Annual report 2001

Financial report

European Bank
for Reconstruction and Development

The European Bank for Reconstruction and Development (EBRD) began operations in 1991. The Bank's mandate is to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the countries of central and eastern Europe and the Commonwealth of Independent States (CIS) committed to and applying the principles of multiparty democracy, pluralism and market economics.

The EBRD helps its 27 countries of operations to implement structural and sectoral economic reforms, promoting competition, privatisation and entrepreneurship, taking into account the particular needs of countries at different stages of transition. Through its investments it promotes private sector activity, the strengthening of financial institutions and legal systems, and the development of the infrastructure needed to support the private sector. The Bank applies sound banking and investment principles in all of its operations.

In fulfilling its role as a catalyst of change, the Bank encourages co-financing and foreign direct investment from the private and public sectors, helps to mobilise domestic capital, and provides technical cooperation in relevant areas. It works in close cooperation with other international financial institutions, and with international and national organisations. In all of its activities, the Bank promotes environmentally sound and sustainable development.

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Contents

The EBRD's Annual Report 2001 comprises two separate companion volumes: the Annual Review and the Financial Report, which includes the financial statements and the financial results commentary.

Both volumes are published in English, French, German and Russian. Copies are available free of charge from the EBRD's Publications Desk:

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Highlights

Financial results

(€ million)	2001	2000	1999	1998	1997
Operating income	501.5	519.2	376.4	450.5	346.0
Expenses and depreciation	(206.7)	(192.1)	(172.8)	(158.7)	(152.1)
Operating profit before provisions	294.7	327.1	203.6	291.8	193.8
Provisions for losses	(137.6)	(174.3)	(160.9)	(553.1)	(177.7)
Profit/(loss) for the period	157.2	152.8	42.7	(261.2)	16.1
Paid-in capital	5,197	5,186	5,163	5,084	4,877
Capital instalments received (cumulative)	4,063	3,769	3,480	3,217	2,949
Total provisions and reserves	1,713	1,278	1,040	762	508
Total assets	20,947	21,290	19,595	16,047	13,495

Operational results

Annual commitments	2001	2000	1999	1998	1997
Number of projects	102	95	88	96	108
EBRD financing (€ million)	3,656	2,673	2,162	2,373	2,315
Resource mobilisation (€ million)	6,212	5,188	4,862	7,541	4,210
Portfolio (€ million) [1]					
Banking portfolio	14,160	12,218	10,835	10,182	8,932
Operating assets	8,838	7,563	6,955	5,761	4,580
Performing assets	8,160	6,805	6,160	5,247	4,393
Cumulative funds mobilised	47,546	41,949	33,964	29,102	22,335

[1] Figures for 1997-2000 are as reported for those years. They do not reflect subsequent changes due, for example, to exchange rates, cancellations, syndications or restructuring.

Financial results

The EBRD recorded a profit after provisions of €157.2 million for 2001 compared with a profit of €152.8 million for 2000. This increase was primarily due to higher net interest income, significant recoveries from projects that had in prior periods experienced difficulties (in particular following the Russian crisis in 1998), strong Treasury results and continuing budgetary discipline. During the year the Bank consolidated its return to positive reserves, which increased from €65.9 million at the end of 2000 to €488.7 million at the end of 2001.

During the year the EBRD implemented International Accounting Standard 39 (IAS39) Financial Instruments: Recognition and Measurement. In general, IAS39 requires the greater use of fair values in accounting for financial instruments than had previously been the case. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. IAS39 also requires that all financial assets and financial liabilities should be recognised on the balance sheet, including all derivatives. They should initially be measured at cost, which is the fair value of the consideration given or received to acquire the financial instrument. Subsequently all financial assets should be remeasured to fair value, except for two main categories of asset that should be carried at cost or amortised cost less any provisions for impairment: loans and receivables originated by the enterprise and not held for trading, and financial assets whose fair value cannot be reliably measured (equity investments with no quoted market price). The principal impact for the Bank is to recognise all listed share investments and all derivatives on the balance sheet at fair value, including those previously accounted for as hedges in accordance with the treatment of the reference hedged asset or liability. A more detailed summary is set out in note 2 of the financial statements, significant accounting policies. Under the transitional arrangements provided by IAS39 the Bank's opening reserves increased by €218.4 million, with subsequent movements and the profit for the year resulting in the year-end level of reserves. It is anticipated that, due to volatility in share prices and hence fair value movements, reserves will fluctuate in future years.

Operating income before general administrative expenses of €501.5 million was 4 per cent below the €519.2 million operating results of last year. Higher net interest income in 2001 (€326.3 million compared with €273.3 million in 2000) and net fee and commission income (€38.9 million compared with €29.4 million in 2000) resulted from increased operational activity, particularly with net disbursements more than trebling and signings increasing by more than a third when comparing 2001 with 2000. Consequently the charge for general portfolio provisions for possible impairment of assets that are not individually identified almost doubled in the year (€136.4 million compared with €71.2 million). The reduction in the value of non-performing loans on which interest is excluded from the profit and loss account continued during 2001, with the restructuring of several projects and a consequent positive impact on interest income. At 31 December 2001, the Bank had 31 such loans totalling €327.4 million, compared with 32 loans totalling €439.3 million at the end of 2000; 47 per cent or €153.0 million were in the Russian portfolio (2000: 68 per cent or €299.6 million). Successful restructuring along with a generally improved portfolio performance were the principal reasons for significantly lower specific provisions required for the impairment of identified assets during the year. The resulting net charge of €1.1 million compared with a charge of €103.2 million in 2000.

Banking operations achieved a net profit of €65.9 million (2000: €79.1 million) after full allocation of expenses, provisions and return on net paid-in capital. Most revenue areas outperformed their 2000 levels, but the 17 per cent decline in net profit primarily reflected the lower profit achieved from the sale of share investments which, as anticipated, totalled €89.3 million in 2001 (2000: €166.8 million). This underlines the variable nature of this revenue item and the increased volatility in equity markets. Treasury had another profitable year, increasing net profit after full allocation of expenses, provisions and return on net paid-in capital to €91.3 million (2000: profit of €73.7 million) by capitalising on attractive funding opportunities as well as achieving good returns on higher asset volumes.

The EBRD's general administrative expenses were well within budget, reflecting continuing budgetary discipline and effective cost controls, and were €14.6 million above the level of the previous year at €206.7 million (2000: €192.1 million).

Total provisions for Banking operations amounted to €1.22 billion at the end of 2001, compared with €1.19 billion at the end of 2000. This represented 13.9 per cent of disbursed outstanding loans and equity investments (2000: 15.8 per cent) and reflects the EBRD's commitment to provide prudently for existing and foreseeable risks based on a continuing assessment of the portfolio and the associated inherent risks. Provisions attributable to operations in Russia accounted for approximately 31 per cent of total provisions (2000: 37 per cent); non-sovereign provisions represented 27 per cent of non-sovereign disbursed outstandings in that country (2000: 34 per cent).

Banking operations

Portfolio

New business volume in 2001 reached €3.66 billion, representing 102 projects. This is the highest level of annual commitments signed by the EBRD to date and represents an increase of 37 per cent over the level recorded in 2000 (€2.7 billion for 95 projects). Share investments and equity-linked products accounted for 18 per cent of the new business volume. The private sector share of the business volume was 76 per cent. The new business included €97 million of restructured operations.

Net cumulative business volume reached €20.2 billion by the end of 2001 across all the EBRD's countries of operations (2000: €16.6 billion), representing a total project value (including co-financing) of €67.8 billion (2000: €58.5 billion). The portfolio of the Bank's net outstanding commitments grew from €12.2 billion at the end of 2000 to €14.2 billion at the end of 2001, an increase of 16 per cent.

The pipeline of projects under development was strengthened during 2001 following Board approval of 111 projects. These consisted of loans and share investments by the Bank totalling €3.7 billion compared with 107 projects totalling €3.6 billion in 2000. The level of Board approvals in 2001 was the second-highest annual level to date. At the end of 2001 the cumulative approvals, net of cancellations, amounted to €24.1 billion (2000: €20.2 billion). The total project value of the cumulative Board approvals amounted to €80.6 billion compared with €70.6 billion at 31 December 2000.

Gross disbursements totalled €2.4 billion in 2001, an increase of 67 per cent from last year. This is the highest level of annual gross disbursements achieved by the Bank to date. Operating assets reached €8.8 billion at the end of 2001 (2000: €7.6 billion), comprising €6.7 billion of disbursed outstanding loans and €2.1 billion of disbursed outstanding share investments.

Risks

Internal rating procedures

The EBRD conducts regular reviews of individual exposures within its portfolio because of the high credit risk associated with many of the countries in which it operates. All projects that have not reached completion are formally reviewed by Risk Management at least twice a year, with more frequent reviews for those that are perceived to be more vulnerable to default. Annual reviews continue after project completion for private sector exposures. Each review includes a consideration of the project risk rating and, for underperforming projects, the level of specific provisions. Control of disbursement is managed by the Operation Administration Unit within Risk Management, which is responsible for ensuring compliance with project conditionality prior to disbursement. It also ensures that the correct procedures are followed in line with approved policy and that the portfolio is monitored for both country and sector diversification. Investments that are in jeopardy are transferred to the Corporate Recovery Unit, which reports jointly to Risk Management and Banking, to manage the restructuring process in cases where this is likely to achieve positive results.

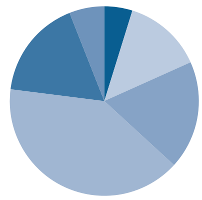
All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (low risk) to 10 (highest risk). The Bank maintains three types of risk ratings: project, country and overall. The project rating is defined through the financial strength of the client and the risk mitigation built into the project structure. The country rating is assessed internally for private sector projects taking into consideration the ratings assessed by the external rating agencies. The overall rating is the worse of the project and country rating. The exception to this for non-sovereign deals is where the Bank has recourse to an unconditional sponsor guarantee, in which case the overall rating is the project rating. For sovereign risk projects, the overall rating is the same as the country rating. For the performing portfolio, general portfolio provisions are established according to a matrix which reflects external indicators of loss, EBRD experience, and project, sector and country risks.

In view of the markets in which it operates and its transition mandate, the EBRD expects the majority of its project ratings in normal circumstances to range from risk categories 4 to 6 (roughly equivalent to Standard & Poor's BBB to B ratings) at the time of approval. At the end of 2001, 72 per cent of the loan and equity portfolio was in risk ratings 4 to 6, as illustrated in the chart shown top right.

The EBRD's portfolio continued to show improvement in 2001, driven by an improving economic performance in Russia which had a knock-on effect in many other national economies. This generally improving trend saw a number of credit rating upgrades of countries of operations by the independent rating agencies. The reduction of the classified portfolio (loans and equity investments in the risk rating categories 7 to 10), which had grown rapidly after the 1998 Russian crisis, continued and for the

Credit quality of the Banking portfolio

31 December 2001

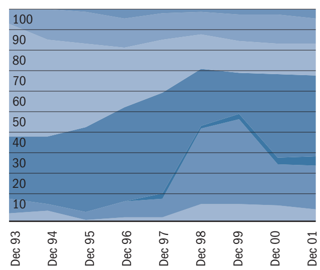


Risk class

1, 2, 3	4.8%
4	13.5%
5	18.5%
6	40.2%
6W, 7	17.0%
8, 9, 10	6.0%

Overall risk rating profile of the loan, guarantee and share investment portfolio over time by signed amounts

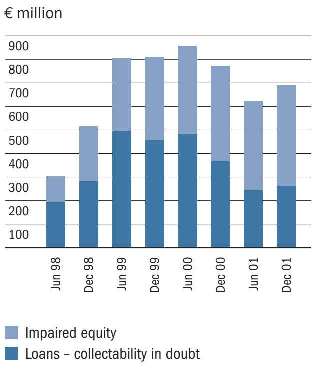
Per cent of total portfolio



Risk class

- 1, 2, 3
- 4
- 5
- 6
- 6W
- 7
- 8, 9, 10

Impaired assets



second consecutive year there was a significant decline in the level of impaired assets. Non-performing loans reduced from €363.8 million to €258.0 million during the year. There was a slight increase in the absolute level of impaired equity from €303.3 million to €316.8 million, but this represented a reduction in the proportion of the growing equity portfolio that was impaired.

The percentage of the portfolio rated 4, 5 or 6 rose to 72 per cent from 68 per cent a year earlier. The proportion of the portfolio in the weaker performance categories of 6W to 10 fell from 30 per cent to 23 per cent.

Impaired assets

Where collectability is in doubt, impairment, being the difference between the carrying value of the loan and the net present value of its expected future cash flows, is recognised in the profit and loss account. Although projects are reviewed for impairment every six months, certain other events may trigger this process sooner, for example when payments of principal or interest are more than 60 days late for non-sovereign exposure or 180 days for sovereign exposure. At this point future collectability is considered and any necessary specific provision put in place. Impaired equity is defined as all those equity investments against which specific provisions have been taken.

The chart on the left illustrates the historical development of the Bank's impaired assets.

The Bank's impaired asset experience peaked in mid-2000, largely reflecting the after-effects of the Russian crisis of 1998. Since then, through the improvements of some projects, successful restructuring and some write-offs, the level of impaired assets has declined to a level of 7.7 per cent of operating assets at 31 December 2001, compared with 10.0 per cent as at 31 December 2000.

Performance

Banking operations recorded a net profit after provisions on a fully allocated basis of €65.9 million for 2001 compared with a net profit of €79.1 million on the same basis for 2000. Operating income of €393.5 million from the Banking business in 2001 was 7 per cent below the €423.0 million achieved in 2000. Net interest income was €45.8 million higher in 2001 and net fee and commission income was €9.5 million higher than in 2000, but the contribution from the equity sector of the portfolio fell as anticipated during 2001 reflecting the increased volatility in equity markets. Dividend income amounted to €20.7 million in 2001 compared with €28.1 million in 2000, while net profit from the sale of share investments totalled €89.3 million in 2001 compared with €166.8 million in 2000. The contribution from this sector of the portfolio to the Bank's profit and loss account is expected to continue to show significant variability from year to year, given its dependence on the timing of equity exits. These are linked to the completion of the Bank's transition role in the specific operation and the opportunity, in the market or otherwise, to achieve a sale of its holding. Exits are projected to increase as the growing equity portfolio continues to mature, but it remains difficult to forecast the potential timing and income from such exits.

Treasury operations

Portfolio

The value of assets under Treasury management was €10.9 billion at 31 December 2001 (2000: €12.4 billion), comprising €7.2 billion of debt securities, €2.9 billion of collateralised placements and €781.4 million of placements with credit institutions (including repurchase agreements).

At the end of 2001, approximately 4 per cent of Treasury assets were managed by a total of 11 external asset managers. The externally managed portfolios comprised a funded and notional amount of €408.9 million of a euro-denominated interest rate trading programme [1] and €405.8 million of a US dollar-denominated mortgage-backed securities programme. The funds are managed by independent managers in order to obtain specialised services and investment techniques, and to establish third-party performance benchmarks. These independent managers are required to comply with the same investment guidelines that the Bank applies to its internally managed funds.

