008).
- Balance Sheet: The Balance Sheet total increased during 2009 from EUR 1,145 million to EUR 1,289 million.
- Credit and interest rate risk: The Investment Facility had disbursed exposure totalling EUR 858 million at the end of 2009, increasing from EUR 765 million at the end of 2008.
- Impairment: The impairment adjustments on loans and receivables continued to accumulate, reaching EUR 98 million at the end of 2009 (EUR 2.7 million at the end of 2007 and EUR 52.7 million as of the end of 2008). Following completion of the 2009 fair valuation, impairments have been proposed on 20 projects. These projects are subject to reinforced monitoring and follow-up by the Bank's services.

IFRS valuation: The Audit Committee noted that 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

In meeting its responsibilities in 2009 the aim of the Audit Committee was to achieve a balanced approach 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. We have received full cooperation from the Investment Facility during the reporting period.

Based on the work undertaken and the information we have received (including the unqualified opinion from the external auditor on the financial statements and a representation letter from the Management of the Bank), we conclude that the 2009 financial statements of the Investment Facility have been drawn up correctly and that they give a true and fair view of the 2009 results and financial status according to the accounting principles applicable to the Investment Facility. On this basis, we signed our annual statement as of 11 March 2010, the date on which the EIB Board of Directors has approved the submission of the IF financial statements to the Board of Governors.

Date, 14 April 2010

O. KLAPPER, Chairman	**G. SMYTH, Member**	**E. MATHAY, Member**
J. RODRIGUES DE JESUS, Member	**D. NOUY, Member**	**J. GALEA, Member**

European Investment Bank

Response of the Management Committee

To the Annual Reports of the Audit Committee

For the Year 2009

RESPONSE OF THE MANAGEMENT COMMITTEE

TO THE ANNUAL REPORTS OF THE AUDIT COMMITTEE

FOR THE YEAR 2009

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1 CORPORATE GOVERNANCE AND INTERNAL CONTROL

The Board of Directors has the overall responsibility for maintaining a sound system of internal control that supports the achievement of Bank's policies, aims and objectives while safeguarding the funds and assets of the Bank in accordance with the responsibilities assigned to the Board of Directors within the Statute of the European Investment Bank. For the purposes of this report the European Investment Bank and Investment Facility are collectively referred to as the "Bank" and the "Bank" with the European Investment Fund (EIF) are collectively referred to as the "EIB Group".

The Management Committee, under the authority of the President and the supervision of the Board of Directors, has the day-to-day responsibility for the system of internal control which is based on an ongoing process designed to identify the principal risks to the achievement of policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively, and economically. In this regard, the Management Committee continues to seek measures to enhance the risk management, audit and other internal control structures of the Bank.

The Management Committee and Bank services meet with the Audit Committee during the year and the Bank endeavours to respond promptly to requests of the Audit Committee. The Bank services have maintained a collaborative approach in supporting the work of the Audit Committee and continue to foster mutually constructive, yet appropriately independent, relationships between the Management Committee, Audit Committee, the internal auditors and external auditors. The Bank commits to maintain this collaborative approach to enable the Audit Committee to execute its responsibilities in line with its statutory provision and respecting the areas of focus identified by the Audit Committee.

In addition to an annual external audit of the financial statements under the discharge rules of the Statute, a number of the Bank's activities under partnership agreements are also subject to separate external audit scrutiny. Further, various audit procedures are required in connection with certain bond issues. As both a Community body and a financial institution, the Bank also cooperates with other independent control bodies such as the European Court of Auditors, European Anti-Fraud Office (OLAF) and the European Ombudsman. As such, the Bank is subject to significant independent review throughout the year, as well as at the year end.

The Bank has a balanced approach to 'risk taking' and adopts an active approach to the mitigation of risk. The Management Committee remains satisfied that the major risks to which the Bank is exposed, as identified through the risk management and internal control framework, have been reviewed and systems, policies and/or procedures have been established to manage those risks. Overall internal controls and procedures are effectively designed and operated to provide reasonable assurance on the integrity, legality and timeliness of the underlying transactions and processes of the annual financial statements. To further enhance the Bank's approach to risk management, in 2010 the Bank shall propose the establishment of a Board of Directors sub-committee on market and credit risk.

