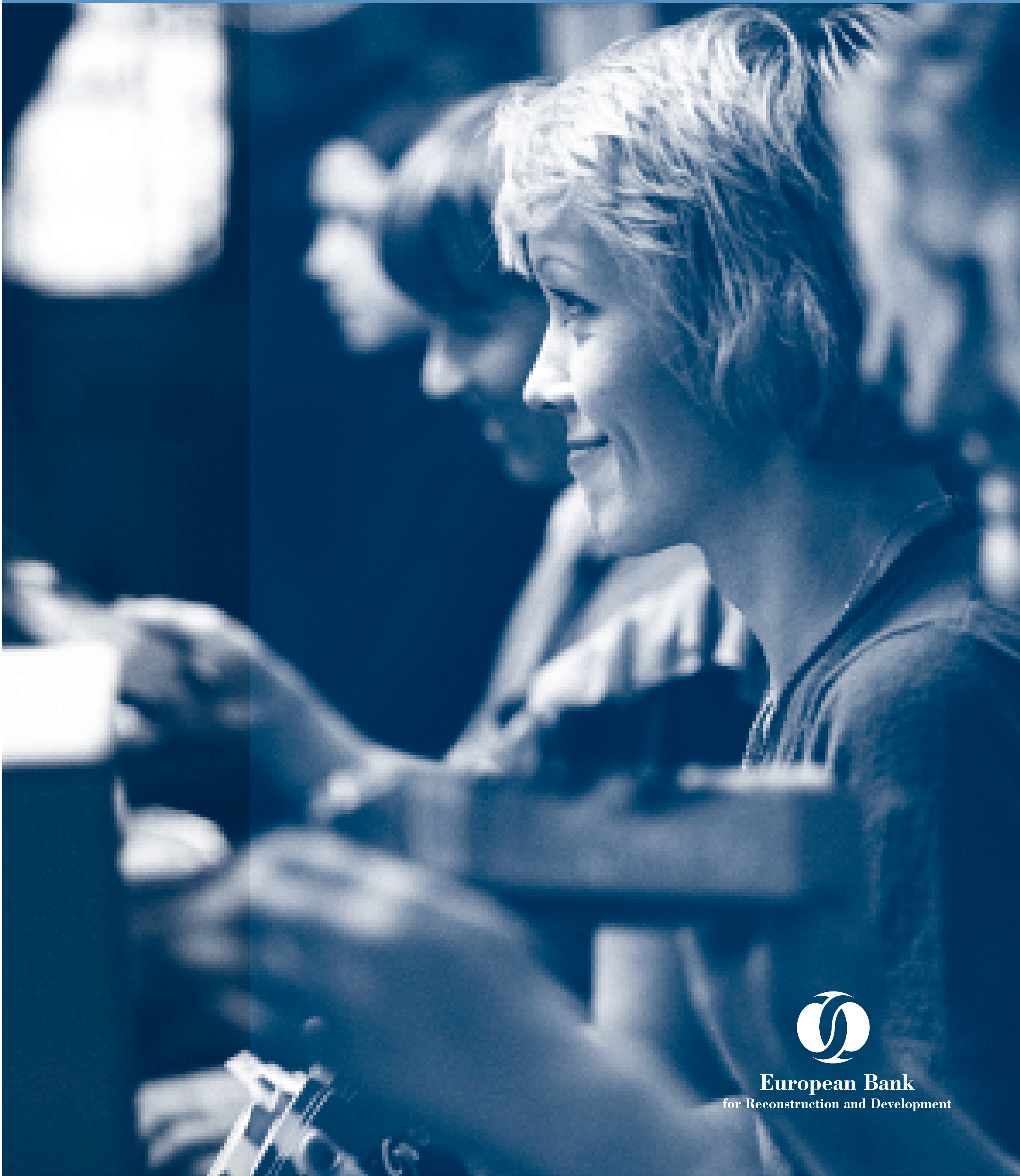
Annual report 2002

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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Annual report 2002

Financial report

Contents

The EBRD's Annual Report 2002 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)	2002	2001	2000	1999	1998
Operating income [1]	471.8	501.5	519.2	376.4	450.5
Expenses and depreciation [1]	(177.2)	(206.7)	(192.1)	(172.8)	(158.7)
Operating profit before provisions	294.7	294.7	327.1	203.6	291.8
Provisions for losses	(186.6)	(137.6)	(174.3)	(160.9)	(553.1)
Operating profit/(loss) for the year	108.1	157.2	152.8	42.7	(261.2)
Paid-in capital	5,197	5,197	5,186	5,163	5,084
Capital instalments received (cumulative)	4,350	4,063	3,769	3,480	3,217
Total provisions and reserves	1,952	1,713	1,278	1,040	762
Total assets	20,112	20,947	21,290	19,595	16,047

[1] During the year the EBRD deferred €45.2 million of direct costs related to loan origination and commitment maintenance on the balance sheet in accordance with International Financial Reporting Standards. These costs, together with the corresponding front-end and commitment fees, will be recorded in interest income over the period from disbursement to repayment of the related loan. Excluding the effect of these deferrals, operating income was €517.0 million for the year and expenses and depreciation was €222.4 million.

Operational results

Annual commitments	2002	2001	2000	1999	1998	Cumulative 1991-2002
Number of projects	102	102	95	88	96	906
EBRD financing (€ million)	3,899	3,656	2,673	2,162	2,373	21,647
Resource mobilisation (€ million)	4,862	6,212	5,188	4,862	7,541	47,516

Financial results

The EBRD recorded a profit after provisions of €108.1 million for 2002 compared with a profit of €157.2 million for 2001. The results for 2002 include a charge under International Accounting Standard 39 (IAS 39) Financial Instruments: Recognition and Measurement of €38.3 million on non-qualifying hedges (2001: €8.7 million). Such charges require a fair value adjustment that will be reversed over time and which does not reflect the underlying economic performance of the Bank during the year. Excluding the impact of IAS 39, the Bank recorded a profit after provisions of €146.4 million (2001: €165.9 million). The Bank's reserves increased from €488.7 million at the end of 2001 to €661.1 million at the end of 2002, primarily reflecting the profit for the year and an increase in the fair value of the Bank's listed share investments.

Operating profit of €333.0 million before provisions and the IAS 39 adjustment was 10 per cent above the €303.4 million operating results of last year. The reduction in the value of impaired loans on which interest is excluded from the profit and loss account continued during 2002, with the restructuring of several projects. At 31 December 2002, the Bank had 23 such loans totalling €204.5 million, compared with 31 loans totalling €327.4 million at the end of 2001. Forty-three per cent or €88.8 million were in the Russian portfolio (2001: 47 per cent or €153.0 million). Successful restructuring along with a generally improved Banking portfolio performance resulted in a net credit of €0.9 million for specific provisions during the year, as new specific provision charges of €65.8 million (2001: €132.0 million) were offset by recoveries of existing specific provisions totalling €66.7 million (2001: €130.9 million). The net result was in line with a net charge of €1.1 million in 2001. Specific provisions for the impairment of identified Treasury assets of €83.6 million were raised during 2002 (2001: nil).