Risks

For monitoring purposes, the Bank distinguishes among market risk, credit risk and operational risk, together with liquidity risk and settlement risk.[2]

Market risk

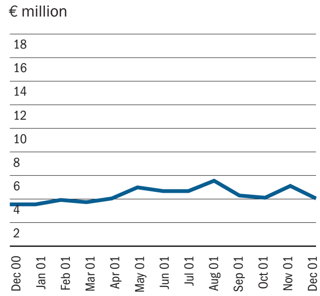
Market risk is the potential loss that could result from adverse market movements. According to the market drivers concerned, market risk is divided into: (i) interest rate risk, (ii) foreign exchange risk, (iii) equity risk and (iv) commodity price risk. The latter two are not relevant to the Bank's Treasury operations, while foreign exchange risk has so far been limited. *Interest rate risks* are further refined into yield curve risk, which measures the impact of changes in the shape of the yield curve for a given currency, and volatility risk, which deals with risks specific to interest rate option transactions. Yield curve risk can in turn be divided into changes in the overall level of interest rates (a parallel shift of an entire yield curve), and changes in the slope or the shape of the yield curve. For *foreign exchange rate risks,* the distinction is also made between risk emanating from changes in the level of foreign exchange rates and those inherent to foreign exchange options.

As at 31 December 2001, the aggregate Value at Risk (VaR) of the Bank's Treasury portfolio, calculated with reference to a 99 per cent confidence level and over a ten-trading-day horizon, stood at €3.9 million [3] (2000: €3.3 million), a moderate year-on-year increase.

These figures and the average utilisation during the year denote a modest utilisation of the total VaR limit for all Treasury funds, whether internally or externally managed, compared with the Board-approved Treasury Authority VaR limit which amounts to €18.0 million when expressed in the same units (99 per cent confidence level, ten-trading-day horizon).

Total VaR – overall limit: €18.0 million

Funding spreads excluded; no diversification effects (10 trading days, 99% confidence level; BIS compliant dataset)



[1] In the euro programme, managers are assigned notional amounts for interest rate positioning without being allocated the actual cash funds.

[2] Settlement risk materialises upon a credit event affecting the counterparty; however, its mitigation relies heavily upon the ability to stop an outgoing payment or transfer with minimal previous notice. Liquidity risk is mainly experienced in situations of market disruption, which in turn could be caused by a failure in industry-wide payment systems.

[3] This means that the Bank had a 1 per cent chance of experiencing a loss of at least €3.9 million over a horizon of ten trading days, due to adverse movements in interest rates and foreign exchange rates.

The VaR of the internally managed portfolios stood at €1.3 million at the end of 2001 (2000: €1.6 million). The range during the year was between €0.5 million and €2.6 million, similar to that observed over previous years. The size of the internally managed portfolio to which these figures relate was €10.2 billion as at 31 December 2001 (2000: €10.7 billion).

In addition, market risks incurred on the externally managed portfolios exhibited a year-end VaR of €0.4 million (2000: €0.6 million) for the euro-denominated programme and €2.2 million (2000: €2.4 million) for the USD-denominated programme.[4] The net asset value of these externally managed portfolios was respectively €49.9 million and €405.8 million as at 31 December 2001.

The specific contribution from foreign exchange risk to the overall VaR stood at €0.6 million at year-end. As in previous years, this contribution was fairly limited at all times in 2001 and never exceeded €1.7 million. Interest rate positioning therefore represented the bulk of the Bank's market risk exposure. Interest rate option positions remained very modest throughout the year, implying very little convexity and sensitivity to interest rate volatility at all times, while foreign exchange options were infrequently used. The proportion of the Bank's overall VaR attributable to option positions remained minimal throughout the year.

Credit risk

Credit risk is the potential loss to a portfolio that could result from the default of a counterparty or the deterioration of its creditworthiness, as exemplified in its downgrading by a rating agency, at any time until the maturity of the longest-dated transaction outstanding with that counterparty. More precisely, it can be referred to as *pre-settlement risk,* as opposed to settlement risk that occurs only at the time when a transaction matures. As a special case, potential losses due to downgrading or, more generally, any change in the relative credit quality of securities are also often known as spread risk or *credit spread risk* (e.g. risks inherent in hedging a long corporate bond position with a short position in government bonds). Also monitored is *concentration risk,* which is the risk arising from too high a proportion of the portfolio being allocated to a specific country, industry sector, obligor, type of instrument or individual transaction.

Liquidity risk is risk arising from the inability to meet short-term cash requirements, difficulties in accessing capital markets for long-term funding, or the inability to liquidate positions in a timely fashion and without adversely affecting market price. In theory, it can also materialise if surplus liquidity has to be invested at below-market rates. Settlement risk is risk incurred on transactions involving payment and/or delivery of cash and/or securities by both parties to a transaction, where no settlement mechanism exists that would ensure that each transfer is conditional upon the other transfer simultaneously occurring. Risk materialises by the counterparty defaulting precisely when a transaction is being settled, once the outgoing transfer is made and before the incoming transfer is received.

[4] The VaR of the USD-denominated programme is computed by an external risk-information provider.

Risk Management assigns internal credit ratings, determined with reference to available ratings by approved credit rating agencies and to the internal assessment of the creditworthiness of counterparties. The internal credit rating scale ranges from 1 to 10, the same as that used for the Banking Department's exposures. The Board-approved Treasury Authority states the minimum rating and maximum tenor by type of eligible counterparty. The actual tenor limit attributed to individual counterparties may be shorter, based on the likely direction of its credit quality over the medium term or on sector considerations. All individual counterparty lines are measured, monitored and reviewed by Risk Management on a regular basis.

The overall credit exposure incurred by the Bank in its Treasury transactions, defined as the aggregate utilisation of credit limits across all countries and all counterparties and across all instruments, is subject to a limit set out in the Treasury Guidelines. Additionally, overall credit risk limits for asset-backed securities (ABS) and for credit derivatives are applied. Large exposure limits and diversification triggers are also in place, together with the specific monitoring of the counterparties to which the Bank has its largest exposures. The Bank devotes particular attention to minimising the risks inherent in over-the-counter derivatives and foreign exchange transactions. These require appropriate documentation to be in place prior to trading, including master agreements, unwinding upon credit downgrading clauses, unilateral break clauses for long-dated transactions and collateral agreements.

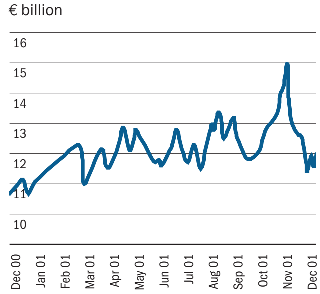
Treasury credit exposure increased by 10.5 per cent over 2001, to reach €12.0 billion at 31 December 2001 (2000: €10.8 billion).

Despite the events of 11 September 2001 and the global economic slowdown, the overall quality of the Treasury credit exposure remained high. At year-end 2001, the weighted average credit risk rating had actually improved to 1.60 (on the Bank's internal rating scale, equivalent to an external rating slightly better than AA+/Aa1), up from 1.65 a year earlier. All exposures were investment grade quality or better, with only sovereign-related exposures in Korea falling below the internal rating of 3.3 (equivalent to A-/A3).

The portfolio's credit risk exposure was diversified across 24 countries with no more than 8 per cent of the exposure in any one country as at 31 December 2001, with the exception of the United States of America at 37.5 per cent (2000: 38.1 per cent) and Germany at 10.6 per cent (2000: 8.2 per cent).

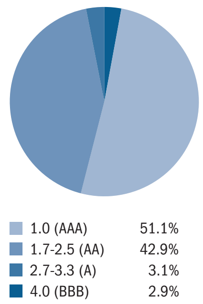
Almost three-quarters of the overall exposure was to banks (53.4 per cent) or to highly rated ABS instruments (19.2 per cent).

Evolution of the overall Treasury credit exposure in 2001



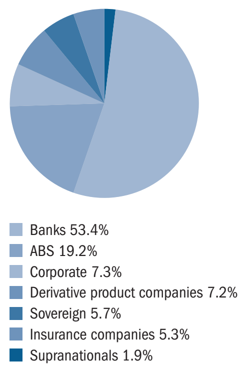
Credit quality profile of the Treasury portfolio

31 December 2001



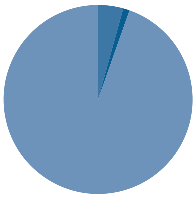
Exposure by counterparty type

31 December 2001



OTC derivatives and foreign exchange exposure [1]

31 December 2001



With Master Agreement (MA) and Credit Support Annex (CSA) 94.6%
With MA only 4.3%
Without MA 1.1%

[1] Percentages are relative to the gross marked-to-market credit exposure.

Credit risk mitigation techniques continue to be actively pursued, notably in the areas of over-the-counter (OTC) derivative transactions and foreign exchange transactions. At the end of 2001, 94.6 per cent of the Bank's gross credit exposure to OTC derivative and foreign exchange transactions was with counterparties with which both a Master Agreement (MA) and a Credit Support Annex (CSA) had been completed. As a consequence, transactions with counterparties either collateralised or triple A rated in their own right, or in many cases, both collateralised and triple A rated, accounted at year-end 2001 for 99.7 per cent of the overall OTC derivatives and foreign exchange exposure.

Operational risk

Operational risk for Treasury transactions is defined as any risk which is neither market nor credit risk; more precisely, it encompasses all situations where controls, systems or processes break down and occasion losses. Management of operational risk in the EBRD's Treasury transactions has continued to emphasise risk monitoring and risk mitigation, rather than operational risk measurement, pending further progress in the quantification techniques for operational risk in the industry at large.

The operational risk indicators have been extensively reviewed. As a result, they have been redesigned in their format and substantially broadened in their reach to permit broad and regular formal management review. Beyond those dealing with transaction processing issues, indicators now also specifically address a variety of other sub-categories of operational risk, from people risk to model risk. This complements the production of risk maps that are regularly produced by the Bank's external auditor and submitted for discussion to the Audit Committee of the Board.

The main drive of operational risk mitigation, beyond ensuring that the principle of segregation of duties is complied with at all stages of the day-to-day processing of transactions, remains focused on systems development. Following the review of all strategic systems performed last year, the replacement of the Bank's back-office and general ledger systems for both Treasury transactions and Banking operations is in progress and due to be completed in 2002. Additionally an across-the-board upgrading of credit risk systems for the management of Treasury exposures is also nearing completion.

Performance

Treasury achieved another strong performance in 2001, contributing €91.3 million profit after provisions (2000: €73.7 million). This increase is principally attributable to improved margins earned on Treasury's investment portfolio, where financial assets were available at historically wide spreads in volatile market conditions.

Funding

Capital

Paid-in capital totalled €5.2 billion at 31 December 2001 and at 31 December 2000. All but three members have now subscribed to the capital increase, with instruments of subscription deposited for 986,975 shares (2000: 982,300). This increases the number of the EBRD's subscribed shares to almost 2.0 million. The fourth instalment of the capital increase became due in April 2001, and paid-in capital received increased to €4.1 billion, from €3.8 billion at the end of 2000.

Overdue capital of cash and promissory notes to be deposited totalled €31.1 million at the end of 2001 (2000: €24.6 million) and a further €9.1 million of encashments of deposited promissory notes is also overdue (2000: €6.4 million). Of the €40.2 million total overdue, €28.7 million relates to the capital increase.

Capital adequacy

The Bank's original authorised share capital was €10.0 billion. By Resolution No. 59, adopted on 15 April 1996, the Board of Governors approved a doubling of the Bank's authorised capital stock to €20.0 billion. The increase allowed the Bank to continue to implement its operational strategy on a sustainable basis.

The Bank's capital usage is guided by statutory and financial policy parameters. Article 12 of the Agreement limits the total amount of outstanding loans, equity investments and guarantees made by the Bank in its countries of operations to the total amount of the Bank's unimpaired subscribed capital, reserves and surpluses, establishing a 1:1 gearing ratio. Article 12 also limits the total amount of disbursed equity investments to the total of the Bank's unimpaired paid-in subscribed capital, surpluses and general reserve.

Consistent with the objective of capital preservation, the EBRD regularly reviews its historic and projected capital adequacy, applying a number of different measures including its statutory headroom limit (i.e. the amount of funds the Bank has available to commit new loans, equity investments and guarantees before it reaches its 1:1 gearing ratio limit) and the Bank's own risk capital model, which distinguishes between debt and equity risks, sovereign and non-sovereign risks. In accordance with the requirements of Article 5.3 of the Agreement, the Bank completed a review of its capital stock during 2001.

This second Capital Resources Review included a review of the transition impact and operational activity of the Bank, an assessment of the economic outlook and transition challenges in the region, the formulation of the medium-term portfolio development strategy and objectives to 2005, and a detailed analysis of the Bank's projected future financial performance and capital adequacy. The traditional headroom measure of capital adequacy was reviewed and further supplemented with a risk-based analysis applying the Bank's own risk capital model. The analysis of capital adequacy showed that the Bank should have sufficient capital to fulfil its medium-term portfolio development objectives within the risk and the financial assumptions of the Capital Resources Review. The analysis of future financial performance showed the Bank to be on course to implement the manageable growth strategy introduced in the first Capital Resources Review, with portfolio turnover and profit generating further headroom for the Bank to enhance its transition impact and operational activity.

Borrowings

The EBRD's borrowing policy is governed by two key principles. First, it seeks to match the average maturity of its assets and liabilities to minimise refinancing risk. Second, it seeks to ensure the availability of long-term funds at optimum cost effectiveness for the Bank.

Total borrowings at 31 December 2001 stood at €14.4 billion, an increase of €0.3 billion compared with 2000. There were 30 new issues under the EBRD's medium- to long-term borrowing programme at an average after-swap cost of Libor minus 26 basis points. This included the Bank's first global US$ 1 billion five-year benchmark issue, which was successfully completed in June. The average remaining life of medium- to long-term debt decreased during the year to stand at 9.0 years at 31 December 2001 (2000: 9.5 years).

In addition to medium- to long-term debt, the figure for total borrowings also reflects short-term debt categorised as debts evidenced by certificates that the Bank raises for cash management purposes.

Expenses

General administrative expenses and depreciation expressed in sterling were £138.5 million for 2001, within budget and representing a £9.0 million increase compared with those for the previous year (2000: £129.5 million), principally reflecting higher staff costs, as staff numbers have been increased to enhance operational capacity, and higher depreciation costs. The Bank continues to focus on budgetary discipline, effective cost controls and a proactive cost-recovery programme. When translated into euro, the EBRD's general administrative expenses, including depreciation, were €206.7 million (2000: €192.1 million).

The average sterling/euro foreign exchange market rate prevailing during the year was 1.62 euro to sterling (2000: 1.64). The actual weighted average rate achieved by the Bank was lower than this due to exchange rate contracts entered into in prior periods of lower sterling to euro exchange rates to minimise the impact of any strengthening of sterling against the euro on the largely sterling-denominated expenses, when translated into euro for reporting purposes. Consequently, a weighted average euro to sterling exchange rate of 1.52 was achieved in 2001 for expenses (2000: 1.52), resulting in a reduction of €11.8 million in 2001 compared with the Bank's expenses reported in euro if the average market foreign exchange rate had applied (2000: €15.0 million).