2 COMPLIANCE AND RISK MONITORING

2.1 Operational Environment and Activities

The protracted financial crisis and more widespread economic downturn motivated a rapid step change in the Bank's financing activities in 2009. In response to calls of the Board of Directors, and in line with the orientations provided by the ECOFIN Council, the Bank pledged its contribution to the EU Recovery Plan by setting and exceeding significantly increased operational activity and borrowing targets for the Corporate Operational Plan (COP) 2009-2011 compared to the orientations given in the COP 2008-2010.

In continuing its contribution to the EU Recovery Plan, the Bank's activity targets for 2010 remain high and will need to be achieved in a market which is yet again uncertain albeit in ways which are somewhat different to that of 2009.

This exceptional increase in activity levels had important implications on resources, systems, procedures and processes. In response, the Bank moved quickly to step-up the recruitment programme and sought efficiency gains through efforts to streamline procedures and processes. The 2010 recruitment programme reflects efforts to normalise staff workloads, support resource intensive operations and meet post-signature obligations. Whenever convenient, temporary peaks in demand for appraisal, monitoring and technical cooperation activities will be managed by the use of external consultants and local agents.

In 2009, the Bank continued to seek and enhance risk and resource-sharing opportunities such as through programmes of "mutual reliance" and co-financing with IFIs and Development Financial Institutions which will be further developed in 2010.

A capital increase came into force in April 2009 and raised subscribed capital to EUR 232bn (from EUR 164bn) corresponding to an outstanding loans ceiling of EUR 628bn under the new Statute. The increase in paid-in capital was fully financed from Bank reserves, without recourse to shareholders' contributions.

The Bank's expanding role has increased public interest and NGO scrutiny hence the Bank shall continue to centralise and sustain management of Civil Society Organisations communications to further enhance transparency of Bank operations, decision making process and implementation of EU policies to strengthen its accountability with public stakeholders.

2.2 Laws and Regulations

The Bank maintains a zero tolerance policy towards fraud and corruption. Improvements derived from the reinforcement of anti-fraud and anti-corruption policies and procedures are fully integrated in the Bank's business dealings and contracts.

The Board of Directors has approved the revised policy proposed by the Management Committee towards offshore financial centres ("OFC"). The Management Committee is further developing detailed procedures to ensure that no OFC Structure in which the EIB Group participates is intended to be used to facilitate prohibited activities such as money laundering, financing of terrorism, tax fraud, tax evasion and harmful tax practices. Indeed at the ECOFIN Council meeting of 2 September 2009, the Council requested the development of common guidelines as regards International Financial Institutions (IFIs) policies and practice vis-à-vis non-cooperative jurisdictions adding that the new EIB policy in this respect could serve as a model.

A number of proactive initiatives primarily aimed at the prevention or deterrence of fraud in Bank supported operations, commenced in 2009 in line with the experience of other IFIs. These initiatives are expected to lead to a higher level of allegations and to the need for even closer cooperation with OLAF and the IFIs as in the case of joint investigation of cases of common interest.

Internally the Bank commenced (i) a thorough programme of fraud awareness training for operations staff and (ii) a new Proactive Integrity Review initiative which uses risk assessment tools to proactively identify projects which may be more vulnerable to fraud or corruption but which have not yet been the subject of a reported suspicion.

2.3 Best Banking Practices

The Bank continues to submit itself voluntarily to the applicable requirements of core EU legislation and relevant standards applicable to the banking sector. The Bank is also committed to the implementation of other relevant accepted best banking practices as defined within a framework established by the Audit Committee in consultation with the Bank's services.

The Bank has already attained full compliance with relevant best banking practices, as defined within the framework, in the areas of corporate governance and accounting/valuation; and almost full compliance in a number of other key areas including Capital requirements and Liquidity risk management.