Banking operations achieved a net profit of €181.7 million (2001: €65.9 million) after full allocation of expenses, provisions and return on net paid-in capital. This reflected a strong performance across all revenue areas, in particular with increased returns on the equity portfolio. Net profit from the sale of share investments totalled €140.0 million in 2002 compared with €89.3 million in 2001, reflecting major exits during the year. Excluding the impact of non-qualifying hedges under IAS 39, Treasury, after full allocation of expenses and return on net paid-in capital, reported a net profit before specific provisions of €48.3 million (2001: €100.0 million). During the year specific provisions of €83.6 million were raised against three originally triple-A rated asset-backed securities (ABS) held by Treasury, giving Treasury a net loss after provisions of €35.3 million (2001: profit of €100.0 million). After the €38.3 million impact of non-qualifying hedges under IAS 39, Treasury's reported loss for the year totalled €73.6 million (2001: profit of €91.3 million).

The EBRD's gross general administrative expenses were well within budget, reflecting continuing budgetary discipline and effective cost controls, and were €15.7 million above the level of the previous year at €222.4 million (2001: €206.7 million). In sterling terms such expenses amounted to £142.0 million compared with £138.5 million in 2001. The bulk of the difference was due to a £4.0 million annual rent increase resulting from a review at end December 2001 of the lease on the Bank's headquarters building at One Exchange Square, London.

Total provisions for Banking operations amounted to €1.21 billion at the end of 2002, compared with €1.22 billion at the end of 2001. This represented 13.3 per cent of disbursed outstanding loans and equity investments (2001: 13.9 per cent) and reflects the EBRD's commitment to provide prudently for all reasonably foreseeable risks based on a continuing assessment of the portfolio and the associated inherent risks. Provisions on non-sovereign exposures represented 17 per cent of non-sovereign disbursed outstandings (2001: 18 per cent). Provisions attributable to operations in Russia accounted for approximately 27 per cent of total Banking provisions (2001: 31 per cent). Provisions on non-sovereign exposures in Russia represented 20 per cent of non-sovereign disbursed outstandings in that country (2001: 27 per cent).

Banking operations

Portfolio

New business volume in 2002 reached €3.9 billion, representing 102 projects. This is the highest level of annual commitments signed by the EBRD to date and represents an increase of 7 per cent over the level recorded in 2001 (€3.7 billion for 102 projects). Share investments and equity-linked products accounted for 16 per cent of the new business volume. The private sector share of the business volume was 71 per cent. The new business included €109 million of restructured operations.

Net cumulative business volume reached €21.6 billion by the end of 2002 (2001: €20.2 billion), representing a total project value (including co-financing) of €68.7 billion (2001: €67.8 billion). The portfolio of the Bank's net outstanding commitments grew from €14.2 billion at the end of 2001 to €14.6 billion at the end of 2002, an increase of 3 per cent.

The number of projects under development increased during 2002 following Board approval of 115 projects. These consisted of loans and share investments by the Bank totalling €4.2 billion, compared with 111 projects totalling €3.7 billion in 2001. The level of Board approvals in 2002 was the highest annual level to date. At the end of 2002 cumulative Board approvals, net of cancellations, totalled €25.4 billion (2001: €24.1 billion).

Gross disbursements totalled €2.4 billion in 2002, the same volume as achieved in 2001. Operating assets reached €9.1 billion at the end of 2002 (2001: €8.8 billion), comprising €6.8 billion of disbursed outstanding loans and €2.3 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. Generally all projects 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 possible 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 impairment and corresponding specific provisions. Control of disbursement is managed by the Operation Administration Unit within Risk Management, which is responsible for checking compliance with project conditionality prior to disbursement. It also ascertains that the correct procedures are followed in line with approved policy and ensures 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 taking into consideration the ratings assessed by the external rating agencies.

The overall rating is the lower of the project and country rating. The exception to this for non-sovereign deals is where the Bank has recourse to unconditional sponsor support, 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 (approximately equivalent to Standard & Poor's BBB to B ratings) at the time of approval. At end 2002, 75 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 2002, driven by an improving economic performance in Russia in particular, allied with a generally resilient economic performance across the region. This 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 third consecutive year there was a significant decline in the level of impaired assets. Impaired loans reduced from €327.4 million to €204.5 million during the year. There was also a slight decrease in the level of impaired equity from €419.7 million to €414.7 million.

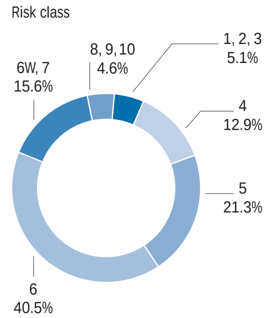
The percentage of the portfolio rated 4, 5 or 6 rose to 75 per cent from 72 per cent a year earlier. The proportion of the portfolio in the weaker performance categories of 6W to 10 fell from 23 per cent to 20 per cent.

Impaired assets

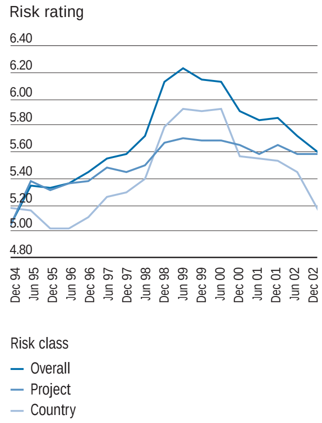
Where loan collectability is in doubt, impairment, being the difference between the carrying value of the loan and the net present value of its expected future cash flows, is recognised in the profit and loss account. Impaired equity is defined as equity investments where it is judged that there has been a permanent diminution in the value of the investment and the future recoverability is in doubt. Although projects are reviewed for impairment every six months, certain 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 made.

Credit quality of the Banking portfolio

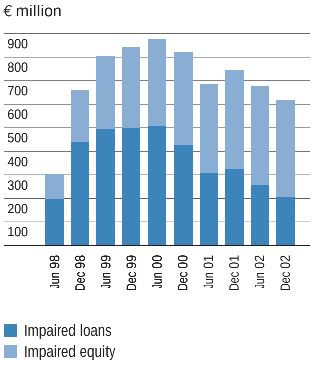
31 December 2002



Facility, overall and country weighted average risk ratings



Impaired assets



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

The Bank's impaired assets peaked in mid-2000, largely reflecting the after-effects of the Russia crisis of 1998. Since then, through the improvements or successful restructuring of some projects and some write-offs, the level of impaired assets has declined to a level of 6.8 per cent of operating assets at 31 December 2002, compared with 8.4 per cent at 31 December 2001. Net write-offs (after recoveries from previously written off projects) were €44.6 million for 2002 (2001: €69.8 million), bringing the cumulative total of net write-offs since the Bank's inception to €299.8 million.