Provisions

The EBRD's general portfolio provisioning relating to the impairment of unidentified assets on non-sovereign exposures is based on a risk-rated approach, as assessed by the Bank's independent Risk Management department and applied at the end of the month of disbursement. A separate methodology is applied for all sovereign risk assets, which takes into account the Bank's preferred creditor status afforded by its members. The EBRD takes specific provisions for the impairment of identified assets as required on a case-by-case basis. Provisions are based on net disbursements at the relevant reporting date.

The application of the EBRD's provisioning policy resulted in a charge for the year of €137.6 million, which is 79 per cent of the 2000 charge of €174.3 million. The charge in 2000 included Treasury provisions of €7.2 million; such provisions were not made in 2001 as Treasury assets were recorded at fair value following the implementation of IAS39. The 2001 charge for Banking provisions can be analysed between general portfolio provisions for the impairment of unidentified assets, which was a €136.4 million charge compared with €71.2 million in 2000, and specific provisions for the impairment of identified assets, which totalled €1.1 million in 2001 compared with a charge of €103.2 million in 2000. Significantly higher net disbursements, which were more than three times the level reported in 2000, were the principal influence on the general portfolio provisions charge, while substantial asset recoveries following the restructuring of projects and the consequent reversal of specific provisions almost entirely offset new specific provision charges during the year.

As a result of the net charge for 2001, total provisions for Banking operations reached €1.22 billion, which amounted to 13.9 per cent of the outstanding disbursed portfolio of loans and equity investments (2000: €1.19 billion and 15.8 per cent).

Outlook for 2002

The EBRD has budgeted for a modest profit in 2002. This reflects the vulnerability of results to enhanced uncertainty in the economic environment and in financial markets, while the recovery process of previously impaired assets has now largely run its course and less substantial releases of provisions for losses are foreseen for 2002.

Additional reporting and disclosures

Through its reports and disclosures, the EBRD follows the reporting conventions of private sector financial institutions, in line with its policy to reflect best industry practice.

Principles of financial management and risk management

The financial policies of the EBRD follow the guiding principles of sound financial management, building on the Agreement Establishing the Bank and providing the financial framework within which the Bank pursues its mandate.

The EBRD's financial management aims to:

> pursue financial viability;

> build up reserves and ensure sustainable profitability;

> follow market and performance orientation in all its activities;

> work within a comprehensive risk management framework; and

> ensure transparency and accountability at all levels and support effective corporate governance.

The EBRD's financial policies define the financial and risk parameters that apply to Banking and Treasury operations. These policies include provisioning, pricing and liquidity policies as well as the Treasury Authority. The provisioning policy determines the amount of general portfolio provisions for, and the process for applying specific provisions to, all assets. To provide a check on the appropriateness of the policy, total provisions are regularly reviewed against expected losses produced by the Bank's Risk Capital Model. The provisioning policy is reviewed annually. Pricing policies determine the considerations and parameters used to price loans, guarantees and equity investments. The liquidity policy determines the amount of liquid assets required by the Bank. The liquidity policy's annual review included in 2001 a review of EBRD liquidity management against recent guidelines recommended by the Basel Committee on Banking Supervision. Furthermore, the financial policies define capital utilisation and provide portfolio risk parameters for Banking operations, hedging policies, equity valuation, exit procedures and strategies, underwriting, risk management and corporate governance policies. These policies are reviewed regularly in light of experience and external developments.

The Treasury Authority is the document by which the Board of Directors delegates authority to the Vice President Finance to manage the EBRD's Treasury operations and which defines the risk parameters to be observed in these activities. The Financial and Operations Policies Committee reviews the Treasury Authority regularly and its review is submitted to the Board for approval. The Credit Process describes the procedures for approval, management and review of Banking exposures. These are reviewed by the Bank's Audit Committee periodically and submitted to the Board for approval.

The EBRD's independent Risk Management department has overall responsibility for the measurement, monitoring and mitigation of all risks incurred by the Bank in both its Banking and Treasury operations. The Director, Risk Management, acts as the Bank's firm-wide Risk Manager and participates in the meetings of the Bank's Executive Committee. The department seeks to ensure that any risks are correctly identified and appropriately managed and mitigated through comprehensive and rigorous processes which reflect best industry practice.

The EBRD is exposed to credit risk in both its Banking operations and its Treasury activities. Credit risk arises since borrowers and Treasury counterparties could default on their contractual obligations, or the value of the Bank's investments could be impaired. Most of the EBRD's credit risk is in the Banking portfolio. All ordinary operations are reviewed on a regular basis to identify promptly any changes required in the assigned risk ratings and any actions required to mitigate increased risk. Exposures are measured against portfolio risk limits and reported to the Audit Committee on a quarterly basis.

The EBRD's main Treasury market risk exposure is that movement of interest rates and foreign exchange rates may adversely affect positions taken by the Bank in its Treasury portfolio. The EBRD aims to limit and manage market risks to the extent possible through active asset and liability management. Interest rate risks are managed through a combination of synthetically matching the interest rate profiles of assets and liabilities, mainly through the use of derivatives for hedging purposes. Exposures to foreign currency and interest rate risks are measured independently of the Treasury function to ensure compliance with authorised limits.

The Bank monitors its exposure to market risk through a combination of limits, based primarily on Value-at-Risk, and a variety of additional risk measures. Risk Management computes VaR on a daily basis. The Bank's overall Value-at-Risk limit is set in the Board-approved Treasury Authority. Foreign exchange transactions are further constrained by a VaR sub-limit dedicated to foreign exchange exposures. For internal monitoring purposes, VaR is defined as the potential loss that could be incurred, due to adverse fluctuations in interest rates and foreign exchange rates, over a one-day horizon and computed with a 95 per cent confidence level. For enhanced comparability across institutions, Value-at-Risk numbers displayed in the Annual Report are however scaled up to a 99 per cent confidence level, over a ten-trading-day horizon. Additional VaR measures are communicated to senior Finance management, in particular for drilling from aggregate VaR measures down to individual market factors (marginal VaR and VaR sensitivities). Monte-Carlo simulation-based VaR numbers are also produced on a daily basis. For the entire portfolio *eVaR* (expected loss beyond VaR) aims at quantifying the impact of large changes in market drivers. For the options portfolio dedicated *options VaR* computations are performed, so as to verify whether the standard assumptions that underlie VaR calculations hold.

A number of other risk measures are employed to complement VaR data with numbers produced using a different set of assumptions, so that material risks are not ignored by focusing on one particular set of risk measures. Foreign exchange risk and the various types of interest rate risks, whether for outright exposures or for options, are monitored with sensitivity-based measures, independently for each currency and type of option. A series of stress tests is produced on an ongoing basis. These encompass notably: (i) stress-testing the options portfolio for joint large changes in the level of the price of the underlying and that of volatility; (ii) analysing for each currency separately, the profit and loss impact of large deformations in the level and shape of the yield curve; (iii) the production of stress tests based on historical scenarios; (iv) specific stress tests aimed at quantifying the impact of a breakdown in correlations.

Operational risk is determined by examining risk-related exposure other than those falling within the scope of credit and market risk. This includes the risk of loss that may occur through errors or omissions in the processing and settlement of transactions, in the reporting of financial results or failures in controls. Operational risk is further refined into:

> *transaction risk,* which considers all types of errors in the processing of transactions, whether in the areas of execution, booking and settlement, or due to inadequate legal documentation;

> *operational control risk,* or breakdown in the controls surrounding trading activities, such as unidentified limit excesses, unauthorised trading or trading outside policies, or insufficient controls on the processing of transactions;

> *people risk,* or dependency on a limited number of key personnel, inadequate or insufficient staffing in trading, risk management, operations processing and reporting activities, or inadequate skills level or training; and

> *systems risk,* defined as errors or failures in transaction support systems, ranging from errors in the mathematical formulae of pricing or hedging models or in the computation of the marked to market value of transactions *(model risk),* to inadequate disaster recovery planning.

Within the EBRD, there are policies and procedures in place covering all significant aspects of operational risk. These include first and foremost the Bank's high standards of business ethics and its established system of internal controls, checks and balances and segregation of duties, which protect the EBRD from any initial exposure to operational risk. These are supplemented with:

> the EBRD's code of conduct;

> disaster recovery/contingency planning;

> the Public Information Policy;

> integrity due diligence procedures;

> procedures regarding corrupt practices and money laundering;

> procedures to be followed in the event of fraud or suspected fraud;

> information management policy; and

> procurement policies.

The Bank has a Chief Compliance Officer and an Anti-Money-Laundering Officer who are responsible for maintaining the Bank's policies of sound business standards and corporate practices. Anti-money-laundering reviews are conducted internally and the Bank seeks to ensure that anti-money-laundering policies and procedures are maintained by its customers. The Bank takes measures to ensure that it is not inadvertently dealing with terrorists or terrorist activities. The Bank recently conducted a special review to ensure compliance with the UN Security Council Resolution regarding the Prevention of Terrorism. Extensive financial and integrity due diligence is integrated into the Bank's normal approval of new business and review of its existing transactions. Even though the Bank is not a deposit-taking institution, it has intensive "know your customer" policies which include identification of specific integrity concerns and independent review of these risks. The Bank provides regular corporate integrity and anti-money-laundering seminars to its staff and to external bodies to raise skill levels and to increase awareness of these concerns.

The Bank also monitors progress in risk management matters under the framework provided by the Risk Management Enhancement Programme for Treasury Transactions, which was introduced in 1995. The objective of this ongoing programme is to ensure that the EBRD's approach to managing market, credit and operational risk in its Treasury activities is kept in line with the evolving best market practice in the industry. Progress in measuring, monitoring and mitigating these risks is regularly reviewed by the Audit Committee of the Bank's Board of Directors.

Use of derivatives

The EBRD's use of derivatives is primarily focused on hedging interest rate and foreign exchange risks arising from both its Banking and Treasury activities. Market views expressed through derivatives are also undertaken as part of Treasury's activities. In addition, the Bank uses credit derivatives as an alternative to investments in specific securities or to hedge certain exposures; the overall amount of credit derivatives transactions is constrained by a dedicated limit.

All risks arising from derivative instruments are combined with those deriving from all other instruments dependent on the same underlying risk factors and subject to overall market and credit risk limits, as well as stress tests. Additionally, special care is devoted to those risks that are specific to the use of derivatives, through, for example, the monitoring of volatility risk for options, spread risk for swaps and basis risk for futures.

For the purpose of controlling credit risk in its Treasury transactions, the EBRD's policy is to pre-approve each counterparty individually and to review its eligibility regularly. Individual counterparty limits are allocated in compliance with guidelines that set a maximum size and duration of exposure based on the counterparty's credit rating. For each eligible derivatives counterparty, a maximum portion of the individual counterparty limit is allocated to foreign exchange and over-the-counter derivatives.

Derivative transactions in particular are normally limited to the highest-rated counterparties. Furthermore, the EBRD pays great attention to mitigating Treasury derivatives credit risks through systematic recourse to a variety of credit enhancement techniques. Over-the-counter derivatives transactions are systematically documented with Master Agreements, providing for close-out netting. The Bank has sought to expand the scope for applicability of this provision through documenting the widest possible range of instruments transacted with a given counterparty under a single Master Agreement.

The EBRD has continued to expand its use of collateral agreements in relation to its activity in over-the-counter derivatives. By the end of 2001, approximately 95 per cent of the Bank's gross exposure to derivatives counterparties was with counterparties with whom a collateral agreement had been completed, and negotiations for signing such agreements were under way with all remaining active counterparties. As a result almost 100 per cent of the Bank's exposure to foreign exchange and over-the-counter derivatives was either with counterparties rated triple A in their own right, or with counterparties with whom a collateral agreement had been completed, allowing for receipt of collateral in the form of cash or triple A rated government securities.

Corporate governance

The EBRD is committed to effective corporate governance, with responsibilities and related controls throughout the Bank properly defined and delineated. Transparency and accountability are integral elements of its corporate governance framework. This structure is further supported by a system of reporting, with information appropriately tailored for and disseminated to each level of responsibility within the EBRD, to enable the system of checks and balances on the Bank's activities to function effectively.

The EBRD's governing constitution is the Agreement Establishing the Bank, which provides that the institution will have a Board of Governors, a Board of Directors, a President, Vice Presidents, officers and staff.

All the powers of the EBRD are vested in the Board of Governors representing the Bank's 62 shareholders. With the exception of certain reserved powers, the Board of Governors has delegated the exercise of its powers to the Board of Directors while retaining overall authority.

Board of Directors and Board Committees

Subject to the Board of Governors' overall authority, the Board of Directors is responsible for the direction of the EBRD's general operations and policies. It exercises the powers expressly assigned to it by the Agreement and those powers delegated to it by the Board of Governors.

The Board of Directors has established three Board Committees to assist the work of the Board of Directors:

> the Audit Committee;

> the Budget and Administrative Affairs Committee; and

> the Financial and Operations Policies Committee.

The composition of these committees during 2001 is detailed in the separate Review section of the Annual Report.

The President and the Executive Committee

The President is elected by the Board of Governors and is the legal representative of the EBRD. Under the guidance of the Board of Directors, the President conducts the current business of the Bank.

The Executive Committee is chaired by the President and is composed of members of the EBRD's senior management.

Reporting

The EBRD's corporate governance structure is supported by appropriate financial and management reporting. In its financial reporting the Bank aims to provide appropriate information on the risks and performance of its activities, and to observe best practice in the content of its public financial reports. In addition, the Bank has a comprehensive system of reporting to the Board of Directors and its committees. Detailed information is available to enable management to monitor closely the implementation of business plans and the execution of budgets.

Compensation policy

The EBRD has designed a market-oriented staff compensation policy, within the constraints of the Bank's status as a multilateral institution, to meet the following objectives:

> to be competitive in order to attract and retain high-calibre employees;

> to take account of differing levels of responsibility;

> to be sufficiently flexible to respond rapidly to the market; and

> to motivate and encourage excellent performance.

To help meet these objectives, the EBRD's shareholders have agreed that the Bank should use market comparators to evaluate its staff compensation and that salary and bonus should be driven by performance.

The bonus programme allocations are structured to recognise individual and team contributions to the EBRD's overall performance. Bonus payments, although an important element of the total staff compensation package, are limited as a percentage of base salaries. In general, bonus payments do not exceed 30 per cent of base salaries.

The EBRD's Board of Directors, the President and Vice Presidents are not eligible to participate in the bonus programme. The Board of Governors establishes the remuneration of the Board of Directors and the President, whereas the Vice Presidents' remuneration is established by the Board of Directors.