Areas for further compliance have been identified and actions, reviews or investigations are underway to address them. The Bank's procedural manuals and Internal Control Frameworks will be updated as necessary to ensure compliance in daily operations. The Bank recognises that evolution in banking activities will require continuous review of the best banking practices and commits to the revision, if necessary, of the Bank's associated compliance measures.

2.4 Specific Risk Management and Monitoring Activities

The Bank has further strengthened the framework for the continuous assessment of credit risk, through close monitoring of key indicators including actual and stressed Basel II solvency ratios, asset quality distribution for existing portfolio and new business, evolution of Watch List and Fund for General Banking Risk, risk concentration measures and ratings migration for the universe of target clients. The Bank has also developed a stress testing framework according to best practice risk management techniques to address the impact of the worsening credit environment on the capital situation of the Bank.

The Bank continues to review and improve its risk management methodology. In 2009, a number of revisions and improvements were made to further strengthen the Credit Risk and Financial Risk policy guidelines and associated reporting of compliance.

In line with expectations due to market conditions, the overall level of credit risk in the Bank's loan portfolio has risen as a result of both growing pressures on the creditworthiness of existing counterparts, driven by the continuing effects of the economic crisis and the higher credit risk embedded in new operations.

A further deterioration in internal credit metrics is likely to continue into 2010, as the effects of crisis linger on and the Bank is called to support what is likely to remain an anaemic economic growth. It is however reasonable to expect that the bulk of deterioration will be attributable to factors outside the Bank's control.

The Basel II Capital Adequacy Ratio stood at 30.3% at the year end and is slightly trending down, predominantly driven by the higher risk embedded in new loan signatures. The ratio is significantly above Basel II minimum requirements and the Bank's current internal limit, based on stress testing performed in 2009, of 25%. The methodology to determine this internal limit takes into account the long-term nature of the Bank's lending business, lower granularity of its portfolio and is discussed externally and considered by the Bank sufficient to safeguard its AAA rating. In accordance with Basel II recommendations, the stress testing procedure will be periodically undertaken and the resulting internal limit updated accordingly. The notional Fund for General Banking Risk (FGBR) increased by 0.15 basis points during the year and represented 0.51 % of the total portfolio at the year end; reflecting the evolution of the overall Expected Loss on the stock of signed loans. Pending the approval of the Board of Governors, and in line with the new Statute, the Bank shall revise the existing reserves framework and introduce a Global Loan Reserve to replace the notional FGBR. The Watch List has slightly increased compared to 2008. At the year end 2009 the Watch List stood at 0.37% of the total portfolio. In the context of the final approval of the 2009 financial statements, the Bank will make proposals to the Board of Governors for the creation of a General Loan Reserve and a Special Activities Reserve.

Monitoring – with significant portfolio growth underway the Bank continues to strengthen its ability to internally monitor its counterparts and respond to the potentially increasing number of contractual covenants breaches and distressed situations resulting from deteriorating financial and economic conditions. Therefore the Management Committee decided to focus and implement the monitoring of exposures related to operations in all geographical regions within a new Transaction Management and Restructuring Directorate. A substantial increase in internal monitoring activity is complementing the use of external rating agencies.

Several significant improvements were made in the management of liquidity risk; access to Eurex repo platform was implemented in early 2009 allowing the Bank access to the liquidity operations of the Swiss National Bank and discussions with the European Central Bank led to EIB having unprecedented access to the monetary policy operations of the European System of Central Banks via the Banque Centrale de Luxembourg. The Management Committee also approved the first Contingency Liquidity Plan, which includes monthly liquidity stress tests, in line with the recommendations of the Bank for International Settlements.

