

**European Bank
for Reconstruction and Development**

The Municipal Finance Facility Special Fund

**Annual Financial Report
31 December 2006**

European Bank for Reconstruction and Development

The Municipal Finance Facility Special Fund

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Income statement For the year ended 31 December 2006	Note	Year to 31 December 2006 €000	Year to 31 December 2005 €000
Interest and similar income		405	278
Maturity enhancement fees payable	4	(202)	(154)
Disbursements for technical cooperation	5	(430)	(267)
Other operating expenses	6	-	(87)
Net loss for the year		(227)	(230)

Balance sheet At 31 December 2006	Note	31 December 2006 €000	31 December 2005 €000
Assets			
Placements with credit institutions		13,883	14,033
Other assets	7	26	12
Contributions receivable	8	19,000	16,000
Total assets		32,909	30,045
Liabilities and contributor's resources			
Other liabilities	9	333	242
Total liabilities		333	242
Contributions	8	33,000	30,000
Reserves and retained earnings		(424)	(197)
Total contributor's resources		32,576	29,803
Total liabilities and contributor's resources		32,909	30,045

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Statement of changes in contributor's resources For the year ended 31 December 2006

	Contributions €000	Accumulated profit/(loss) €000	Total €000
At 31 December 2004	30,000	33	30,033
Loss for the year	-	(230)	(230)
At 31 December 2005	30,000	(197)	29,803
Contribution agreement	3,000	-	3,000
Loss for the year	-	(227)	(227)
At 31 December 2006	33,000	(424)	32,576

Statement of cash flows For the year ended 31 December 2006

	Year to 31 December 2006 €000	Year to 31 December 2005 €000
Cash flows from operating activities		
Operating loss for the year	(227)	(230)
Increase in operating assets:		
Interest receivable	(14)	(5)
Increase in operating liabilities:		
Accrued expenses	91	242
Net cash from operating activities	(150)	7
Cash flows from financing activities		
Contributions	-	7,000
Net cash from financing activities	-	7,000
Net (decrease)/increase in cash and cash equivalents	(150)	7,007
Cash and cash equivalents at beginning of year	14,033	7,026
Cash and cash equivalents at 31 December	13,883	14,033

The Municipal Finance Facility Special Fund

Notes to the financial statements

1 Creation of the Special Fund

The creation of The Municipal Finance Facility Special Fund (“the Fund”) was approved by the Board of Directors (“the Board”) of the European Bank for Reconstruction and Development (“the Bank”) at its meeting of 29 April 2003 and is administered, *inter alia*, under the terms of Rules and Regulations of such Special Fund approved by the Board on that date. On 12 December 2003, the Bank entered into a contribution agreement (“the Agreement”) in respect of the Fund with the European Community (“EC”).

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to alleviate the financing problems of municipalities and their utility companies for small infrastructure investments in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia (“the Accession countries”).

2 President’s responsibilities

The President of the Bank is responsible for preparing the financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community’s Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

3 Accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

i Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and the overall principles of the European Community’s Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. The financial statements have been prepared under the historical cost convention.

ii Significant changes in the financial statements

Standards early adopted by the Fund

No standards were early adopted by the Fund in 2006.

Standards, amendments and interpretations effective in 2006 but not relevant to the Fund’s operations

The following new standards, amendments and interpretations to existing standards are mandatory for the Fund’s 2006 financial statements but are not relevant to the Fund’s operations:

- IAS 19 (Amendment), Employee Benefits;
- IAS 21 (Amendment), Net Investment in a Foreign Operation;
- IAS 39 (Amendment), Cash Flow Hedge Accounting for Forecast Intragroup Transactions;
- IAS 39 (Amendment), The Fair Value Option;
- IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts;
- IFRS 1 (Amendment), First-Time Adoption of International Financial Reporting Standards;
- IFRS 6, Exploration for and Evaluation of Mineral Resources;
- IFRIC 4, Determining whether an Arrangement contains a Lease;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

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Notes to the financial statements (continued)

3 Accounting policies (continued)

Standards that are not yet effective and have not been early adopted by the Fund

The following standards have been published that are mandatory for the Fund's accounting period beginning on 1 January 2007 or later periods but that the Fund has not early adopted:

IFRS 7, Financial Instruments: Disclosures, and the complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective for accounting periods from 1 January 2007)

IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including an analysis of sensitivity to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. IAS 1 (Amendment) introduces disclosures about the level of an entity's capital and how it manages that capital. The Fund has assessed the impact of IFRS 7 and IAS 1 (Amendment) and concluded that the main additional disclosures will be in relation to sensitivity analysis. The Fund will apply IFRS 7 and IAS 1 (Amendment) from its annual period beginning 1 January 2007.