Financial statements

Profit and loss account

For the year ended 31 December 2001	Note	Year to 31 December 2001 € 000	Year to 31 December 2000 € 000
Interest and similar income			
From loans	7	**423,828**	410,190
From fixed-income debt securities and other interest		**476,543**	581,345
Interest expenses and similar charges		**(574,121)**	(718,223)
Net interest income		**326,250**	273,312
Dividend income from share investments		**20,689**	28,081
Net fee and commission income	4	**38,850**	29,379
Financial operations			
Net profit on sale of share investments		**89,343**	166,770
Net profit on dealing activities and foreign exchange	5	**26,343**	21,685
Operating income		**501,475**	519,227
General administrative expenses	6	**(189,743)**	(179,002)
Depreciation	12	**(16,993)**	(13,099)
Operating profit before provisions		**294,739**	327,126
Provisions for losses	7	**(137,557)**	(174,334)
Profit for the year		**157,182**	152,792

Balance sheet

At 31 December 2001	Note	€ 000	31 December 2001 € 000	€ 000	31 December 2000 € 000
Assets					
Placements with and advances to credit institutions		**781,378**		5,344,328 [1]	
Collateralised placements		**2,867,937**			
Debt securities	8	**7,214,548**		7,075,502	
			10,863,863		12,419,830
Other assets	9		**677,485**		763,672
Loans and share investments					
Loans	10	**6,112,052**		4,940,425	
Share investments	10	**1,747,301**		1,386,372	
			7,859,353		6,326,797
Property, technology and office equipment	12		**44,874**		38,894
Paid-in capital receivable	15		**1,501,718**		1,740,817
Total assets			**20,947,293**		21,290,010
Liabilities					
Borrowings					
Amounts owed to credit institutions		**508,327**		455,745	
Debts evidenced by certificates	13	**13,927,335**		13,621,661	
			14,435,662		14,077,406
Other liabilities	14		**826,318**		1,960,609
Subscribed capital	15	**19,789,500**		19,742,750	
Callable capital	15	**(14,592,845)**		(14,556,615)	
Paid-in capital	15		**5,196,655**		5,186,135
Reserves and profit for the year			**488,658**		65,860
Members' equity			**5,685,313**		5,251,995
Total liabilities and members' equity			**20,947,293**		21,290,010
Memorandum items					
Undrawn commitments	11		**5,322,481**		4,655,228

[1] Included in this total, an amount of €2,659,162 relates to financial assets classified at 31 December 2001 as collateralised placements. The reclassification of these assets in 2001 is required under IAS39.

Statement of changes in members' equity

	31 December 2001 € million	31 December 2000 € million
Share capital		
Subscribed capital	**19,789.5**	19,742.8
Callable capital	(**14,592.9**)	(14,556.7)
Paid-in capital	**5,196.6**	5,186.1
Reserves and profit for the year:		
General reserve		
Balance at the beginning of the year	**90.6**	86.2
Internal tax for the year	**5.2**	4.4
IAS39 opening transitional reinstatement	**218.4**	–
IAS39 movement during the year	**42.0**	–
Balance at the end of the year	**356.2**	90.6
Special reserve		
Balance at the beginning of the year	**125.6**	115.7
Qualifying fees and commissions from the prior year	**11.0**	9.9
Balance at the end of the year	**136.6**	125.6
Accumulated profit and loss reserve		
Balance at the beginning of the year	(**303.1**)	(335.9)
Qualifying fees and commissions from the prior year	(**11.0**)	(9.9)
Profit set aside from the prior year	**152.8**	42.7
Balance at the end of the year	(**161.3**)	(303.1)
Profit for the year	**157.2**	152.8
Total reserves and profit for the year	**488.7**	65.9
Total members' equity	**5,685.3**	5,252.0

The **general reserve** contains the retention of internal tax paid in accordance with Article 53 of the Agreement, which requires that all Directors, Alternate Directors, officers and employees of the Bank are subject to an internal tax imposed by the Bank on salaries and emoluments paid by the Bank. Under the Agreement, the Bank retains the internal tax deducted for its benefit. Article 53 of the Agreement, as supplemented by Article 16 of the Headquarters Agreement, provides that salaries and emoluments paid by the Bank are exempt from United Kingdom income tax. The balance at the end of the year relating to internal tax is €38.8 million (2000: €33.6 million). The Bank implemented IAS39 in 2001, and the related movements in reserves reflect the movement in the fair value of available-for-sale assets. Under the transitional arrangements contained in the standard, the Bank recognised in reserves the initial restatement to fair value of available-for-sale financial assets previously held at historic cost. These arrangements added €218.4 million to reserves at the start of 2001, of which €217.4 million related to the fair valuing of the Bank's listed share investments and €1.0 million to Treasury available-for-sale assets. The associated movement in the year increased reserves by a further €42.0 million, of which an increase of €57.9 million related to the fair valuing of the Bank's listed share investments and a decrease of €15.9 million related to Treasury available-for-sale assets. During 2001 €21.3 million has been transferred from reserves to the profit and loss account (€22.3 million transferred out of reserves as a result of realised gains on the sale of listed share investments and €1.0 million positive flow to reserves from Treasury available-for-sale assets). In line with IAS39 the conversion reserve has been added to the general reserve. For further description relating to the implementation of IAS39 please see note 2.

The **special reserve** is maintained, in accordance with the Agreement, for meeting certain defined losses of the Bank. The special reserve has been established, in accordance with the Bank's financial policies, by setting aside 100 per cent of qualifying fees and commissions received by the Bank associated with loans, guarantees and underwriting the sale of securities, until such time as the Board of Directors determines that the size of the special reserve is adequate. In accordance with the Agreement it is intended that an amount of €21.0 million (2000: €11.0 million), being qualifying fees and commissions earned in the year to 31 December 2001, will be appropriated in 2002 from the profit for the year to 31 December 2001 and set aside to the special reserve.

The **accumulated profit and loss reserve** brought forward from prior years represents the accumulated losses after appropriations of qualifying fee and commission income to the special reserve.

Statement of cash flows

For the year ended 31 December 2001	€ 000	Year to 31 December 2001 € 000	€ 000	Year to 31 December 2000 € 000
Cash flows from operating activities				
Operating profit for the year	**157,182**		152,792	
Adjustments for:				
Provisions for losses	**137,557**		174,334	
Unwinding of the discount relating to impaired identified assets	(**5,737**)		–	
Depreciation	**16,993**		13,099	
Realised gains on share investments	(**89,343**)		(166,770)	
Internal taxation	**5,193**		4,366	
Unrealised losses/(gains) on marked to market portfolio	**388**		(2,389)	
Realised (gains) on investment portfolio	(**968**)		(1,829)	
Foreign exchange movements on provisions	**24,395**		37,562	
Operating profit before changes in operating assets	**245,660**		211,165	
Decrease/(increase) in operating assets:				
Interest receivable and prepaid expenses	**160,599**		8,033	
Positions held in marked to market portfolio	(**620,291**)		41,251	
(Decrease)/increase in operating liabilities:				
Interest payable and accrued expenses	(**238,992**)		130,649	
Net cash (used in)/from operating activities		(**453,024**)		391,098
Cash flows from investing activities				
Proceeds from repayment of loans	**1,713,874**		1,410,119	
Net placements with credit institutions	(**207,426**)		(21,197)	
Proceeds from sale of share investments	**320,055**		253,175	
Proceeds from sale of investment securities	**2,365,991**		3,129,471	
Purchases of investment securities	(**2,826,515**)		(2,244,432)	
Funds advanced for loans and share investments	(**3,266,951**)		(2,190,162)	
Purchase of property, technology and office equipment	(**22,996**)		(10,984)	
Net cash (used in)/from investing activities		(**1,923,968**)		325,990
Cash flows from financing activities				
Capital received	**249,619**		206,907	
Issue of debts evidenced by certificates	**12,428,292**		4,721,974	
Redemption of debts evidenced by certificates	(**12,122,461**)		(2,910,913)	
Net cash from financing activities		**555,450**		2,017,968
Net (decrease)/increase in cash and cash equivalents		(**1,821,542**)		2,735,056
Cash and cash equivalents at beginning of period		**4,867,385**		2,132,329
Cash and cash equivalents at 31 December [1]		**3,045,843**		4,867,385

[1] Cash and cash equivalents comprise the following amounts maturing within 3 months:

	2001 € 000	2000 € 000
Placements with and advances to credit institutions	**721,543**	2,523,617
Collateralised placements	**2,703,616**	2,659,162
Amounts owed to credit institutions	(**379,316**)	(315,394)
Cash and cash equivalents at 31 December	**3,045,843**	4,867,385

Note: Operating profit includes dividends received of €20.7 million (2000: €28.1 million).

Notes to the financial statements

1. Establishment of the Bank

i Agreement Establishing the Bank

The European Bank for Reconstruction and Development ("the Bank"), whose principal office is located in London, is an international organisation formed under the Agreement Establishing the Bank dated 29 May 1990 ("the Agreement"). As at 31 December 2001 the Bank's shareholders comprised 60 countries, together with the European Community and the European Investment Bank.

ii Headquarters Agreement

The status, privileges and immunities of the Bank and persons connected therewith in the United Kingdom are defined in the Headquarters Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Bank ("Headquarters Agreement"). The Headquarters Agreement was signed in London upon the commencement of the Bank's operations on 15 April 1991.

2. Significant accounting policies

i Accounting convention

The financial statements have been prepared in accordance with the Bank's Accounting Policies, which comply with International Financial Reporting Standards, as approved by the International Accounting Standards Board (IASB), and the overall principles of the European Community's Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions. Future standards issued by the IASB will be known as International Financial Reporting Standards. Standards already issued by the IASB will continue to be known as International Accounting Standards (IAS).

ii Financial Instruments following IAS39 adoption

IAS39, Financial Instruments: Recognition and Measurement became a requirement for financial reporting periods beginning on or after 1 January 2001. The standard provides comprehensive guidance on the accounting treatment for all financial instruments. Financial instruments are categorised into financial assets, financial liabilities and derivatives and are required to be recognised on the balance sheet by the standard. IAS39 (paragraphs 171-172) provides transitional arrangements for the adoption of this standard, requiring restatement as at the beginning of the current reporting period, and states that financial statements of prior financial years should not be restated. Consequently some balance sheet and related footnote disclosures as at 31 December 2001 are not necessarily comparable with those displayed relating to the prior period. This is principally related to share investments and debts evidenced by certificate.

A Financial assets

(a) Trading

This category comprises assets acquired for the purpose of generating profits from short-term price fluctuations. Such assets are measured at fair value on the basis of market quotes with all changes in value reported in the profit and loss account as they occur. Assets held in this category are accounted for at the trade date.

(b) Loans and receivables

Loans and receivables originated by the Bank are measured at cost less any provision for impairment or uncollectibility, unless they form part of a qualifying hedging relationship with a derivative position (see "hedge accounting" below). This occurs in cases of fixed rate loans that, through association with individual swaps, are transformed from a fixed rate basis to a floating rate basis. In such cases, the loan is re-measured to fair value in respect of interest rate risk with the change in value reported in the profit and loss account as an offset to the change in value of the related swap. This category of financial asset is recognised at settlement date. Included in this category are bonds held as banking assets which, in prior years, were disclosed in debt securities.

(c) Available-for-sale

This category comprises assets that do not specifically belong to one of the other categories. For the Bank this comprises its share investments and the majority of its Treasury portfolio. Such assets are measured at fair value on the balance sheet. The standard affords a one-off option to recognise changes in the fair value of these assets either in reserves or in the profit and loss account. The Bank has chosen to record changes in fair value through reserves, as disclosed in the 'Statement of changes in members' equity', until the financial asset is sold, collected or otherwise disposed of, or until the financial asset is determined to be impaired, at which time the cumulative profit or loss previously recognised in reserves is included in the profit and loss account. The Bank has decided to report this through reserves as it believes it would be misleading to recognise immediately in its profit and loss account short-term price fluctuations on assets that are generally intended to be held for the medium to long term.

Where an available-for-sale asset is the hedged item in a qualifying fair value hedge (see "hedge accounting" below), the fair value gain or loss attributable to the risk being hedged is reported in the profit and loss account rather than reserves. This is to ensure there is consistency of reporting as the fair value changes on the derivative acting as the hedge must be reported in the profit and loss account. Hedge accounting features in Treasury positions where asset swaps are used to transform the returns on fixed interest-rate securities to a floating rate basis.

Share investments
The basis of fair value for listed share investments is the quoted closing market price on the balance sheet date, less discount applied to take into account the illiquid nature of the Bank's portfolio. The Bank's unlisted share investments are held at historic cost because there is no active market to allow for a fair value to be determined, less any provisions for impairment at the balance sheet date. Purchases and sales of share investments are recorded at trade date. Note 10 analyses listed and unlisted share investments indicating purchases and sales.

Treasury portfolio
The fair value of assets comprising Treasury's available-for-sale portfolio is based on bid quotes obtained from external brokers. Included in this category are collateralised placements, which are structures wherein the risks and rewards associated with the ownership of a reference asset are transferred to another party through the use of a swap contract and economically are a form of collateralised lending. In prior years this category was included in placements. The 2000 comparatives have not been adjusted to show the two categories separately in line with IAS39.

B Financial liabilities

(a) Liabilities held for trading

This occurs where the Bank has sold debt securities it does not yet own, known as "short" selling, with the intention of buying those securities more cheaply at a later date and thus generating a trading profit. Such liabilities are measured at fair value with all changes in value reported in the profit and loss account as they occur.

(b) All other financial liabilities

With the exception of liabilities held for trading, all other financial liabilities are measured at amortised cost using the effective yield method, unless they form part of a qualifying hedge relationship with a derivative position (see "hedge accounting" below).

C Derivatives

All derivatives are measured at fair value with immediate effect in the profit and loss account unless they form part of a qualifying cash-flow hedging relationship (see "hedge accounting" below). In this case, the fair value of the derivative is taken to reserves to the extent that it is a perfect hedge to the identified risk. Any hedge ineffectiveness will result in that proportion of the fair value remaining in the profit and loss account.

Hedge accounting
Hedge accounting is designed to bring consistency of accounting treatment to financial instruments, which would not otherwise be permitted. A valid hedge relationship exists when a specific relationship can be identified between two or more financial instruments in which the change in value of one instrument, the "hedge", is highly negatively correlated to the change in value of the other, the "hedged item". To qualify for hedge accounting this correlation must remain within boundaries of 80 to 125 per cent.

The Bank's hedging activities are primarily designed to mitigate interest rate risk by using swaps to convert fixed interest rate risk, on both assets and liabilities, into floating rate risk. Such hedges are known as "fair value" hedges. In such cases, the fair value changes on the hedged items, attributable to the risks being hedged, are reported in the profit and loss account along with the fair value changes on the swaps.

IAS39 requires that hedge relationships must be identified to an individual asset or liability, or similar groups thereof. Hedges of net risks between assets and liabilities ("macro" hedging) do not qualify for hedge accounting. The Bank, in common with most financial institutions, engages in such macro hedging on grounds of cost, prudence and efficiency. However. because this type of hedging does not qualify for hedge accounting under IAS39, the fair value changes of the hedging derivatives are immediately reflected in the profit and loss account, while no such adjustment is made in respect of the movements in fair value of the hedged item being reflected. The fair value changes arising on the net positions hedged, which would otherwise largely offset the change in fair values of the derivatives, cannot be reported in the profit and loss account. These circumstances therefore introduce a new source of volatility into the profit and loss account. However, provided the macro hedges are economically effective, the short-term gains and losses impacting the profit and loss account are reversed over time as the net income or expense on the underlying positions accrues into the profit and loss account.