Financial performance

Banking operations recorded a net profit (after provisions, fully allocated expenses and the allocation of the return on capital) of €181.7 million for 2002 compared with a net profit of €65.9 million on the same basis for 2001. Excluding the deferral of front-end and commitment fees, operating income of €488.8 million from the Banking business in 2002 was 24 per cent above the €393.5 million achieved in 2001. This increase was mainly attributable to an increased contribution from the equity sector of the portfolio. Dividend income amounted to €35.9 million in 2002 compared with €20.7 million in 2001, while net profit from the sale of share investments totalled €140.0 million in 2002 compared with €89.3 million in 2001.

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.

Treasury operations

Portfolio

The value of assets under Treasury management was €9.1 billion at 31 December 2002 (2001: €10.9 billion), comprising €5.2 billion of debt securities, €2.9 billion of collateralised placements and €1.0 billion of placements with credit institutions (including repurchase agreements).

At the end of 2002, approximately 8 per cent of Treasury assets were managed by a total of 10 external asset managers. The externally managed portfolios comprised a funded and notional amount of €238.4 million of a euro-denominated interest rate trading programme[1] and €518.5 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.

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

Risks

For monitoring purposes, the Bank distinguishes between market, credit and operational risks, together with liquidity and settlement risks.

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. 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. These risks have so far been limited.

At 31 December 2002, 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 €4.2 million[2] (2001: €3.7 million), a moderate year-on-year increase. Its highest and lowest values over the year were €4.8 million and €2.4 million respectively.

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).

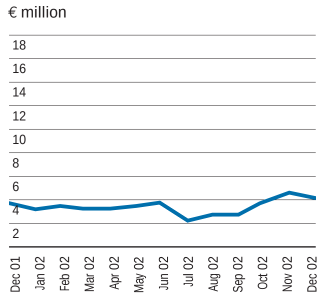
The VaR of the internally managed portfolios stood at €2.3 million at the end of 2002 (2001: €1.3 million). The range during the year was between €0.5 million and €2.7 million, similar to that observed over previous years. The size of the internally managed portfolio to which these figures relate was €8.7 billion as at 31 December 2002 (2001: €10.2 billion).

In addition, market risks incurred on the externally managed portfolios exhibited a year-end VaR of €0.8 million (2001: €0.4 million) for the euro-denominated programme and €2.7 million (2001: €2.2 million) for the USD-denominated programme.[3] The net asset value of these externally managed portfolios was respectively €28.2 million (2001: €49.9 million) and €352.5 million (2001: €405.8 million) at 31 December 2002.

The specific contribution from foreign exchange risk to the overall VaR stood at €0.2 million at year-end (2001: €0.6 million). As in previous years, this contribution was limited at all times in 2002 and never exceeded €1.5 million. Interest rate positioning thus continued to represent the majority of the Bank's market risk exposure.

Total VaR – overall limit: €18.0 million

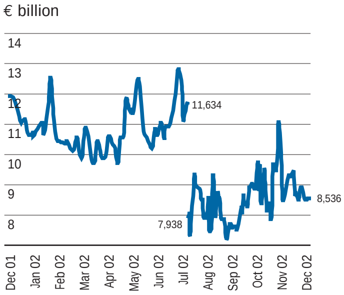
(10 trading days, 99% confidence level, BIS compliant dataset)



[2] This means that the Bank had a 1 per cent chance of experiencing a loss of at least €4.2 million over a horizon of ten trading days, due to adverse movements in interest rates and foreign exchange rates. The aggregate VaR reported here is based on a linear P&L, i.e. assumes that changes in the value of the Bank's portfolio are proportional to changes in the risk drivers (interest rates, foreign exchange rates). Options VaR, reported on further in the text, examines departures from linearity.

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

Evolution of the overall Treasury credit exposure in 2002[1]



[1] The break in the data series on 6 August 2002 represents the changeover from the previous credit exposure measurement method to the one current at 31 December 2002. There are two primary reasons why the overall exposure fell substantially upon adoption of the new methodology: 1) the new approach takes into account, whereas the old one did not, netting, where allowable under legal documentation, and portfolio effects whereby some trades naturally hedge the exposure of other trades with a given counterparty; and 2) the new approach recognises that the maximum exposures to different counterparties will naturally occur at different time points in the future while the previous approach implied that all maximum counterparty exposure occurred immediately and simultaneously.

Interest rate and foreign exchange options were used more frequently than in previous years. However, options VaR,[4] a measure of the departure of the Bank's position from linearity, stood at only €0.05 million at year-end and represented only a fraction of total VaR 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, such as 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, typically at the onset and at the maturity, when an exchange of cash or securities occurs in a transaction. 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.

Risk Management normally 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 exposure size limit and/or tenor limit attributed to individual counterparties may be smaller or shorter, respectively, based on the likely direction of its credit quality over the medium term or on sector considerations. Individual counterparty lines for banks, corporates and insurance companies are measured, monitored and reviewed by Risk Management on a regular basis.

In 2002, the Bank upgraded its credit exposure measurement methodology for Treasury credit risk. Previously the methodology was based on additive transaction-by-transaction notional amounts for cash instruments and "add-ons" for derivatives, which in particular did not fully factor in diversification effects or the benefits from close-out netting provisions and collateral agreements. The new methodology uses a Monte Carlo simulation technique that produces, to a high degree of confidence, maximum exposure amounts at future points in time for each counterparty (i.e. counterparty exposure profiles).

[4] Options VaR is computed on a portfolio comprising a) the options (interest rate, foreign exchange) held by the Bank; and b) delta-hedges made of discount bonds and spot foreign exchange positions in relevant currencies. Its computation involves a) a Monte Carlo simulation to generate the portfolio's P&L profile; b) a full valuation of each option and delta-hedge in the portfolio; and c) the same confidence level and trading horizon at linear VaR. By construction, Options VaR captures the non-linear aspects of the P&L of the options portfolio of the Bank. Although the delta-hedges are notional ones, in the sense that they have not been necessarily traded by Treasury in the market, the mirror images of these delta-hedges are taken into account in the computation of linear VaR, so as to render both risk measures consistent and complementary.

The overall credit exposure incurred by the Bank in its Treasury transactions, defined as the peak amount from the overall credit exposure profile created from the aggregation of all counterparty exposure profiles, is subject to a limit set out in the Risk Management Guidelines. Additionally, overall credit risk limits for 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, calculated under the new methodology at 31 December 2002 was €8.5 billion.

Despite the reductions in the credit ratings of assets and bank counterparties in the difficult environment of 2002, the overall quality of the Treasury credit exposure remained high, although below the level of 2001. At year-end 2002, the average credit rating weighted by peak counterparty exposure was 1.69 (on the Bank's internal rating scale, broadly equivalent to an external rating of AA+ by Standard & Poor's or Fitch Ratings and Aa1 by Moody's).