IFRS 8, Operating Segments (effective for accounting periods from 1 January 2009)

IFRS 8 requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. As the Fund currently comprises a single primary segment (Banking operations) and one geographic region ("the Accession countries") IFRS 8 is not expected to impact the financial statements. The Fund will apply IFRS 8 from its annual period beginning 1 January 2009.

Interpretations to existing standards that are not yet effective and not relevant for the Fund's operations

The following interpretations to existing standards have been published that are mandatory for the Fund's accounting period beginning on 1 January 2007 or later periods but are not relevant for the Fund's operations:

- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective for accounting periods from 1 March 2006);
- IFRIC 8, Scope of IFRS 2 (effective for accounting periods from 1 May 2006);
- IFRIC 9, Reassessment of Embedded Derivatives (effective for accounting periods from 1 June 2006);
- IFRIC 10, Interim Financial Reporting and Impairment (effective for accounting periods from 1 November 2006);
- IFRIC 11, IFRS 2 – Group and Treasury Share Transactions (effective for accounting periods from 1 March 2007); and
- IFRIC 12, Service Concession Arrangements (effective for accounting periods from 1 January 2008).

iii Contributions

Contributions are recognised as receivable in the balance sheet on the date of signature of a contribution agreement by the Bank and a contributor. Contributions receivable have not been discounted on a present value basis as there has been no indication as to the precise payment date of outstanding contributions. The Fund is satisfied that they will be realised for the amounts stated in the financial statements.

iv Disbursements for technical cooperation

Disbursements for technical cooperation, which represent payments for consultancy services provided to the Fund over a period of time, are recorded as expenditure over the period during which the services are received.

v Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, which are available for use at short notice and which are subject to insignificant risk of changes in value. This definition includes balances of cash and current accounts with foreign banks.

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Notes to the financial statements (continued)

3 Accounting policies (continued)

vi Taxation

In accordance with Article 53 of the Agreement Establishing the Bank dated 29 May 1990, within the scope of its official activities, the Bank, its assets, property and income are exempt from all direct taxes and all taxes and duties levied upon goods and services acquired or imported.

vii Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

4 Maturity enhancement fees

Maturity enhancement fees are incentive payments paid from the Fund to partner banks participating in the Municipal Finance Facility, to encourage longer-term lending to small, medium and micro borrowers. The fees are paid either annually or semi-annually and are calculated as one-off payments for each sub-loan, on a sliding scale based on the maturity enhancement of the sub-loan and paid directly to the partner bank.

5 Disbursements for technical cooperation

	Commitments Approved €000	Disbursements €000	Undrawn commitments €000
Projects in operation			
At 1 January 2005	8,050	-	8,050
Movement in the year	-	(267)	(267)
At 31 December 2005	8,050	(267)	7,783
Movement in the year	250	(430)	(180)
At 31 December 2006	8,300	(697)	7,603

6 Other operating expenses

Other operating expenses comprise administrative expenses directly relating to the Fund and include a management fee payable to the Bank which is set at 1.25 per cent of each contribution instalment. External auditors' remuneration of €7,400 (2005: €7,100) is payable by the Bank from this management fee.

7 Other assets

	2006 €000	2005 €000
Interest receivable on placements	26	12
At 31 December	26	12

8 Contributions

Contributions received and receivable from the EC are set out below:

	2006 €000	2005 €000
Cumulative contributions received	14,000	14,000
Contributions receivable	19,000	16,000
Total contributions at 31 December	33,000	30,000

A replenishment agreement for €3 million was signed on 22 December 2006 (2005: €nil). No contribution instalments were received during the year ended 31 December 2006 (2005: €7 million).

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Notes to the financial statements (continued)

9 Other liabilities

	2006	2005
	€000	€000
Maturity enhancement fees payable	116	63
Disbursements for technical cooperation	217	179
At 31 December	333	242

10 Liquidity position

The table below provides an analysis of assets, liabilities and contributor's resources into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date.