For further information on risk and related management policies refer to the section on risk in the Financial Results commentary.

Adjustment to opening balances
As a result of adopting IAS39, and in accordance with the transitional provisions of this standard, the Bank classified its investment securities as 'available-for-sale'. The opening transitional adjustment for fair valuing all financial assets was to add €218.4 million to retained earnings, which principally related to the Bank's listed share investments.

iii Foreign currencies

In accordance with Article 35 of the Agreement, the Bank used the European Currency Unit (ECU) as the reporting currency for the presentation of its financial statements. Following the replacement of ECU with euro from 1 January 1999, the reporting currency, for the presentation of the financial statements, is euro (€). The measurement currency is also euro, as this is the primary currency of economic activity within the Bank.

Monetary assets and liabilities denominated in foreign currencies are translated into euro at spot rates as at 31 December 2001. Non-monetary items are expressed in euro at the exchange rates ruling at the time of the transaction. Revenue and expense items are translated into euro at the month-end rate at which they occurred, except for sterling expenses, which are hedged and converted at the weighted average hedge rate.

iv Capital subscriptions

The Bank's share capital is denominated in euro. However, in addition to settling their capital obligations in euro, members are also entitled to settle in United States dollars or Japanese yen. For this purpose, a fixed exchange rate for each currency was defined in Article 6 of the Agreement and these fixed exchange rates are used to measure the value of the associated capital as reported in 'Members' equity' in the balance sheet. Current exchange rates are, however, used to report the corresponding value of capital receivable on the asset side of the balance sheet. The difference between the current value of capital receivable and its Agreement value is reported in the profit and loss account.

In order to ensure that capital receipts due in United States dollars or Japanese yen retain, at a minimum, their value as determined by the Agreement's fixed rates, the Bank's policy is to lock in their euro value through foreign exchange hedge contracts. These hedge contracts are marked to market in accordance with IAS39 with any gain or loss being recorded in the profit and loss account.

v Associates

The Bank has considered both IAS28 and the European Community's Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions, in relation to its share investments and has taken advantage of the provision in IAS28 which, as the Bank does not produce consolidated financial statements, allows for investments in associates to be held at cost. In cases where the Bank holds 20 per cent or more of an investee company, the Bank does not normally seek to exert significant influence. Since the Bank does not prepare consolidated financial statements, all such equity investments are carried at cost, with disclosure in note 10 of their book value and of the profit and loss impact were equity accounting principles to have been applied.

vi Provision for losses

Where the collectability of identified loans and advances and future cash flows from identified unlisted share investments is in doubt, specific provisions for impairment, being the difference between the carrying value of the asset and the net present value of expected future cash flows, are recognised in the profit and loss account. If a specific provision for impairment is made for a listed share investment, where there is objective evidence of the impairment available, any change in fair value that had previously been recognised in reserves is reversed from reserves and taken to the profit and loss account. Assets are reviewed for impairment at least every six months by the Bank's independent Risk Management function. Resulting adjustments may include the unwinding of the discount in the profit and loss account over the life of the loan, and any adjustments required in respect of a reassessment of the initial impairment.

Provisions for impairment of classes of similar assets that are not individually identified as impaired are calculated on a portfolio basis for loans, advances and unlisted share investments. The methodology used for assessing such impairment is based on a risk-rated approach for non-sovereign assets applied at the end of the month of disbursement. A separate methodology is applied for all sovereign risk assets which takes into account the Bank's preferred creditor status afforded by its members. The effect of applying this methodology is considered to approximate to the calculation of impairment on a portfolio basis, being the difference between the carrying value of the groups of similar assets and the net present value of their expected future cash flows.

Impairment as determined is deducted from the loans and share investments asset categories. Impairment of guarantees is applied when effective and based on utilisation using a consistent methodology to that on non-sovereign risk assets (as above) and is included in 'Other liabilities'.

Impairment, less any amounts reversed during the period, is charged to the profit and loss account, as summarised in note 7. When a loan is deemed uncollectable or there is no possibility of recovery of a share investment, the principal is written off against the related estimated impairment. Subsequent recoveries are credited to the profit and loss account if previously written off.

vii Property, technology and office equipment

Property, technology and office equipment is stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method to write off the cost of each asset to its residual value over the estimated life as follows:

Freehold property: Nil
Improvements on leases of less than 50 years unexpired: Unexpired periods
Technology and office equipment: 1 year.

viii Accounting for leases

Leases of equipment where the Bank assumes substantially all the benefits and risks of ownership are classified as finance leases. The assets are treated as if they had been purchased outright at the values equivalent to the estimated value of the underlying lease payments during the periods of the lease. The corresponding lease commitments are included under liabilities. The interest element of the finance charge is charged to the profit and loss account over the lease period. The equipment acquired under such leasing contracts is capitalised and depreciated in accordance with (vii) above.

Leases of assets under which all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. The Bank has entered into such leases for most of its office accommodation, both in London and in the Bank's countries of operations. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which the termination takes place.

ix Interest, fees and commissions and dividends

Interest is recorded on an accruals basis. Where collectability is in doubt, impairment, being the difference between the carrying value of the loan and the net present value of expected future cash flows, is recognised in the profit and loss account. Assets are reviewed individually for impairment at least every six months by the Bank's independent Risk Management function. Resulting adjustments may include the unwinding of the net present value discount in the profit and loss account over the life of the loan, and any adjustments required in respect of a reassessment of the initial impairment. For loans on which the Bank has allowed interest and fee payments to be deferred or capitalised, income may, however, be recognised when received based on the underlying performance of the project.

Front-end fees are recorded as income when the loan becomes effective. Commitment fees and fees received in respect of services provided over a period of time are recorded as income over the period during which the commitment exists or the services are provided from the date when the loan becomes effective. Other fees and commissions are taken to income when received. Issuance fees and redemption premiums or discounts are amortised over the period to maturity of the related borrowings.

Dividends relating to share investments are recognised when received.

x Staff retirement plan

The Bank has a defined contribution scheme and a defined benefit scheme to provide retirement benefits to substantially all of its staff. Under the defined contribution scheme, the Bank and staff contribute to provide a lump sum benefit. The defined benefit scheme is funded entirely by the Bank and benefits are based on years of service and a percentage of final gross base salary as defined in the scheme.

All contributions to the schemes and all other assets and income held for the purposes of the schemes are kept by the Bank separately from all of its other assets. Actual contributions made to the defined contribution scheme are charged to the profit and loss account and transferred to the schemes' independent custodians. The charge to the profit and loss account in respect of the defined benefit scheme is based on the current service cost and other actuarial adjustments as determined by qualified external actuaries. Also included in this charge are actuarial gains and losses in excess of a 10 per cent corridor which are amortised over the estimated average service life remaining of the Bank's employees. The 10 per cent corridor is the higher of 10 per cent of the defined benefit obligation or fair value of assets. The actuaries also advise the Bank as to the necessary contributions to be made to the defined benefit scheme which are transferred to the schemes' independent custodians.

xi Taxation

In accordance with Article 53 of the Agreement, 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, except for those parts of taxes or duties that represent charges for public utility services.

xii Government grants

Government grants relating to fixed asset expenditure considered as part of the initial establishment of the Bank are recognised in the profit and loss account on a straight-line basis over the same period as that applied for depreciation purposes. Other grants are matched against the qualifying expenditure in the period in which it is incurred. The balance of grants received or receivable that have not been taken to the profit and loss account are carried in the balance sheet as deferred income within 'Other liabilities'.

3. Segment information

Business segments

For management purposes the business of the Bank is comprised primarily of Banking and Treasury operations. Banking activities represent investments in projects which, in accordance with the Agreement, are made for the purpose of assisting the countries of operations in their transition to a market economy, while applying sound banking principles. The main investment products are loans, share investments and guarantees. Treasury activities include raising debt finance, investing surplus liquidity, managing the Bank's foreign exchange and interest rate risks and assisting clients in asset and liability management matters.

Primary reporting format – business segment:

	Banking 2001 € 000	**Treasury 2001 € 000**	**Aggregated 2001 € 000**	Banking 2000 € 000	Treasury 2000 € 000	Aggregated 2000 € 000
Interest income	**429,539**	**470,832**	**900,371**	415,805	575,730	991,535
Other income	**148,882**	**26,343**	**175,225**	224,230	21,685	245,915
Total segment revenue	**578,421**	**497,175**	**1,075,596**	640,035	597,415	1,237,450
Less interest expenses and similar charges	**(336,155)**	**(406,057)**	**(742,212)**	(350,948)	(516,088)	(867,036)
Allocation of capital benefit	**151,282**	**16,809**	**168,091**	133,932	14,881	148,813
Less general administrative expenses	**(174,753)**	**(14,990)**	**(189,743)**	(164,861)	(14,141)	(179,002)
Less depreciation	**(15,379)**	**(1,614)**	**(16,993)**	(11,855)	(1,244)	(13,099)
Segment result before provisions	**203,416**	**91,323**	**294,739**	246,303	80,823	327,126
Provisions	**(137,557)**	**–**	**(137,557)**	(167,177)	(7,157)	(174,334)
Net profit after provisions	**65,859**	**91,323**	**157,182**	79,126	73,666	152,792
Segment assets	**8,111,665**	**11,333,910**	**19,445,575**	6,591,157	12,958,036	19,549,193
Paid-in capital receivable			**1,501,718**			1,740,817
Total assets			**20,947,293**			21,290,010
Segment liabilities	**8,111,665**	**11,333,910**	**19,445,575**	6,591,157	12,958,036	19,549,193
Members' equity receivable			**1,501,718**			1,740,817
Total liabilities			**20,947,293**			21,290,010
Capital expenditure	**20,811**	**2,185**	**22,996**	9,940	1,044	10,984

Interest expense and similar charges, and the capital benefit from above together total €574.1 million (2000: €718.2 million), which is the Bank's 'Interest expenses and similar charges' as reported in the profit and loss account.

Secondary reporting format – geographical segment:

Banking activities in the countries of operations are divided into three regions for internal management purposes.

	Segment revenue 2001 € 000	Segment revenue 2000 € 000	**Segment assets 2001 € 000**	Segment assets 2000 € 000
Advanced countries [1]	**248,045**	235,207	**3,703,838**	2,869,969
Early/Intermediate countries [2]	**216,380**	285,081	**3,015,176**	2,637,139
Russian Federation	**113,996**	119,747	**1,392,651**	1,084,049
Total	**578,421**	640,035	**8,111,665**	6,591,157

[1] Advanced countries are Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia.

[2] Early/Intermediate countries are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Federal Republic of Yugoslavia, Former Yugoslav Republic of Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Geographical segment data in respect of Banking activities is disclosed above. A geographical analysis of Treasury activities is not considered beneficial due to the use of derivative instruments switching revenues into different currencies and locations to that from which the assets originate. The geographical segment revenue above and the Treasury business segment revenue together form total segment revenue of €1.1 billion.

4. Net fee and commission income

The main components of net fee and commission income are as follows:

	2001 € 000	2000 € 000
Front-end fees	**17,101**	9,685
Commitment fees	**11,702**	11,669
Guarantee fees	**2,594**	770
Management fees	**2,411**	3,434
Administration fees	**2,251**	967
Trade finance fees	**2,195**	2,496
Other	**596**	358
Net fee and commission income	**38,850**	29,379

5. Net profit on dealing activities and foreign exchange

	2001 € 000	2000 € 000
Available-for-sale portfolio	**968**	749
Dealing portfolio	**31,005**	22,925
Foreign exchange	**3,068**	(1,989)
(Losses) on non-qualifying hedges	(**8,698**)	–
Net profit on dealing activities and foreign exchange	**26,343**	21,685

Net profit on dealing activities represents, in the case of the Bank's available-for-sale portfolio, the realised gains arising on disposal of debt securities in that portfolio. In the case of the dealing portfolio, net profit includes both realised and unrealised gains or losses together with associated interest income and expense. The loss on non-qualifying hedge represents the change in fair value of derivatives not qualifying as hedges.

6. General administrative expenses

	2001 € 000	2000 € 000
Personnel costs [1]	**121,675**	111,183
Overhead expenses net of government grants [2]	**68,068**	67,819
General administrative expenses [3]	**189,743**	179,002

[1] The average numbers of staff included in personnel costs during the year were: regular staff of 866 (2000: 848), contract staff of 72 (comprising special contract staff of 37 and interns/short-term staff of 35), locally hired staff in Resident Offices of 249, and Board of Directors personnel of 76. Of these 46 were externally funded.

Staff numbers at 31 December 2001 were: regular staff of 894 (2000: 862), contract staff of 77 (comprising special contract staff of 36 and interns/short-term staff of 41), locally hired staff in Resident Offices of 259, and Board of Directors personnel of 76. Of these 53 were externally funded.

In addition, 211 Project Bureau staff (2000: 206) were engaged by the Regional Venture Funds and Russia Small Business Fund on projects in the Russian Federation.

[2] During the year, government grants of €2.1 million (2000: €2.1 million) were taken to the profit and loss account.

[3] Sterling general administrative expenses totalled £126.1 million (2000: £119.3 million).

The Bank has had exchange rate contracts to minimise the impact of any strengthening of sterling against the euro on the largely sterling denominated expenses, when translated into euro for reporting purposes. This had the impact of reducing general administrative expenses by €11.8 million in 2001 (2000: €15.0 million).

7. Summary of provisions for losses

Profit and loss charges	Loans € 000	Share investments € 000	Total loans and share investments € 000	Guarantees and other € 000	Treasury provisions € 000	**2001 Total € 000**	2000 Total € 000
Portfolio provision for the impairment of unidentified assets:							
Non-sovereign risk assets	59,738	68,612	128,350	(1,626)	–	**126,724**	228,605
Sovereign risk assets	7,471	–	7,471	–	–	**7,471**	1,866
Guarantees	–	–	–	2,218	–	**2,218**	14,305
Specific provisions for the impairment of identified assets [1]	(52,081)	53,428	1,347	(203)	–	**1,144**	103,179
Outstanding commitments	–	–	–	–	–	**–**	(173,621)
For the year ended 31 December 2001	**15,128**	**122,040**	**137,168**	**389**	**–**	**137,557**	
For the year ended 31 December 2000	6,530	151,763	158,293	8,884	7,157		174,334

[1] During the year new specific provisions for the impairment of identified assets of €132.0 million were made and €130.9 million were released resulting in a net charge to the profit and loss account of €1.1 million.