2.5 Follow Up Actions

<u>IFRS accounting treatment (subsidiary v Group)</u> - The EIB and EIF both hold investment portfolios made up of similar types of treasury bonds and from an EIB Group perspective, they are classified as Held to Maturity. In 2006, the annual accounts of the EIF were prepared for the first time in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union. The EIF did apply IFRS1 (First Time Adoption) which provides entities with four mandatory exceptions with twelve optional exemptions. The EIF decided to use the following optional exemption:

- *Designation of previously recognised financial instruments: recognition and measurement, permitting a financial instrument to be designated on initial recognition as a financial asset or financial liability at fair value through profit or loss or as a financial asset available for sale. First time adopters have the option of making such a designation at the date of transition to IFRS. The EIF took advantage* *of this exemption and designated the previously recognised Held to Maturity EIF investment portfolio as Available for Sale at the date of transition.*

The above recognition was approved by the previous EIB Group auditors, Ernst & Young, on the understanding that the EIF would never sell any of the bonds, which would otherwise make the whole EIB Group investment portfolio subject to the tainting rule (reclassifying all investment portfolio bonds to Available for Sale). From the EIB Group's perspective, the main concern was to avoid any risk of tainting and as a result, the EIB and EIF agreed to stop any new investments in the "Investment Portfolios" of both entities and to ensure all redemptions would be re-invested in other similar “Available for Sale” portfolios.

There remains some IFRS accounting treatment differences between the EIF own accounts and EIB Group accounts. Further harmonisation of the treatments will take place, with the entry into application of a new accounting framework under IFRS 9.

Information Technology (IT) expertise - The Bank welcomes the inclusion of an Audit Committee member or observer with IT risk experience. The Management Committee fully appreciates the power and importance of IT as a business enabler and remains mindful of the need to properly invest in IT to contribute to business effectiveness and efficiency and also to managing the security risks associated with Bank’s information technology assets.

GAP risk analysis - In 2010 the Bank will begin to develop a cartography of risk that will allow the identification and assessment of all possible risks. This process shall commence with the risk directly identified within the scope of the Risk Management directorate.

Review of counterpart’s limit - As part of the process to align the Bank's policies and reporting with Best Banking Practices, the Bank has undertaken a review of the requirements as outlined in the EU Directive amendments of November 2009. The Bank’s internal credit risk guidelines are being analysed in light of the new EU Directive requirements. The results of the analysis will help determine the impact of this regulation on the Bank's risk management of large exposures. Given that the EU Directive does not explicitly provide all necessary details on how certain treatments are to be applied, some interpretations will only be clarified once the EU Directive amendments are translated into national legislation which is expected in late 2010.

New mandates and products – In October 2009, the Management Committee approved the creation of a New Business Areas Committee (NBAC) to reinforce the screening of technical assistance and partnership-related proposals prior to submission to the Management Committee as well as to ensure the application of a consistent approach. Furthermore the Management Committee endorses the revision of the role and scope of the New Product Committee (NPC) with a view to secure a thorough and structured assessment of new products and initiatives in a complementary and coherent fashion to the newly created NBAC. While the operating procedures of the NPC have already been adapted through a more systematic identification of critical issues, the full review of the NPC as well as the implementation of NBAC will take place in the first semester of 2010. Furthermore, to focus operational knowledge about new EIB lending products and to share cross-Bank experiences at the earliest stage possible, the responsibilities of the former Action for Growth Instruments department have been broadened and developed into a New Product and Special Transaction department.

3 THE INVESTMENT FACILITY

3.1 Allocation of Resources

The Bank is entrusted with the management of the Investment Facility (IF), financed by the EU Member State’s budgets. Resources from the IF, alongside the Bank’s own resources (OR), are utilised in the finance of operations in the African Caribbean and Pacific Countries (ACPs) and in the Overseas Countries and Territories (OCTs). The operations flowing from the IF and the Bank’s own resources are complementary in nature. IF operations typically focus on the riskier market segment of private sector projects that would not normally meet the prudential requirements set under the financing of OR supported operations.

3.2 Common platform for Management and Internal Controls

The key transactions and internal activities related to the management of the IF are handled by the same processes, procedures and infrastructure of the Bank. Hence key management and internal controls, particularly in regard to risk management, internal audit, human resources, treasury and financial reporting are same as those applied to the operations of the EIB. So too, external mandates, including those of the IF, are subject to external audit.