Those assets and liabilities that do not have a contractual maturity date are grouped together in the "Maturity undefined" category.

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Maturity undefined €000	Total €000
Liquidity position at 31 December 2006				
Assets				
Placements with credit institutions	3,471	10,412	-	13,883
Other assets	22	4	-	26
Contributions receivable	-	-	19,000	19,000
Total assets	3,493	10,416	19,000	32,909
Liabilities and contributor's resources				
Other liabilities	(217)	(116)	-	(333)
Total contributor's resources	-	-	(32,576)	(32,576)
Total liabilities and contributor's resources	(217)	(116)	(32,576)	(32,909)
Net liquidity position at 31 December 2006	3,276	10,300	(13,576)	-
Cumulative net liquidity position at 31 December 2006	3,276	13,576	-	-

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Maturity undefined €000	Total €000
Liquidity position at 31 December 2005				
Assets				
Placements with credit institutions	3,620	10,413	-	14,033
Other assets	7	5	-	12
Contributions receivable	-	-	16,000	16,000
Total assets	3,627	10,418	16,000	30,045
Liabilities and contributor's resources				
Other liabilities	-	(242)	-	(242)
Total contributor's resources	-	-	(29,803)	(29,803)
Total liabilities and contributor's resources	-	-	(29,803)	(30,045)
Net liquidity position at 31 December 2005	3,627	10,176	(13,803)	-
Cumulative net liquidity position at 31 December 2005	3,627	13,803	-	-

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Notes to the financial statements (continued)

11 Interest rate risk

The table below summaries the Fund's exposure to interest rate risks. Included in the table are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Non-interest- bearing funds €000	Total €000
Interest rate risk at 31 December 2006				
Assets				
Placements with credit institutions	3,471	10,412	-	13,883
Other assets	-	-	26	26
Contributions receivable	-	-	19,000	19,000
Total assets	3,471	10,412	19,026	32,909
Liabilities and contributor's resources				
Other liabilities	-	-	(333)	(333)
Total contributor's resources	-	-	(32,576)	(32,576)
Total liabilities and contributor's resources	-	-	(32,909)	(32,909)
Interest sensitivity gap at 31 December 2006	3,471	10,412	(13,883)	-

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Non-interest- bearing funds €000	Total €000
Interest rate risk at 31 December 2005				
Assets				
Placements with credit institutions	3,620	10,413	-	14,033
Other assets	-	-	12	12
Contributions receivable	-	-	16,000	16,000
Total assets	3,620	10,413	16,012	30,045
Liabilities and contributor's resources				
Other liabilities	-	-	(242)	(242)
Total contributor's resources	-	-	(29,803)	(29,803)
Total liabilities and contributor's resources	-	-	(30,045)	(30,045)
Interest sensitivity gap at 31 December 2005	3,620	10,413	(14,033)	-

The effective interest rate at 31 December 2006 for Placements with credit institutions was 3.55 per cent (2005: 2.41 per cent).

12 Undrawn commitments

	2006 €000	2005 €000
Disbursements for technical cooperation	7,603	7,783
At 31 December	7,603	7,783

13 Segment information

In accordance with IAS 14, the primary segment of the Fund is business operation and the secondary segment is geographical. At 31 December 2006, the activities of the Fund comprised a single primary segment (Banking operations) and one geographic region ("the Accession countries"). Consequently, no additional disclosure is required.

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Notes to the financial statements (continued)

14 Post balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements.

Independent auditor's report to the Governors of the European Bank for Reconstruction and Development (the 'Bank')

Report on the Financial Statements

We have audited the financial statements of The Municipal Finance Facility Special Fund for the year ended 31 December 2006 which comprise the income statement, the balance sheet, the statement of changes in contributor's resources, the statement of cash flows, the accounting policies and the notes to the financial statements ("financial statements").

President's responsibility for the financial statements

The President is responsible for the preparation and fair presentation of the financial statements in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board, and in accordance with the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the Fund at 31 December 2006 and its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

Other matters

We also report to you if, in our opinion, the financial results section of the Financial Report is not consistent with the financial statements, if the Bank has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

This report, including the opinion, has been prepared for, and only for, the Bank and for the confidential use of the Contributors to the Fund and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

6 March 2007

The maintenance and integrity of the EBRD's website is the responsibility of the President; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing preparation and dissemination of financial statements may differ from legislation in other jurisdictions.