Movement of provisions	Loans € 000	Share investments € 000	Total loans and share investments € 000	Guarantees and other € 000	Treasury provisions € 000	**2001 Total € 000**	2000 Total € 000
At 1 January 2001	600,075	580,460	1,180,535	18,366	13,192	**1,212,093**	1,131,093
Charge	15,128	122,040	137,168	389	–	**137,557**	174,334
Unwinding of the discount relating to the provision for the impairment of identified assets [1]	(5,737)	–	(5,737)	–	–	**(5,737)**	–
Foreign exchange adjustments	24,118	–	24,118	277	–	**24,395**	37,562
IAS39 opening reinstatement adjustment [2]	–	(61,104)	(61,104)	–	(13,192)	**(74,296)**	–
Release against amounts written off	(35,076)	(34,736)	(69,812)	–	–	**(69,812)**	(130,896)
At 31 December	**598,508**	**606,660**	**1,205,168**	**19,032**	**–**	**1,224,200**	1,212,093
Analysed between							
Portfolio provision for the impairment of unidentified assets:							
Non-sovereign risk assets	260,779	289,889	550,668	2,509	–	**553,177**	493,673
Sovereign risk assets	75,592	–	75,592	–	–	**75,592**	68,121
Specific provisions for the impairment of identified assets	262,137	316,771	578,908	–	–	**578,908**	635,994
Deducted from assets	598,508	606,660	1,205,168	2,509	–	**1,207,677**	1,197,788
Included in other liabilities	–	–	–	16,523	–	**16,523**	14,305
At 31 December	**598,508**	**606,660**	**1,205,168**	**19,032**	**–**	**1,224,200**	1,212,093

[1] Included in interest income from loans is €5.7 million relating to the unwinding of the net present value discount.

[2] This relates to the reversal of provisions on financial assets which are fair valued, following the implementation of IAS39.

8. Debt securities

Analysis by issuer	**Book value 2001 € 000**	Book value 2000 € 000
Governments	**719,651**	701,060
Public bodies	**689,181**	904,537
Other borrowers	**5,805,716**	5,469,905
At 31 December	**7,214,548**	7,075,502
Analysis by portfolio		
Available-for-sale portfolio	**5,861,808**	5,208,121
Dealing portfolio		
Internally managed funds	**814,715**	1,190,365
Externally managed funds	**538,025**	625,440
	1,352,740	1,815,805
Bonds held as banking assets [1]	**–**	51,576
At 31 December	**7,214,548**	7,075,502

[1] The bonds held as banking assets were reclassified to loans in 2001 following IAS39 implementation.

9. Other assets

	2001 € 000	2000 € 000
Interest receivable	**166,461**	382,853
Treasury-related	**382,512**	290,964
Other	**128,512**	89,855
At 31 December	**677,485**	763,672

10. Loans and share investments

Outstanding disbursements	Loans € 000	Unlisted share investments € 000	Listed [1] share investments € 000	Total share investments € 000	Total loans and share investments € 000
At 1 January 2001	5,540,500	1,287,035	679,797	1,966,832	7,507,332
IAS39 adjustments [1]	70,650	–	236,495	236,495	307,145
Disbursements	2,611,879	409,240	6,842	416,082	3,027,961
Repayments, prepayments and disposals	(1,713,874)	(174,971)	(55,741)	(230,712)	(1,944,586)
Foreign exchange movements	238,990	–	–	–	238,990
Written off	(35,076)	(34,736)	–	(34,736)	(69,812)
At 31 December 2001	**6,713,069**	**1,486,568**	**867,393**	**2,353,961**	**9,067,030**
Provisions at 31 December 2001 [2]	(601,017)	(502,417)	(104,243)	(606,660)	(1,207,677)
Total outstanding disbursements at 31 December 2001	**6,112,052**	**984,151**	**763,150**	**1,747,301**	**7,859,353**
Total outstanding disbursements at 31 December 2000	4,940,425	848,986	537,386	1,386,372	6,326,797

[1] This includes bonds held as banking assets reclassified from debt securities to loans in 2001 and the revaluation to fair value of the listed share investments portfolio following the implementation of IAS39. Comparatives have not been restated. IAS39 also required the reversal of the portfolio provision on unidentified listed share investments, which is in the provisions line above, as analysed in note 7. Total outstanding disbursements for listed share investments, at 31 December 2000, include general provisions and exclude the fair value revaluation.

[2] Provisions for loans includes €2.5 million for bonds held as banking assets classified in note 7 under guarantees and other.

At 31 December 2001 the Bank categorised 31 loans as impaired, totalling €327.4 million (2000: 32 loans totalling €439.3 million). Specific provisions on these assets amounted to €262.1 million (2000: €337.9 million). Interest has been excluded from the profit and loss account of approximately €21.4 million as a result of the estimated impairment. The unwinding of the net present value discount relating to provisions for the impairment of identified assets has added €5.7 million of income to the profit and loss account in interest income from loans.

Since the Bank has no subsidiaries it does not prepare consolidated financial statements. It accounts for all unlisted share investments at cost less provision for impairment. If the Bank were to have equity accounted for all investments in which it owns 20 per cent or more of the investee share capital, the book value of which, included in share investments in the balance sheet as at 31 December 2001, was approximately €574.0 million, the net incremental impact on the profit and loss account would be a profit of approximately €46.1 million (31 December 2000: €585.0 million and €17.2 million respectively). This represents the Bank's share of net profits or losses from the most recent available audited financial statements of its investee companies. The Bank's share of retained earnings in respect of these investee companies since acquisition would be a profit of approximately €264.4 million. Due to the time delay in obtaining audited financial statements that have been prepared in accordance with International Financial Reporting Standards from all investee companies, these figures are based on profits or losses from the most recent 12-month period for which such information is available.

Listed below are all share investments where the Bank owned more than 20 per cent of the investee share capital at 31 December 2001 and where the Bank's total investment less specific provisions on the impairment of identified assets exceeded €20.0 million. Significant shareholdings are normally only taken in anticipation of, wherever possible, subsequent external participation.

	%
Lafarge: Romcim	38
Danone MPF – Danone Industria LLC	30
Lafarge: Kujawy	22

11. Analysis of operational activity

Analysis by country	**Outstanding disbursements 2001 € 000**	Outstanding disbursements 2000 € 000	**Undrawn commitments 2001 € 000**	Undrawn commitments 2000 € 000
Albania	**30,696**	31,924	**62,237**	46,926
Armenia	**74,205**	74,666	**26,997**	29,724
Azerbaijan	**210,940**	204,204	**92,792**	90,171
Belarus	**75,654**	87,903	**13,665**	7,365
Bosnia and Herzegovina	**73,604**	57,133	**113,090**	79,903
Bulgaria	**323,080**	305,924	**42,110**	57,670
Croatia	**383,581**	336,318	**379,187**	232,733
Czech Republic	**376,532**	294,691	**139,823**	141,801
Estonia	**228,881**	199,082	**22,867**	40,760
Federal Republic of Yugoslavia	**6,566**	–	**225,815**	–
Former Yugoslav Republic of Macedonia	**114,587**	94,377	**74,214**	88,122
Georgia	**115,456**	89,481	**70,418**	85,502
Hungary	**492,555**	489,086	**135,583**	108,158
Kazakhstan	**306,120**	233,800	**329,228**	324,552
Kyrgyzstan	**106,687**	109,782	**24,426**	25,778
Latvia	**112,292**	95,534	**48,669**	68,576
Lithuania	**209,555**	250,858	**89,745**	54,531
Moldova	**87,822**	75,109	**62,313**	69,229
Poland	**1,249,510**	863,884	**598,251**	526,418
Romania	**996,919**	880,414	**364,520**	339,971
Russian Federation	**1,724,770**	1,494,710	**764,791**	732,937
Slovak Republic	**382,649**	206,613	**83,990**	35,628
Slovenia	**202,981**	200,879	**11,190**	22,322
Tajikistan	**11,255**	10,972	**22,790**	2,786
Turkmenistan	**56,910**	40,473	**77,396**	111,467
Ukraine	**432,126**	336,531	**542,255**	629,728
Uzbekistan	**300,017**	255,443	**233,938**	217,526
Regional	**381,080**	243,192	**670,181**	484,944
At 31 December	**9,067,030**	7,562,983	**5,322,481**	4,655,228

Analysis by instrument

Loans	**6,652,604**	5,540,500	**4,008,212**	3,527,185
Share investments	**2,353,961**	1,966,832	**782,671**	806,876
Debt securities	**60,465**	55,651	**–**	–
Guarantees	**–**	–	**531,598**	321,167
At 31 December	**9,067,030**	7,562,983	**5,322,481**	4,655,228

Analysis by sector

Commerce and tourism	**213,194**	222,636	**111,949**	72,016
Community and social services	**160,251**	122,133	**151,193**	126,859
Energy/power generation	**1,042,309**	847,324	**1,499,977**	1,393,283
Extractive industries	**595,356**	506,013	**183,491**	263,123
Finance	**2,958,269**	2,330,210	**1,272,207**	1,166,492
Manufacturing	**2,039,655**	1,807,801	**755,453**	596,054
Primary industries	**139,031**	111,902	**150,736**	106,053
Telecommunications	**897,086**	709,042	**160,264**	210,735
Transport and construction	**1,021,879**	905,922	**1,037,211**	720,613
At 31 December	**9,067,030**	7,562,983	**5,322,481**	4,655,228

Note: the 2000 comparatives have not been restated to include the fair value revaluation above cost for listed share investments.

12. Property, technology and office equipment

	Property € 000	Technology and office equipment € 000	Total € 000
Cost			
At 1 January 2001	68,711	75,780	144,491
Additions	924	22,072	22,996
Disposals	(2,134)	(1,061)	(3,195)
At 31 December 2001	**67,501**	**96,791**	**164,292**
Depreciation			
At 1 January 2001	37,956	67,641	105,597
Charge	4,678	12,315	16,993
Disposals	(2,111)	(1,061)	(3,172)
At 31 December 2001	**40,523**	**78,895**	**119,418**
Net book value			
At 31 December 2001	**26,978**	**17,896**	**44,874**
At 31 December 2000	30,755	8,139	38,894

There were no additions during the year for assets purchased under finance leases. The related minimum payments under finance leases amount to €0.8 million, of which €0.3 million are due within 12 months of the balance sheet date and €0.5 million are due after one year but within five years of the balance sheet date. These future payments are included in 'Other liabilities'.

13. Debts evidenced by certificates

The Bank's outstanding debts evidenced by certificates and related swaps are summarised below:

	Principal at nominal value € 000	Unamortised premium € 000	Adjusted principal value € 000	Currency swaps payable/ (receivable) € 000	Fair value adjustment € 000	**Net currency obligations 2001 € 000**	Net currency obligations 2000 € 000
Australian dollars	785,357	–	785,357	(785,357)	–	**–**	–
Canadian dollars	138,554	–	138,554	(138,554)	–	**–**	–
Czech koruna	113,396	–	113,396	(113,396)	–	**–**	–
Estonian kroons	6,373	–	6,373	(6,373)	–	**–**	–
Euro	1,430,266	24,961	1,455,227	657,600	1,118,557	**3,231,384**	2,264,622
Gold bullion	667,192	–	667,192	(667,192)	–	**–**	–
Hong Kong dollars	354,917	–	354,917	(354,917)	–	**–**	–
Hungarian forints	81,722	–	81,722	(73,988)	–	**7,734**	7,549
Japanese yen	1,347,740	–	1,347,740	(906,521)	–	**441,219**	480,001
Korean won	74,950	–	74,950	(74,950)	–	**–**	–
New Taiwan dollars	614,102	–	614,102	(614,102)	–	**–**	–
Polish zloty	193,137	–	193,137	(193,137)	–	**–**	–
Russian roubles	37,834	–	37,834	(23,601)	–	**14,233**	–
Singapore dollars	91,787	–	91,787	(91,787)	–	**–**	–
Slovak koruna	34,954	–	34,954	(34,954)	–	**–**	–
South African rands	368,691	–	368,691	(368,691)	–	**–**	–
Sterling	3,165,064	–	3,165,064	(1,030,630)	–	**2,134,434**	1,869,621
Turkish lire	121,571	17,100	138,671	(138,671)	–	**–**	–
United States dollars	3,136,145	2,965	3,139,110	4,959,221	–	**8,098,331**	8,999,868
At 31 December	**12,763,752**	**45,026**	**12,808,778**	**–**	**1,118,557**	**13,927,335**	**13,621,661**

During the year the Bank redeemed €184.2 million of bonds and medium-term notes prior to maturity generating a net gain of €1.7 million.

14. Other liabilities

	2001 € 000	2000 € 000
Interest payable	**126,018**	369,246
Treasury-related	**524,375**	1,437,085
Other	**175,925**	154,278
At 31 December	**826,318**	1,960,609

15. Subscribed capital

	Number of shares 2001	2001 Total € 000	Number of shares 2000	2000 Total € 000
Authorised share capital	**2,000,000**	**20,000,000**	2,000,000	20,000,000
of which				
Subscriptions by members – initial capital	**991,975**	**9,919,750**	991,975	9,919,750
Subscriptions by members – capital increase	**986,975**	**9,869,750**	982,300	9,823,000
Subtotal – subscribed capital	**1,978,950**	**19,789,500**	1,974,275	19,742,750
Shares to be allocated	**–**	**–**	4,675	46,750
Unallocated shares [1]	**6,050**	**60,500**	6,050	60,500
Authorised and issued share capital	**1,985,000**	**19,850,000**	1,985,000	19,850,000
Not yet subscribed	**15,000**	**150,000**	15,000	150,000
At 31 December	**2,000,000**	**20,000,000**	2,000,000	20,000,000

[1] Shares potentially available to new or existing members.

During 2001 the Federal Republic of Yugoslavia subscribed to the Bank's capital increase (4,675 shares), which increased subscribed capital by €46.8 million.

The Bank's capital stock is divided into paid-in shares and callable shares. Each share has a par value of €10,000. Payment for the paid-in shares subscribed to by members is made over a period of years determined in advance. Article 6.4 of the Agreement provides that payment of the amount subscribed to the callable capital shall be subject to call, taking account of Articles 17 and 42 of the Agreement, only as and when required by the Bank to meet its liabilities. Article 42.1 provides that in the event of termination of the operations of the Bank, the liability of all members for all uncalled subscriptions to the capital stock shall continue until all claims of creditors, including all contingent claims, shall have been discharged.

Under the Agreement, payment for the paid-in shares of the original capital stock subscribed to by members was made in five equal annual instalments. Of each instalment, up to 50 per cent was payable in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the subscribing member and payable to the Bank at par value upon demand. Under Resolution No. 59, payment for the paid-in shares subscribed to by members under the capital increase is to be made in eight equal annual instalments, and a member may pay up to 60 per cent of each instalment in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the member and payable to the Bank at par value upon demand. The Board of Directors agreed a policy of encashment in three equal annual instalments for promissory notes relating to initial capital, and five equal annual instalments for promissory notes relating to the capital increase.

A statement of capital subscriptions showing the amount of paid-in and callable shares subscribed to by each member, together with the amount of unallocated shares and votes, is set out in the following table. Under Article 29 of the Agreement, the voting rights of members that have failed to pay any part of the amounts due in respect of their capital subscription obligations are proportionately reduced for so long as the obligation remains outstanding.