At year-end 2001, the weighted average rating was 1.60 based on exposures calculated under the prior measurement approach. Some 96.5 per cent of exposure from Treasury transactions was of investment grade quality. Exposure to below investment grade risk resulted from the rapid and substantial downgrading of ratings during the year from a few ABS investments that were originally rated 1.0 (AAA/Aaa equivalent).

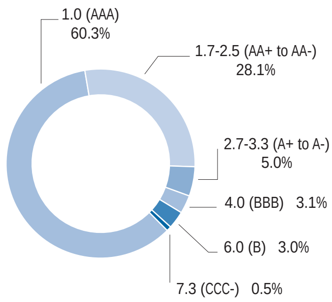
The portfolio's credit risk exposure was diversified across 24 countries with no more than 8 per cent of the exposure in any one country at 31 December 2002, with the exception of the United States of America at 40.3 per cent (2001: 37.5 per cent).

Almost three-quarters of the overall exposure was to banks (41.2 per cent) or to ABS instruments (31.9 per cent).

Credit risk mitigation techniques continued to be actively pursued, notably in the areas of over-the-counter (OTC) derivative transactions and foreign exchange transactions. At the end of 2002, 72.1 per cent[5] of the Bank's 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 1.0-rated (AAA/Aaa equivalent) in their own right, or, in many cases, both collateralised and 1.0-rated, accounted at year-end 2002 for 96.7 per cent of the overall OTC derivatives and foreign exchange exposure, compared with 99.7 per cent at year-end 2001.

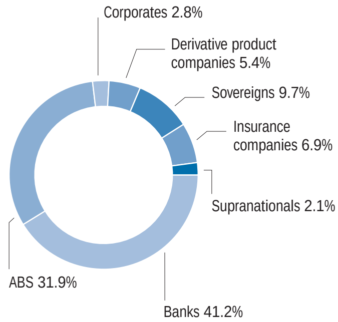
Credit quality profile of the Treasury portfolio

31 December 2002



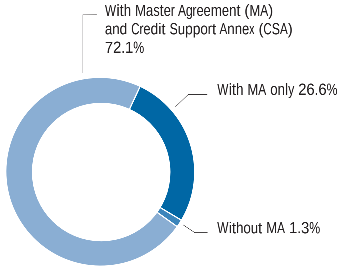
Exposure by counterparty type

31 December 2002



OTC derivatives and foreign exchange exposure[1]

31 December 2002



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

[5] The decrease from 94.6 per cent reported at 31 December 2001 is due to a significant increase in transaction volume with, and corresponding exposure to, a small number of 1.0/AAA/Aaa rated counterparties with which no collateral agreement has been put in place, as well as to the change of methodology in credit exposure measurement. The number of collateral agreements put in place covers the vast majority of active counterparties. Under the Bank's standard collateral agreements triple-A rated counterparties are not required to post collateral.

Operational risk

Operational risk for Treasury transactions is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Liquidity risk and settlement risk also display some operational risk features.[6]

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 would materialise by the counterparty defaulting precisely when a transaction is being settled, once the outgoing transfer is made and before the incoming transfer is received.

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.

An Operational Risk Management Group, chaired by the Vice-President, Finance and co-ordinated by the Director, Risk Management, has been set up, its objective being to develop an integrated Bank-wide operational risk management framework, including responsibilities for identification, assessment, management and mitigation of the Bank's principal exposures to operational risk.

Risk maps are regularly produced by the Bank's external auditors and discussed with the Audit Committee. Responses are developed to mitigate those risks which are perceived to be both financially significant and likely to occur. Such mitigation includes segregation of duties at all stages of processing transactions, maintenance and upgrade of systems and a regular review of compliance with the Bank's policies.

In terms of operational risk mitigation, substantial progress has been achieved in systems development. For Treasury transactions in particular, the Bank's back-office and general ledger systems as well as the credit risk measurement and monitoring systems have been replaced. This process yielded significant improvement in the quality of the transaction data.

Operational risk indicators have been reviewed and further enhanced during the year. The Bank is currently engaged in an exercise to establish key risk indicators across the whole range of its activities which will be introduced later in 2003 as an enhancement to the Bank's management of operational risk.

Financial performance

Treasury operations, excluding the impact of non-qualifying hedges under IAS 39, recorded a profit of €48.3 million for 2002 before provisions but after fully allocated expenses and the allocation of the return on capital. This compared with a profit of €100.0 million on the same basis for 2001. During the year specific provisions of €83.6 million (2001: nil) were raised to reflect the credit rating downgradings of three originally triple-A rated ABS held by Treasury, giving a net loss after provisions of €35.3 million (2001: profit of €100.0 million). This year's performance reflected the difficult credit conditions which prevailed in the capital markets throughout 2002. After the €38.3 million impact of non-qualifying hedges under IAS 39, Treasury's reported loss for the year totalled €73.6 million (2001: profit of €91.3 million).

Funding

Capital

Paid-in capital totalled €5.2 billion at 31 December 2002 and at 31 December 2001, with the number of the EBRD's subscribed shares being almost two million. The fifth instalment of the capital increase became due in April 2002, and paid-in capital received increased to €4.3 billion, from €4.1 billion at the end of 2001.

Overdue capital of cash and promissory notes to be deposited totalled €19.4 million at the end of 2002 (2001: €31.1 million) and a further €4.8 million of encashments of deposited promissory notes is also overdue (2001: €9.1 million). Of the €24.2 million total overdue, €15.8 million relates to the capital increase.

[6] 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.

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 operation 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 to 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, 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. This approach is being reviewed annually as part of the Bank's medium-term strategy updates. The 2002 update confirmed that the Bank should have sufficient capital to fulfil its medium-term portfolio development objectives within the stated risk and financial assumptions. The analysis of future financial performance confirmed the Bank to be on course to implement its manageable growth strategy, with portfolio turnover and profit generating further headroom and risk-bearing capacity for the Bank to continue 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 2002 stood at €13.4 billion, a decrease of €1.0 billion compared with 2001. There were 134 new issues under the EBRD's medium- to long-term borrowing programme at an average after-swap cost of Libor minus 39 basis points. The average remaining life of medium- to long-term debt decreased slightly during the year to stand at 8.7 years at 31 December 2002 (2001: 9.0 years). To take advantage of favourable borrowing opportunities in the market during December 2002, €0.5 billion of borrowing capacity was pre-authorised against the 2003 medium- to long-term borrowing programme. Of this, €162.5 million was utilised.

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

Operating expenditure in 2002 of £128.8 million was £2.7 million or 2.1 per cent higher than in 2001. However, excluding the £4.0 million increase in the cost of the Bank's London headquarters in 2002 following the rent review, operating costs reduced by £1.3 million, or 1.0 per cent.

Overall staff costs were broadly similar to 2001, with gross costs up by 2.7 per cent, a 33 per cent increase in recovery and non-staff costs lower by £1.0 million.

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 €222.4 million (2001: €206.7 million).