Summary of paid-in capital receivable:	2001 € 000	2000 € 000
Promissory notes issued by members:		
– not yet due for encashment	**354,469**	317,368
– due for encashment	**9,090**	6,420
Total promissory notes received	**363,559**	323,788
Paid-in subscribed capital:		
– amounts not yet due	**1,107,099**	1,392,463
– amounts due but not yet received	**31,060**	24,566
Total paid-in subscribed capital receivable	**1,138,159**	1,417,029
Paid-in capital receivable at 31 December	**1,501,718**	1,740,817

15. Subscribed capital (continued)

Statement of capital subscriptions

At 31 December 2001 Members	Total shares (number)	Resulting votes[1] (number)	Total capital € 000	Callable capital € 000	Paid-in capital[2] € 000
Members of the European Union					
Austria	45,600	45,600	456,000	336,300	119,700
Belgium	45,600	45,600	456,000	336,300	119,700
Denmark	24,000	24,000	240,000	177,000	63,000
Finland	25,000	25,000	250,000	184,370	65,630
France	170,350	170,350	1,703,500	1,256,335	447,165
Germany	170,350	170,350	1,703,500	1,256,335	447,165
Greece	13,000	13,000	130,000	95,870	34,130
Ireland	6,000	6,000	60,000	44,250	15,750
Italy	170,350	170,350	1,703,500	1,256,335	447,165
Luxembourg	4,000	4,000	40,000	29,500	10,500
Netherlands	49,600	49,600	496,000	365,800	130,200
Portugal	8,400	8,400	84,000	61,950	22,050
Spain	68,000	62,220	680,000	501,500	178,500
Sweden	45,600	45,600	456,000	336,300	119,700
United Kingdom	170,350	170,350	1,703,500	1,256,335	447,165
European Community	60,000	60,000	600,000	442,500	157,500
European Investment Bank	60,000	60,000	600,000	442,500	157,500
Other European countries					
Cyprus	2,000	2,000	20,000	14,750	5,250
Iceland	2,000	2,000	20,000	14,750	5,250
Israel	13,000	13,000	130,000	95,870	34,130
Liechtenstein	400	388	4,000	2,950	1,050
Malta	200	200	2,000	1,470	530
Norway	25,000	25,000	250,000	184,370	65,630
Switzerland	45,600	45,600	456,000	336,300	119,700
Turkey	23,000	23,000	230,000	169,620	60,380
Countries of operations					
Albania	2,000	1,592	20,000	14,750	5,250
Armenia	1,000	867	10,000	7,370	2,630
Azerbaijan	2,000	989	20,000	14,750	5,250
Belarus	4,000	4,000	40,000	29,500	10,500
Bosnia and Herzegovina	3,380	2,029	33,800	24,930	8,870
Bulgaria	15,800	15,800	158,000	116,520	41,480
Croatia	7,292	7,292	72,920	53,780	19,140
Czech Republic	17,066	17,066	170,660	125,861	44,799
Estonia	2,000	2,000	20,000	14,750	5,250
Federal Republic of Yugoslavia	9,350	9,350	93,500	68,960	24,540
Former Yugoslav Republic of Macedonia	1,382	1,341	13,820	10,200	3,620
Georgia	2,000	867	20,000	14,750	5,250
Hungary	15,800	15,800	158,000	116,520	41,480
Kazakhstan	4,600	4,600	46,000	33,920	12,080
Kyrgyzstan	2,000	1,167	20,000	14,750	5,250
Latvia	2,000	2,000	20,000	14,750	5,250
Lithuania	2,000	2,000	20,000	14,750	5,250
Moldova	2,000	1,433	20,000	14,750	5,250
Poland	25,600	25,600	256,000	188,800	67,200
Romania	9,600	9,600	96,000	70,800	25,200
Russian Federation	80,000	80,000	800,000	590,000	210,000
Slovak Republic	8,534	8,534	85,340	62,939	22,401
Slovenia	4,196	4,196	41,960	30,940	11,020
Tajikistan	2,000	761	20,000	14,750	5,250
Turkmenistan	200	178	2,000	1,470	530
Ukraine	16,000	14,880	160,000	118,000	42,000
Uzbekistan	4,200	4,168	42,000	30,970	11,030
Non-European countries					
Australia	20,000	20,000	200,000	147,500	52,500
Canada	68,000	68,000	680,000	501,500	178,500
Egypt	2,000	1,750	20,000	14,750	5,250
Japan	170,350	170,350	1,703,500	1,256,335	447,165
Korea, Republic of	20,000	20,000	200,000	147,500	52,500
Mexico	3,000	3,000	30,000	21,000	9,000
Mongolia	200	200	2,000	1,470	530
Morocco	1,000	1,000	10,000	7,000	3,000
New Zealand	1,000	1,000	10,000	7,000	3,000
United States of America	200,000	200,000	2,000,000	1,475,000	525,000
Capital subscribed by members	**1,978,950**	**1,965,018**	**19,789,500**	**14,592,845**	**5,196,655**
Unallocated shares	6,050		60,500		
Authorised and issued share capital	**1,985,000**		**19,850,000**		

[1] Voting rights are restricted for non-payment of amounts due in respect of the member's obligations in relation to paid-in shares. Total votes before restrictions amount to 1,978,950 (2000: 1,969,600).

[2] Of paid-in capital, €4.1 billion has been received (2000: €3.8 billion). €1.1 billion is not yet due (2000: €1.4 billion), which relates primarily to the capital increase and is payable on or before 15 April 2005.

16. Net currency position

	Euro € 000	United States dollars € 000	Japanese yen € 000	Sterling € 000	Other currencies € 000	**Total € 000**
Assets						
Placements with and advances to credit institutions	174,724	515,360	43,088	44,744	3,462	**781,378**
Collateralised placements	2,699,788	3,828	–	–	164,321	**2,867,937**
Debt securities	1,025,445	4,633,790	775,880	721,368	58,065	**7,214,548**
Other assets	112,567	400,962	23,496	72,350	68,110	**677,485**
Loans	1,944,544	3,976,882	9,694	–	180,932	**6,112,052**
Share investments	–	–	–	–	1,747,301	**1,747,301**
Property, technology and office equipment	44,874	–	–	–	–	**44,874**
Paid-in capital receivable	841,993	506,287	153,438	–	–	**1,501,718**
Total assets	**6,843,935**	**10,037,109**	**1,005,596**	**838,462**	**2,222,191**	**20,947,293**
Liabilities						
Amounts owed to credit institutions	(320,050)	(38,419)	(129,011)	(1,453)	(19,394)	(**508,327**)
Debts evidenced by certificates	(2,573,783)	(3,139,111)	(1,347,740)	(3,165,064)	(3,701,637)	(**13,927,335**)
Other liabilities	(323,401)	(299,889)	(15,885)	(121,572)	(65,571)	(**826,318**)
Total liabilities	(**3,217,234**)	(**3,477,419**)	(**1,492,636**)	(**3,288,089**)	(**3,786,602**)	(**15,261,980**)
Net assets/(liabilities)	**3,626,701**	**6,559,690**	(**487,040**)	(**2,449,627**)	(**1,564,411**)	**5,685,313**
Off balance sheet instruments	298,593	(6,554,065)	491,260	2,455,386	3,308,826	**–**
Currency position at 31 December 2001	**3,925,294**	**5,625**	**4,220**	**5,759**	**1,744,415**	**5,685,313**
Currency position at 31 December 2000	3,864,064	(7,960)	4,378	(920)	1,392,433	5,251,995

In addition to the Bank's functional currency, euro, currencies individually disclosed are those in which the Bank primarily raises funds (see note 13) and which expose the Bank to exchange rate risk. Amounts aggregated under 'Other currencies' and which, after allowing for off balance sheet instruments, expose the Bank to exchange rate risk, are primarily derived from the currency risks undertaken through the Bank's share investments in countries of operations where currency hedges were not readily available.

17. Liquidity position

Liquidity is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank's commitment to maintaining a strong liquidity position is embodied in policies which require a minimum target liquidity ratio, based on a multi-year context, of 45 per cent of its next three years' net cash requirements, with full coverage of all committed but undisbursed project financing, together with a requirement that 40 per cent of its net Treasury investments mature within one year. This policy is implemented by maintaining liquidity in a target zone, above the required minimum level, of 90 per cent of the next three years' net cash requirements.

The table below provides an analysis of assets, liabilities and members' equity 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 where options or repayment patterns allow for early repayment possibilities. 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	Over 3 months and up to and including 1 year € 000	Over 1 year and up to and including 5 years € 000	Over 5 years € 000	Maturity undefined € 000	**Total € 000**
Assets							
Placements with and advances to credit institutions	620,919	100,624	29,869	–	29,966	–	**781,378**
Collateralised placements	3,828	2,699,788	164,321	–	–	–	**2,867,937**
Debt securities	419,081	157,701	587,529	2,479,248	3,570,989	–	**7,214,548**
Other assets	400,542	30,713	214,649	2,056	29,525	–	**677,485**
Loans	248,577	554,969	879,292	3,263,110	1,444,186	(278,082)	**6,112,052**
Share investments	–	–	–	–	–	1,747,301	**1,747,301**
Property, technology and office equipment	–	–	–	–	–	44,874	**44,874**
Promissory notes received	–	–	141,292	212,231	946	9,090	**363,559**
Paid-in capital subscribed but not yet due	–	–	276,775	830,324	–	–	**1,107,099**
Overdue capital	–	–	–	–	–	31,060	**31,060**
Total assets	**1,692,947**	**3,543,795**	**2,293,727**	**6,786,969**	**5,075,612**	**1,554,243**	**20,947,293**
Liabilities							
Amounts owed to credit institutions	(378,167)	(1,149)	–	–	(129,011)	–	(**508,327**)
Debts evidenced by certificates	(948,432)	(461,932)	(1,707,840)	(4,792,474)	(6,016,657)	–	(**13,927,335**)
Other liabilities	(200,766)	737,819	(137,557)	(90,347)	(94,008)	(1,041,459)	(**826,318**)
Members' equity	–	–	–	–	–	(5,685,313)	(**5,685,313**)
Total liabilities and members' equity	(**1,527,365**)	**274,738**	(**1,845,397**)	(**4,882,821**)	(**6,239,676**)	(**6,726,772**)	(**20,947,293**)
Liquidity position at 31 December 2001	**165,582**	**3,818,533**	**448,330**	**1,904,148**	(**1,164,064**)	(**5,172,529**)	**–**
Cumulative liquidity position at 31 December 2001	**165,582**	**3,984,115**	**4,432,445**	**6,336,593**	**5,172,529**	**–**	**–**
Cumulative liquidity position at 31 December 2000	2,347,195	3,279,051	3,256,815	5,065,916	5,008,946	–	**–**

18. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk. The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next repricing date. Securities that comprise the Bank's dealing portfolio are assumed to reprice within the 'Up to and including 1 month' category.

Repricing interval	Up to and including 1 month € 000	Over 1 month and up to and including 3 months € 000	Over 3 months and up to and including 1 year € 000	Over 1 year and up to and including 5 years € 000	Over 5 years € 000	Non-interest-bearing funds € 000	**Total € 000**
Assets							
Placements with and advances to credit institutions	620,919	100,624	29,869	–	29,966	–	**781,378**
Collateralised placements	3,828	2,699,788	164,321	–	–	–	**2,867,937**
Debt securities	2,801,726	1,962,762	754,660	1,000,577	694,823	–	**7,214,548**
Other assets	177,249	–	166,460	–	–	333,776	**677,485**
Loans	956,086	2,084,861	3,180,858	107,545	115,118	(332,416)	**6,112,052**
Non-interest-earning assets including paid-in capital receivable	–	–	–	–	–	3,293,893	**3,293,893**
Total assets	**4,559,808**	**6,848,035**	**4,296,168**	**1,108,122**	**839,907**	**3,295,253**	**20,947,293**
Liabilities							
Amounts owed to credit institutions	(378,167)	(1,149)	–	–	(129,011)	–	(**508,327**)
Debts evidenced by certificates	(838,272)	(1,188,027)	(1,859,753)	(4,404,446)	(5,636,837)	–	(**13,927,335**)
Other liabilities	(157,967)	–	(126,016)	(25,349)	(61,953)	(455,033)	(**826,318**)
Members' equity	–	–	–	–	–	(5,685,313)	(**5,685,313**)
Total liabilities and members' equity	(**1,374,406**)	(**1,189,176**)	(**1,985,769**)	(**4,429,795**)	(**5,827,801**)	(**6,140,346**)	(**20,947,293**)
Net assets	3,185,402	5,658,859	2,310,399	(3,321,673)	(4,987,894)	(2,845,093)	**–**
Derivative financial instruments	1,095,775	(3,259,856)	(4,844,626)	3,098,945	3,909,762	–	**–**
Interest rate risk at 31 December 2001	**4,281,177**	**2,399,003**	(**2,534,227**)	(**222,728**)	(**1,078,132**)	(**2,845,093**)	**–**
Cumulative interest rate risk at 31 December 2001	**4,281,177**	**6,680,180**	**4,145,953**	**3,923,225**	**2,845,093**	**–**	**–**
Cumulative interest rate risk at 31 December 2000	4,319,722	5,888,337	3,243,127	3,243,127	3,243,127	–	**–**

The Bank's interest rate risk measurement is complemented by accepted market techniques including Value-at-Risk ("VaR"), spread risk and volatility risk on which frequent management reporting takes place. At 31 December 2001, the Bank's total VaR, including externally managed investment programmes, calculated with reference to a 99 per cent confidence level over a 10-trading-days horizon, was €3.9 million (2000: €3.3 million).

19. Credit-related information on Treasury derivative financial instruments

	2001 € 000	2000 € 000
Credit derivatives [1]	**4,005,656**	3,133,554
Swaps and over-the-counter option agreements: [2]		
Pre netting/collateral agreements	**1,156,976**	717,220
Post netting/collateral agreements	**298,668**	103,140

[1] These amounts represent the total notional value of all credit derivatives, including collateralised placements, contracted by the Bank.

[2] These amounts represent the replacement cost to the Bank in the event of non-performance by the counterparties to those swap and over-the-counter option agreements that have a positive value to the Bank.

The Bank is highly selective in its choice of counterparties and considers that non-performance does not represent a significant risk. Derivative transactions in particular are normally limited to AA– or better-rated counterparties which have entered into a collateral agreement with the Bank.

20. Average balance sheet

	€ 000	For the year to 2001 € 000	€ 000	For the year to 2000 € 000
Assets				
Placements with and advances to credit institutions	**2,397,501**		2,001,071	
Collateralised placements	**2,403,867**		1,827,091	
Debt securities	**7,364,961**		7,324,032	
		12,166,329		11,152,194
Other assets		**958,569**		967,785
Loans and share investments				
Loans	**5,564,671**		4,940,821	
Share investments	**1,633,521**		1,248,462	
		7,198,192		6,189,283
Property, technology and office equipment		**39,770**		39,553
Paid-in capital receivable		**1,597,465**		1,819,559
Total assets		**21,960,325**		20,168,374
Liabilities				
Borrowings				
Amounts owed to credit institutions	**735,009**		644,901	
Debts evidenced by certificates	**13,039,578**		12,152,353	
		13,774,587		12,797,254
Other liabilities		**2,547,176**		2,184,087
Subscribed capital	**19,793,908**		19,700,676	
Callable capital	(**14,590,058**)		(14,519,715)	
Paid-in capital		**5,203,850**		5,180,961
Reserves and profit for the year		**434,712**		6,072
Members' equity		**5,638,562**		5,187,033
Total liabilities and members' equity		**21,960,325**		20,168,374
Memorandum items				
Undrawn commitments		**4,722,113**		4,078,738

The average balance sheet is based on daily averaging.