During the year the Bank deferred €45.2 million of direct costs related to loan origination and commitment maintenance on the balance sheet. These costs, together with the corresponding front-end and commitment fees, which will be recorded in interest income, will be amortised over the period from disbursement to repayment of the related loan. Therefore the reported figure for general administration expenses and depreciation for the year was €177.2 million. In prior years the Bank's policy has been to record both fee income and direct costs related to loan origination and commitment maintenance in the period in which they occurred. Due to the increase in volume of front-end and commitment fees as the Bank's portfolio has grown, it has become necessary to defer these direct costs and related fees and record them in the profit and loss account over the period from disbursement to repayment of the related loan in accordance with IAS 18.

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 Bank takes specific provisions for the impairment of identified assets as required on a case-by-case basis. Provisions are based on outstanding net disbursements at the relevant reporting date.

The application of the EBRD's provisioning policy resulted in a charge for the year of €186.6 million compared with the 2001 charge of €137.6 million. The charge in 2002 included Treasury specific provisions of €83.6 million (2001: nil) reflecting the difficult credit conditions in capital markets during the year. The 2002 charge for Banking provisions of €103.0 million was split between general portfolio provisions for the impairment of unidentified assets, which totalled €103.9 million compared with €136.4 million in 2001, and specific provisions for the impairment of identified assets, which were a net credit of €0.9 million in 2002 compared with a net charge of €1.1 million in 2001. Lower net disbursements were the principal influence on the general portfolio provisions charge. As in 2001, substantial asset recoveries following the restructuring of projects and the consequent reversal of specific provisions totalling €66.7 million offset new specific provision charges of €65.8 million during the year.

As a result total provisions for Banking operations stood at €1.21 billion at the end of 2002, which amounted to 13.3 per cent of the outstanding disbursed portfolio of loans and equity investments (2001: €1.22 billion and 13.9 per cent).

Outlook for 2003

The EBRD has budgeted for a modest profit in 2003. This reflects the vulnerability of results due to continued uncertainty in the economic environment and in financial markets.

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 in 2002 reconfirmed the outcome of a 2001 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 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 and monitored 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 VaR, and a variety of additional risk measures. Risk Management computes VaR on a daily basis. The Bank's overall VaR 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, VaR 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 true.

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 primarily encompass: (i) stress-testing the options portfolio for joint large changes in the level of the price of the underlying security 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;

> *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 conducted a special review in 2001 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 extensive "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 over-the-counter derivative 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 internal credit rating. For those counterparties that are deemed eligible for foreign exchange and over-the-counter derivatives, a maximum portion of the individual counterparty limit is allocated to these instruments. Utilisation of limits, whether individual counterparty limits or foreign exchange and over-the-counter derivatives limits, is calculated daily for all counterparties.

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, notably foreign exchange transactions.

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 2002, approximately 72 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 rated below triple-A. As a result 97 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 2002 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 2002	Note	Year to 31 December 2002 € 000	Year to 31 December 2001 € 000
Interest and similar income			
From loans	8	**355,959**	423,828
From fixed-income debt securities and other interest		**259,498**	476,543
Interest expenses and similar charges		**(303,012)**	(574,121)
Net interest income		**312,445**	326,250
Dividend income from share investments		**35,886**	20,689
Net fee and commission income	4	**11,197**	38,850
Financial operations			
Net profit on sale of share investments		**140,049**	89,343
Net profit on dealing activities and foreign exchange	5	**10,581**	35,041
IAS 39 impact on non-qualifying hedges	6	**(38,311)**	(8,698)
Operating income		**471,847**	501,475
General administrative expenses	7	**(158,590)**	(189,743)
Depreciation	13	**(18,577)**	(16,993)
Operating profit before provisions		**294,680**	294,739
Provisions for losses	8	**(186,602)**	(137,557)
Operating profit for the year		**108,078**	157,182

Balance sheet

At 31 December 2002	Note	€ 000	31 December 2002 € 000	€ 000	31 December 2001 € 000
Assets					
Placements with and advances to credit institutions		**990,207**		781,378	
Collateralised placements		**2,932,443**		2,867,937	
Debt securities	9	**5,197,124**		7,214,548	
			9,119,774		10,863,863
Other assets	10		**1,431,617**		677,485
Loans and share investments					
Loans	11	**6,289,444**		6,112,052	
Share investments	11	**1,980,074**		1,747,301	
			8,269,518		7,859,353
Property, technology and office equipment	13		**43,562**		44,874
Paid-in capital receivable	16		**1,247,727**		1,501,718
Total assets			**20,112,198**		20,947,293
Liabilities and members' equity					
Borrowings					
Amounts owed to credit institutions		**599,898**		508,327	
Debts evidenced by certificates	14	**12,761,856**		13,927,335	
			13,361,754		14,435,662
Other liabilities	15		**892,722**		826,318
Subscribed capital	16	**19,789,500**		19,789,500	
Callable capital	16	**(14,592,845)**		(14,592,845)	
Paid-in capital	16		**5,196,655**		5,196,655
Reserves and profit for the year			**661,067**		488,658
Members' equity			**5,857,722**		5,685,313
Total liabilities and members' equity			**20,112,198**		20,947,293
Memorandum items					
Undrawn commitments	12		**5,474,017**		5,322,481

Statement of changes in members' equity

	31 December 2002 € million	31 December 2001 € million
Share capital		
Subscribed capital	**19,789.5**	19,789.5
Callable capital	(**14,592.9**)	(14,592.9)
Paid-in capital	**5,196.6**	5,196.6
Reserves and profit for the year:		
General reserve		
Balance at the beginning of the year	**356.2**	90.6
Internal tax for the year	**4.9**	5.2
IAS 39 opening transitional reinstatement	**–**	218.4
Fair value movement of available-for-sale assets and cash flow hedges for the year	**59.4**	42.0
Balance at the end of the year	**420.5**	356.2
Special reserve		
Balance at the beginning of the year	**136.6**	125.6
Qualifying fees and commissions from the prior year	**21.0**	11.0
Balance at the end of the year	**157.6**	136.6
Accumulated profit and loss reserve		
Balance at the beginning of the year	(**161.3**)	(303.1)
Qualifying fees and commissions from the prior year	(**21.0**)	(11.0)
Profit set aside from the prior year	**157.2**	152.8
Balance at the end of the year	(**25.1**)	(161.3)
Operating profit for the year	**108.1**	157.2
Total reserves and profit for the year	**661.1**	488.7
Total members' equity	**5,857.7**	5,685.3

The **general reserve** includes the retention of internal tax paid in accordance with Article 53 of the Agreement Establishing the Bank, 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 and which is retained for its benefit. The balance at the end of the year relating to internal tax is €43.7 million (2001: €38.8 million). The Bank implemented IAS 39 in 2001, and the related movements in reserves reflect the movement in the fair value of available-for-sale assets and cash flow hedges. The associated movement in 2002 increased reserves by €59.4 million. This comprised an increase of €103.7 million related to the fair valuing of the Bank's listed share investments and decreases related to Treasury available-for-sale assets and cash flow hedges of €41.7 million and €2.6 million respectively. At the year end the Bank had purchased £60.0 million in the forward foreign exchange market as a partial hedge against the budgeted sterling expenses for 2003. The fair valuing of these transactions resulted in an unrealised loss of €2.6 million which was held in reserves at the year end. This loss will be released to the profit and loss account in the 2003 financial year as the hedged expenditure is incurred. During 2002 €27.3 million has been transferred from reserves to the profit and loss account (€34.5 million transferred out of reserves as a result of realised gains on the sale of listed share investments and €7.2 million of unrealised losses transferred out in relation to Treasury available-for-sale assets). Specific provisions raised for the impairment of Treasury assets in 2002 have resulted in the transfer of previous mark-to-market losses from reserves to the profit and loss account.

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 €5.3 million (2001: €21.0 million), being qualifying fees and commissions recognised in the profit and loss account in the year to 31 December 2002, will be appropriated in 2003 from the profit for the year to 31 December 2002 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 2002	€ 000	Year to 31 December 2002 € 000	€ 000	Year to 31 December 2001 € 000
Cash flows from operating activities				
Operating profit for the year	**108,078**		157,182	
Adjustments for:				
Gross provisions for losses before recoveries from assets previously written off	**208,990**		137,557	
Unwinding of the discount relating to impaired identified assets	(**2,171**)		(5,737)	
Depreciation	**18,577**		16,993	
Realised gains on share investments	(**140,049**)		(89,343)	
Profit on disposal of property, technology and office equipment	(**23**)		(22)	
Internal taxation	**4,889**		5,193	
Unrealised gains on dealing securities	**1,284**		388	
Realised losses/(gains) on available-for-sale securities	**4,884**		(968)	
Foreign exchange	(**1,736**)		(6,519)	
Operating profit before changes in operating assets	**202,723**		214,724	
(Increase)/decrease in operating assets:				
Interest receivable and prepaid expenses	(**64,242**)		160,599	
Marked-to-market	(**243,862**)		(1,226,889)	
Increase/(decrease) in operating liabilities:				
Interest payable and accrued expenses	**2,670**		(238,992)	
Net cash used in operating activities		(**102,711**)		(1,090,558)
Cash flows from investing activities				
Proceeds from repayments and prepayments of loans	**2,483,549**		1,713,874	
Net placements with credit institutions	(**171,786**)		(38,186)	
Proceeds from sale of share investments	**336,457**		320,055	
Proceeds from sale of available-for-sale securities	**2,647,600**		2,470,290	
Proceeds from sale of property, technology and office equipment	**142**		23	
Purchases of available-for-sale securities	(**1,684,192**)		(2,826,516)	
Funds advanced for loans and share investments	(**3,733,851**)		(3,027,961)	
Purchase of property, technology and office equipment	(**17,384**)		(22,996)	
Net cash used in investing activities		(**139,465**)		(1,411,417)
Cash flows from financing activities				
Capital received	**253,991**		249,619	
Issue of debts evidenced by certificates	**8,751,592**		12,553,275	
Redemption of debts evidenced by certificates	(**8,510,614**)		(12,122,461)	
Net cash from financing activities		**494,969**		680,433
Net increase/(decrease) in cash and cash equivalents		**252,793**		(1,821,542)
Cash and cash equivalents at beginning of year		**3,045,843**		4,867,385
Cash and cash equivalents at 31 December [1]		**3,298,636**		3,045,843

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

	2002 € 000	2001 € 000
Placements with and advances to credit institutions	**966,091**	721,543
Collateralised placements	**2,932,443**	2,703,616
Amounts owed to credit institutions	(**599,898**)	(379,316)
Cash and cash equivalents at 31 December	**3,298,636**	3,045,843

Note: Operating profit includes dividends received of €35.9 million for the year to 31 December 2002 (31 December 2001: €20.7 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"). At 31 December 2002 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 (the "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 (IFRS), 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.

ii Financial instruments

IAS 39, 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, with the latter now required to be recognised on the balance sheet.

A Financial assets

(a) Dealing

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 amortised 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.

(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 changes in the fair value of these assets 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" under "Derivatives" 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 specific provisions following objective evidence of impairment. 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 11 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 third party sources. 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.

B Financial liabilities

(a) Liabilities held for dealing

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 dealing 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 dealing, all other financial liabilities are measured at amortised cost, 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.

IAS 39 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 IAS 39, 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 and therefore increases volatility. 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.

The Bank engages in cash flow hedges in order to minimise the exchange rate risk associated with its future administrative expenses being incurred in sterling. The amount and timing of such hedges fluctuates in line with the Bank’s views on opportune moments to execute the hedges. The majority of any such hedging activity is for the following financial year but hedges beyond one year can be undertaken. Hedging is mainly through the purchase of sterling in the forward foreign exchange market, but currency options can also be used. Such hedging activity is explicitly identified and appropriately documented by the Bank’s Treasury department.

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

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 at 31 December 2002. 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 rate on the date on 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 IAS 39 with any gain or loss being recorded in the profit and loss account.

v Associates

The Bank has considered both IAS 28 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 IAS 28 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 11 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 or Treasury asset, 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 normally 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 above, is deducted from the loans, share investments and Treasury asset categories on the balance sheet. Impairment of guarantees is applied when the guarantees are effective and for trade finance is based on utilisation. The methodology is consistent to that on non-sovereign risk assets (as above) and is included in “Other liabilities”.

Impairment, less any amounts reversed during the year, is charged to the profit and loss account under the caption “Provisions for losses”, as summarised in note 8. 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:

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 normally 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 interest has been deferred, income may however be recognised when received based on the underlying performance of the project.

Front-end fees and commitment fees are deferred, together with the related direct costs of originating and maintaining the commitment, and are recognised as an adjustment to the effective yield, being recorded in the profit and loss account over the period from disbursement to repayment of the related loan. If the commitment expires without the loan being drawn down, the fee is recognised as income on expiry.

In prior years the Bank's policy was to record front-end fees as income when the loan became effective and to record commitment fees as income over the period during which the commitment existed. Due to the comparatively small volume of front-end and commitment fees earned in prior years, the impact of applying this policy was considered to approximate to the impact of deferring such fees, together with their related costs, and recognising these as an adjustment to the effective yield. Due to the increase in volume of these fees as the Bank's portfolio has grown (front-end and commitment fees have increased by 57 per cent between 2001 and 2002 and 112 per cent between 2000 and 2002), the Bank considers it now more appropriate to incorporate these fees and the related direct costs in the effective yield of the loan in a more specific manner. No adjustment to prior year figures is required since such an adjustment would be immaterial as the method previously used provided a reasonable approximation.