21. Operating lease commitments

The Bank leases its headquarters building in London and certain of its Resident Office buildings in countries of operations. These are standard operating leases and include renewal options, periodic escalation clauses and are mostly non-cancellable in the normal course of business without the Bank incurring substantial penalties. The most significant lease is that for the headquarters building. Rent payable under the terms of this lease is reviewed every five years and is based on market rates. Such a review was concluded in March 2002. The Bank has a break clause effective in the year 2006, which allows the Bank to terminate the lease.

The Bank has entered into sub-lease arrangements for two floors of its headquarters building. The terms of the sub-leases mirror the terms of the Bank's head lease. The total minimum future lease payments expected to be received under these sub-leases is €22.1 million at 31 December 2001 (31 December 2000: €17.4 million). Income from sub-lease payments for the year amounted to €4.2 million (31 December 2000: €3.9 million).

Minimum future lease payments under long-term non-cancellable operating leases are shown below.

Payable:	**2001 € 000**	2000 € 000
Not later than one year	**34,858**	26,536
Later than one year and not later than five years	**121,617**	98,988
Later than five years	**–**	17,321
At 31 December	**156,475**	142,845

22. Staff retirement schemes

Defined benefit scheme
A full actuarial valuation of the defined benefit scheme is performed every three years by a qualified actuary using the projected unit method. For IAS19 purposes this will be rolled forward annually. The most recent valuation was as at 30 June 2001. The present value of the defined benefit obligation and current service cost were calculated using the projected unit credit method.

Amounts recognised in the balance sheet are as follows:

	2001 € 000	2000 € 000
Fair value of plan assets	**73,174**	81,095
Present value of the defined benefit obligation	(**69,332**)	(57,286)
	3,842	23,809
Unrecognised actuarial losses [1]	**25,683**	1,610
Prepayment at 31 December	**29,525**	25,419

Movement in the prepayment (included in 'Other assets'):

At 1 January	**25,419**	22,706
Exchange differences	**543**	(120)
Contributions paid	**13,069**	11,119
Total expense as below	(**9,506**)	(8,286)
At 31 December	**29,525**	25,419

The amounts recognised in the profit and loss account are as follows:

Current service cost	(**11,180**)	(9,778)
Interest cost	(**3,957**)	(3,712)
Expected return on assets	**5,770**	5,524
Amortisation of actuarial loss	(**139**)	(320)
Total included in staff costs	(**9,506**)	(8,286)

[1] These unrecognised actuarial losses represent the difference between the actuarial assumptions at the beginning of the period and the actual experience of the Plan. The two primary causes are lower than expected asset returns and decline in the discount rate used to value the Plan's liabilities.

Principal actuarial assumptions used:

Discount rate	**5.75%**	6.50%
Expected return on plan assets	**7.50%**	7.50%
Future salary increases	**4.00%**	4.00%
Average remaining working life of employees	**15 years**	15 years

Actuarial gains and losses in excess of a corridor (10 per cent of the greater of assets or liabilities) are amortised over the remaining working life of employees.

Defined contribution scheme
The pension charge recognised under the defined contribution scheme was €5.9 million (2000: €5.1 million) and is included in 'General administrative expenses'.

23. Other fund agreements

In addition to the Bank's operations and the Special Funds programme, the Bank administers numerous bilateral and multilateral grant agreements to provide technical assistance and investment support in the countries of operations. These agreements focus primarily on project preparation, project implementation (including goods and works), advisory services and training. The resources provided by these fund agreements are held separately from the ordinary capital resources of the Bank and are subject to external audit.

At 31 December 2001 the Bank administered 74 technical cooperation fund agreements (2000: 68) for an aggregate of €768.0 million (2000: €715.7 million) which includes €283.0 million for the Tacis and Phare programmes of the European Commission under the Bangkok Facility. Of this pledged amount, funds received at 31 December 2001 totalled €648.7 million. The total uncommitted balance of the funds at 31 December 2001 was €172.2 million. In addition, the Bank administered 70 project-specific technical cooperation agreements for an aggregate amount of €40.0 million.

The Bank also administered ten investment cooperation fund agreements during the year for an aggregate amount of €58.9 million and two EU Pre-accession Preparation Funds for an aggregate amount of €34.9 million for the specific purpose of co-financing EBRD projects.

Following a proposal by the G-7 countries for a multilateral programme of action to improve safety in nuclear power plants in the countries of operations, the Nuclear Safety Account ("the NSA") was established by the Bank in March 1993. The NSA funds are in the form of grants and are used for funding immediate safety improvement measures. At 31 December 2001, 15 contributors had made pledges up to a total amount of €260.6 million, using the fixed exchange rates defined in the Rules of the NSA.

At their Denver Summit in June 1997, the G-7 countries and the European Union endorsed the setting up of the Chernobyl Shelter Fund ("the CSF"). The CSF was established on 7 November 1997, when the Rules of the CSF were approved by the Board, and became operational on 8 December 1997, when the required eight contributors had entered into contribution agreements with the Bank. The objective of the CSF is to assist Ukraine in transforming the existing Chernobyl sarcophagus into a safe and environmentally stable system. At 31 December 2001, 22 contributors had made pledges up to a total amount of €523.9 million using the fixed exchange rates defined in the Rules of the CSF.

In 1999, in pursuit of their policy to accede to the European Union, three central European countries, namely Lithuania, Bulgaria and Slovak Republic, undertook firm commitments to close and decommission their nuclear power plant units with RBMK and VVER 440/230 type of reactors by certain dates. In response to this, the European Commission announced its intention to support the decommissioning of these reactors with substantial grants over a period of eight to ten years, and invited the Bank to administer three International Decommissioning Support Funds (IDSFs). On 12 June 2000, the Bank's Board of Directors approved the Rules of the Ignalina, Kozloduy and Bohunice IDSFs and the role of the Bank as their Administrator. The Funds will finance selective projects which will support the first phase of decommissioning of the designated reactors as well as finance measures for facilitating the necessary restructuring, upgrading and modernisation of the energy production, transmission and distribution sectors and improvements in energy efficiency which are consequential to the closure decisions. At 31 December 2001, 15 contributors had made pledges to the Ignalina IDSF up to a total amount of €145.8 million, nine contributors had made pledges to the Kozloduy IDSF up to a total amount of €96.3 million and six contributors had made pledges to the Bohunice IDSF up to a total amount of €116.3 million, using the fixed exchange rates defined in the Rules of Funds.

24. Post balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements. On 12 March 2002, the Board of Directors reviewed the financial statements and authorised them for issue. These financial statements will be submitted for approval to the Annual Meeting of Governors to be held on 20 May 2002.

Summary of Special Funds

Special Funds are established in accordance with Article 18 of the Agreement Establishing the Bank and are administered, *inter alia,* under the terms of Rules and Regulations approved by the Board of Directors of the Bank. At 31 December 2001, the Bank administered 11 Special Funds: eight Investment Special Funds and three Technical Cooperation Special Funds. Extracts from the financial statements of the Special Funds are summarised in the following tables, together with a summary of contributions pledged by donor country. Financial statements for each Special Fund have been separately audited. The audited financial statements are available on application to the Bank.

The objectives of the Special Funds are as follows:

The Baltic Investment Special Fund and
The Baltic Technical Assistance Special Fund:

To promote private sector development through support for small and medium-sized enterprises in Estonia, Latvia and Lithuania.

The Russia Small Business Investment Special Fund and
The Russia Small Business Technical Cooperation Special Fund:

To assist the development of small businesses in the private sector in the Russian Federation.

The Moldova Micro Business Investment Special Fund:

To assist the development of micro businesses through support for small and medium-sized enterprises in the Republic of Moldova.

The Financial Intermediary Investment Special Fund:

To support financial intermediaries in the countries of operations of the Bank.

The Italian Investment Special Fund:

To assist the modernisation, restructuring, expansion and development of small and medium-sized enterprises in certain countries of operations of the Bank.

The SME Finance Facility Special Fund:

To alleviate the financing problems of small and medium-sized enterprises in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

The Balkan Region Special Fund:

To assist the reconstruction of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Federal Republic of Yugoslavia, Former Yugoslav Republic of Macedonia and Romania.

The EBRD Technical Cooperation Special Fund:

To serve as a facility for financing technical cooperation projects in countries of operations of the Bank.

The EBRD SME Special Fund:

To assist the development of small and medium-sized enterprises in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Federal Republic of Yugoslavia, Former Yugoslav Republic of Macedonia and Romania.

Investment Special Funds

Extract from the profit and loss account for the year ended 31 December 2001	The Baltic Investment Special Fund € 000	The Russia Small Business Investment Special Fund € 000	The Moldova Micro Business Investment Special Fund € 000	The Financial Intermediary Investment Special Fund € 000	The Italian Investment Special Fund € 000	The SME Finance Facility Special Fund € 000	The Balkan Region Special Fund € 000	The EBRD SME Special Fund € 000	Aggregated Investment Special Funds € 000
Operating profit/(loss) before provisions	224	4,013	189	522	1,047	(5,098)	233	(2,394)	(1,264)
(Charge)/release for provisions for losses	(697)	(717)	231	(181)	(557)	(91)	–	–	(2,012)
(Loss)/profit for the year	**(473)**	**3,296**	**420**	**341**	**490**	**(5,189)**	**233**	**(2,394)**	**(3,276)**
Extract from the balance sheet at 31 December 2001									
Loans	10,667	33,359	–	1,134	3,027	–	–	–	48,187
Provisions for losses	(351)	(3,566)	–	(153)	(392)	–	–	–	(4,462)
	10,316	29,793	–	981	2,635	–	–	–	43,725
Share investments	9,135	3,750	–	2,616	1,956	1,475	–	–	18,932
Provisions for losses	(2,262)	(1,875)	–	(620)	(619)	(153)	–	–	(5,529)
	6,873	1,875	–	1,996	1,337	1,322	–	–	13,403
Placements and other assets	24,180	21,150	2,406	4,621	12,060	2,870	14,546	20,361	102,194
Contributions not yet received	–	–	–	9,037	–	70,000	1,130	–	80,167
Total assets	**41,369**	**52,818**	**2,406**	**16,635**	**16,032**	**74,192**	**15,676**	**20,361**	**239,489**
Other liabilities and provisions for losses	7	11,972	6	19	7	–	32	38	12,081
Contributions	41,500	59,351	1,261	15,506	13,435	80,000	15,615	22,955	249,623
Reserves and (loss)/profit for the year	(138)	(18,505)	1,139	1,110	2,590	(5,808)	29	(2,632)	(22,215)
Total liabilities	**41,369**	**52,818**	**2,406**	**16,635**	**16,032**	**74,192**	**15,676**	**20,361**	**239,489**
Undrawn commitments and guarantees	7,000	75,040	–	1,121	882	30,336	10,949	9,297	134,625

Technical Cooperation Special Funds

Extract from the statement of movement in fund balance and balance sheet for the year ended 31 December 2001	The Baltic Technical Assistance Special Fund € 000	The Russia Small Business Technical Cooperation Special Fund € 000	The EBRD Technical Cooperation Special Fund € 000	Aggregated Technical Cooperation Special Funds € 000
Balance of fund brought forward	5,764	13,055	195	19,014
Contributions received	1,680	–	–	1,680
Interest and other income	202	3,597	7	3,806
Disbursements	(2,764)	(7,095)	(108)	(9,967)
Other operating expenses	(92)	(3)	(7)	(102)
Balance of fund available	**4,790**	**9,554**	**87**	**14,431**
Cumulative commitments approved	22,224	62,847	879	85,950
Cumulative disbursements	(18,022)	(58,675)	(794)	(77,491)
Allocated fund balance	4,202	4,172	85	8,459
Unallocated fund balance	588	5,382	2	5,972
Balance of fund available	**4,790**	**9,554**	**87**	**14,431**

Special Fund contributions pledged by donor country

	The Baltic Investment Special Fund € 000	The Russia Small Business Investment Special Fund € 000	The Moldova Micro Business Investment Special Fund € 000	The Financial Intermediary Investment Special Fund € 000	The Italian Investment Special Fund € 000	The SME Finance Facility Special Fund € 000	The Balkan Region Special Fund € 000	The EBRD SME Special Fund € 000	The Baltic Technical Assistance Special Fund € 000	The Russia Small Business Technical Cooperation Special Fund € 000	The EBRD Technical Cooperation Special Fund € 000	Aggregated Special Funds € 000
Austria	–	–	–	–	–	–	276	–	–	–	–	276
Canada	–	2,707	–	–	–	–	1,472	–	–	4,309	–	8,488
Denmark	8,940	–	–	–	–	–	750	–	1,450	–	–	11,140
European Community	–	–	–	–	–	80,000	–	–	–	–	–	80,000
Finland	8,629	–	–	–	–	–	–	–	1,411	–	–	10,040
France	–	7,686	–	–	–	–	–	–	–	4,980	–	12,666
Germany	–	9,843	–	–	–	–	2,250	–	–	3,025	–	15,118
Iceland	427	–	–	–	–	–	–	–	69	–	–	496
Italy	–	8,401	–	–	13,435	–	–	–	–	1,360	–	23,196
Japan	–	21,162	–	–	–	–	–	–	–	3,295	–	24,457
Netherlands	–	–	–	–	–	–	4,000	–	–	–	–	4,000
Norway	7,732	–	–	–	–	–	1,145	–	1,256	–	–	10,133
Sweden	15,772	–	–	–	–	–	–	–	2,564	–	–	18,336
Switzerland	–	2,360	1,261	655	–	–	3,097	–	–	1,244	–	8,617
Taipei China	–	–	–	13,114	–	–	1,495	–	–	–	–	14,609
United Kingdom	–	–	–	–	–	–	–	–	–	12,824	247	13,071
United States of America	–	7,192	–	1,737	–	–	–	22,955	–	24,677	–	56,561
Total at 31 December 2001	**41,500**	**59,351**	**1,261**	**15,506**	**13,435**	**80,000**	**14,485**	**22,955**	**6,750**	**55,714**	**247**	**311,204**

Independent auditors' report to the Governors of the European Bank for Reconstruction and Development

We have audited the financial statements of the European Bank for Reconstruction and Development for the year ended 31 December 2001 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Cash Flows, the Statement of Changes in Members' Equity, the related Notes numbered 1 to 24 and the Summary of Special Funds. These financial statements have been prepared under the accounting policies set out therein, for the purpose of submitting approved and audited financial statements to the Board of Governors as required by Article 27 of the Agreement Establishing the Bank and Section 13 of the By-Laws.

Respective responsibilities of management and auditors

Management is responsible for preparing the financial statements in accordance with International Financial Reporting Standards. Our responsibility is to audit the financial statements in accordance with relevant regulatory requirements and International Standards on Auditing.

We report to you our opinion as to whether the financial statements are presented fairly in all material respects.

We read other information published with the financial statements, and consider whether it is consistent with those statements. This other information comprises only the commentary on Financial Results. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by management in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements present fairly, in all material respects, the state of the Bank's affairs at 31 December 2001 and of its profit for the year then ended and have been properly prepared 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 the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

Arthur Andersen

Arthur Andersen, *Chartered Accountants*
London, 12 March 2002

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