Fees received in respect of services provided over a period of time are recognised as income as the services are provided. 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 has 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 2002 € 000	**Treasury 2002 € 000**	**Aggregated 2002 € 000**	Banking 2001 € 000	Treasury 2001 € 000	Aggregated 2001 € 000
Interest income	**355,959**	**259,498**	**615,457**	429,539	470,832	900,371
Other income	**187,132**	**10,581**	**197,713**	148,882	35,041	183,923
Total segment revenue	**543,091**	**270,079**	**813,170**	578,421	505,873	1,084,294
Less interest expenses and similar charges	**(229,049)**	**(217,860)**	**(446,909)**	(336,155)	(406,057)	(742,212)
Allocation of capital benefit	**129,507**	**14,390**	**143,897**	151,282	16,809	168,091
Less IAS 39 impact of non-qualifying hedges	**–**	**(38,311)**	**(38,311)**	–	(8,698)	(8,698)
Less general administrative expenses	**(141,222)**	**(17,368)**	**(158,590)**	(174,753)	(14,990)	(189,743)
Less depreciation	**(17,585)**	**(992)**	**(18,577)**	(15,379)	(1,614)	(16,993)
Segment result before provisions	**284,742**	**9,938**	**294,680**	203,416	91,323	294,739
Provisions for losses	**(103,030)**	**(83,572)**	**(186,602)**	(137,557)	–	(137,557)
Operating profit / (loss) for the year	**181,712**	**(73,634)**	**108,078**	65,859	91,323	157,182
Segment assets	**8,500,856**	**10,363,615**	**18,864,471**	8,111,665	11,333,910	19,445,575
Paid-in capital receivable			**1,247,727**			1,501,718
Total assets			**20,112,198**			20,947,293
Segment liabilities	**8,500,856**	**10,363,615**	**18,864,471**	8,111,665	11,333,910	19,445,575
Members' equity receivable			**1,247,727**			1,501,718
Total liabilities			**20,112,198**			20,947,293
Capital expenditure	**16,456**	**928**	**17,384**	20,811	2,185	22,996

Interest expense and similar charges, and the capital benefit total €303.0 million (2001: €574.1 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 2002 € 000	Segment revenue 2001 € 000	**Segment assets 2002 € 000**	Segment assets 2001 € 000
Advanced countries [1]	**286,068**	248,045	**4,006,043**	3,703,838
Early / Intermediate countries [2]	**166,649**	216,380	**2,881,641**	3,015,176
Russian Federation	**90,374**	113,996	**1,613,172**	1,392,651
Total	**543,091**	578,421	**8,500,856**	8,111,665

[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 Yugoslavia Republic of Macedonia, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. In February 2003 the Federal Republic of Yugoslavia was renamed "Serbia and Montenegro". As this Report covers 2002, we refer to the country as FR Yugoslavia.

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 €813.2 million (2001: €1.1 billion).

4. Net fee and commission income

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

	2002 € 000	2001 € 000
Front-end fees	**31,104**	17,101
Commitment fees	**14,139**	11,702
Guarantee fees	**4,001**	2,594
Management fees	**2,995**	2,411
Trade finance fees	**2,812**	2,195
Other	**1,389**	2,847
Gross fee and commission income	**56,440**	38,850
Deferral of front-end and commitment fees	(**45,243**)	–
Net fee and commission income	**11,197**	38,850

Front-end and commitment fees received in 2002, together with an equal amount of related direct costs shown in gross administrative expenses below, have been deferred on the balance sheet and will be recorded in interest income over the period from disbursement to repayment of the related loan in accordance with IAS 18.

5. Net profit on dealing activities and foreign exchange

	2002 € 000	2001 € 000
Available-for-sale portfolio	(**4,884**)	968
Dealing portfolio	**13,729**	31,005
Foreign exchange	**1,736**	3,068
Net profit on dealing activities and foreign exchange	**10,581**	35,041

For the available-for-sale portfolio, the realised gains and losses arose 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.

6. IAS 39 impact on non-qualifying hedges

IAS 39 impact on non-qualifying hedges does not derive from dealing activities but is a consequence of the accounting rules introduced by IAS 39. This accounting standard requires all derivatives to be fair valued in the profit and loss account. In the case of derivative positions taken for hedging purposes (which represents the majority of the Bank's derivatives exposure) it does not permit recognition of the largely offsetting changes in fair value of the underlying hedged balance sheet positions in the absence of a specific one-to-one hedge relationship. In line with modern risk management practices, much of the Bank's hedging activity is conducted on a portfolio as opposed to individual asset basis, and this form of hedging does not qualify for special hedge accounting treatment under IAS 39. There are two principal categories of derivative hedging activity conducted by the Bank which do not qualify for hedge accounting.

First, derivatives macro-hedging the Bank's fixed-rate loan book, in which the Bank exchanges the fixed rate flows on the loan assets in return for floating interest payments using swap contracts, are subject to fair value accounting, while the fixed rate loan assets being hedged are not. As the Bank is paying fixed rates of interest in these contracts, increases in the relevant interest rates, essentially US dollar and the euro, will result in mark-to-market gains on these contracts, while the converse will happen if rates fall. Taking into account the average life of these fixed rate exposures, the US dollar and euro interest rates have fallen in the order of 2.11 per cent and 0.87 per cent in 2002 generating unrealised IAS 39 losses of €20.8 million for the year. These charges do not represent an economic loss and will be recouped over the life of the fixed rate loans.

Second, the derivatives hedging the Bank's capital to be received in US dollar or Japanese yen are subject to fair value accounting while the underlying capital sums receivable are not. This difference in measurement will cause interim volatility in the profit and loss account until the transactions settle. The Bank has recorded an IAS 39 loss of €17.5 million in this connection for the year 2002. These charges do not represent an economic loss and will reverse over time as the capital is received in cash, but fluctuating interest and exchange rates will continue to cause reported profit and loss volatility in the interim.

The International Accounting Standards Board has issued an exposure draft containing amendments to IAS 39, which, if adopted, would permit hedge accounting treatment to be applied to a broader range of hedging activity.

7. General administrative expenses

	2002 € 000	2001 € 000
Personnel costs [1]	**128,141**	121,675
Overhead expenses net of government grants [2, 3]	**75,692**	68,068
General administrative expenses [4]	**203,833**	189,743
Deferral of direct costs related to loan origination and commitment maintenance [5]	**(45,243)**	–
Net general administrative expenses	**158,590**	189,743

[1] The average numbers of staff included in personnel costs during the year were: regular staff of 903 (2001: 866), contract staff of 89 (comprising special contract staff of 40 and interns/short-term staff of 49), locally hired staff in Resident Offices of 254, and Board of Directors personnel of 73. Of these 54 were externally funded.

Staff numbers at 31 December 2002 were: regular staff of 893 (2001: 894), contract staff of 93 (comprising special contract staff of 38 and interns/short-term staff of 55), locally hired staff in Resident Offices of 247, and Board of Directors personnel of 73. Of these 54 were externally funded.

In addition, 137 Project Bureau staff (2001: 211) 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 (2001: €2.1 million) were taken to the profit and loss account.

[3] Included in overhead expenses above are the following fees in respect of work performed by the Bank's auditors:

	2002 € 000	2001 € 000
Services as auditors [(a)]	**122**	113
Further assurance services		
Tax compliance	**3**	3
Other non-audit services [(b)]		
Consultancy services	**1,332**	76
Consultancy services – countries of operations	**30**	228
	1,362	304

[(a)] Services as auditors have been recorded on an accruals basis.

[(b)] Payments to the auditors for consulting and advisory services during the period of audit appointment are recorded on a cash basis and reflect payments to Arthur Andersen in 2001 and for the period from 1 January 2002 to 31 July 2002 and to Deloitte & Touche for the period from 1 August 2002 to 31 December 2002. Deloitte & Touche entered into an agreement with Arthur Andersen under which partners and staff of Arthur Andersen joined Deloitte & Touche as of 1 August 2002. The Bank appointed Deloitte & Touche as auditors in succession to Arthur Andersen with effect from that date. Of the fees for other non-audit services of €1.4 million, 84 per cent relates to contracts entered into by Deloitte & Touche prior to 1 August 2002.

[4] Sterling general administrative expenses totalled £128.8 million (2001: £126.1 million).

[5] Direct costs related to loan origination and commitment maintenance in 2002, together with front-end and commitment fees received shown in net fee and commission income above, have been deferred on the balance sheet and will be recorded in interest income over the period from disbursement to repayment of the related loan.

8. Summary of provisions for losses

Profit and loss charge / (release)	Loans € 000	Share investments € 000	Total loans and share investments € 000	Guarantees and other € 000	Treasury provisions € 000	**2002 Total € 000**	2001 Total € 000
Portfolio provision for the impairment of unidentified assets:							
Non-sovereign risk assets	57,141	30,193	87,334	(1,288)	–	**86,046**	126,724
Sovereign risk assets	(1,422)	–	(1,422)	–	–	**(1,422)**	7,471
Guarantees	–	–	–	19,289	–	**19,289**	2,218
Specific provisions for the impairment of identified assets [1]	(28,238)	27,355	(883)	–	83,572	**82,689**	1,144
For the year ended 31 December 2002	**27,481**	**57,548**	**85,029**	**18,001**	**83,572**	**186,602**	
For the year ended 31 December 2001	15,128	122,040	137,168	389	–		137,557

[1] During the year new specific provisions for the impairment of identified assets of €149.3 million were made and €66.6 million were released resulting in a net charge to the profit and loss account of €82.7 million.

Movement in provisions	Loans € 000	Share investments € 000	Total loans and share investments € 000	Guarantees and other € 000	Treasury provisions € 000	**2002 Total € 000**	2001 Total € 000
At 1 January	598,508	606,660	1,205,168	19,032	–	**1,224,200**	1,212,093
Charge	27,481	57,548	85,029	18,001	83,572	**186,602**	137,557
Unwinding of the discount relating to the provision for the impairment of identified assets [1]	(2,171)	–	(2,171)	–	–	**(2,171)**	(5,737)
Foreign exchange adjustments	(70,491)	–	(70,491)	(194)	(2,346)	**(73,031)**	24,395
IAS 39 opening reinstatement adjustment	–	–	–	–	–	**–**	(74,296)
Release against amounts written off [2]	(19,863)	(24,713)	(44,576)	–	–	**(44,576)**	(69,812)
At 31 December	**533,464**	**639,495**	**1,172,959**	**36,839**	**81,226**	**1,291,024**	1,224,200
Analysed between							
Portfolio provision for the impairment of unidentified assets:							
Non-sovereign risk assets	288,757	320,083	608,840	1,027	–	**609,867**	553,177
Sovereign risk assets	64,669	–	64,669	–	–	**64,669**	75,592
Specific provisions for the impairment of identified assets	180,038	319,412	499,450	–	81,226	**580,676**	578,908
Deducted from assets	533,464	639,495	1,172,959	1,027	81,226	**1,255,212**	1,207,677
Included in other liabilities	–	–	–	35,812	–	**35,812**	16,523
At 31 December	**533,464**	**639,495**	**1,172,959**	**36,839**	**81,226**	**1,291,024**	1,224,200

[1] Included in interest income from loans is €2.2 million relating to the unwinding of the net present value discount.

[2] Release against amounts written off is reduced by €22.4 million relating to receipts from previously written off investments which have been deducted from the charge for the year.

9. Debt securities

Analysis by issuer	**Book value 2002 € 000**	Book value 2001 € 000
Governments	**296,763**	719,651
Public bodies	**400,108**	689,181
Other borrowers	**4,500,253**	5,805,716
At 31 December	**5,197,124**	7,214,548

Analysis by portfolio		
Available-for-sale portfolio	**4,403,371**	5,861,808
Dealing portfolio		
Internally managed funds	**241,213**	814,715
Externally managed funds	**552,540**	538,025
	793,753	1,352,740
At 31 December	**5,197,124**	7,214,548

10. Other assets

	2002 € 000	2001 € 000
Interest receivable	**209,633**	166,461
Mark-to-market valuation of derivative assets	**378,048**	1,723
Treasury deals pending settlement	**449,947**	177,248
Other	**393,989**	332,053
At 31 December	**1,431,617**	677,485

11. Loans and share investments

Outstanding disbursements	Loans € 000	Unlisted share investments € 000	Listed share investments € 000	Total share investments € 000	Total loans and share investments € 000
At 1 January 2002	6,713,069	1,486,568	867,393	2,353,961	9,067,030
IAS 39 movement in fair value revaluation	8,165	–	103,736	103,736	111,901
Disbursements	3,350,230	300,959	82,662	383,621	3,733,851
Repayments, prepayments and disposals	(2,483,549)	(115,143)	(81,265)	(196,408)	(2,679,957)
Foreign exchange movements	(722,356)	–	–	–	(722,356)
Written off	(41,624)	(22,141)	(3,200)	(25,341))	(66,965)
At 31 December 2002	**6,823,935**	**1,650,243**	**969,326**	**2,619,569**	**9,443,504**
Provisions at 31 December 2002 [1]	(534,491)	(525,133)	(114,362)	(639,495)	(1,173,986)
Total outstanding disbursements at 31 December 2002	**6,289,444**	**1,125,110**	**854,964**	**1,980,074**	**8,269,518**
Total outstanding disbursements at 31 December 2001	6,112,052	984,151	763,150	1,747,301	7,859,353

[1] Provisions for loans includes €1.0 million for bonds held as banking assets classified in note 8 under guarantees and other.

At 31 December 2002 the Bank categorised 23 loans as impaired, totalling €204.5 million (2001: 31 loans totalling €327.4 million). Specific provisions on these assets amounted to €180.0 million (2001: €262.1 million). Interest has been excluded from the profit and loss account of approximately €9.7 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 €2.2 million of income to the profit and loss account in interest income from loans.

Of the net profit on sale of share investments of €140.0 million, €56.4 million relates to profit on the sale of unlisted share investments, which were held at cost of €121.8 million at the time of sale, because their fair value could not previously be measured reliably.

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 at 31 December 2002, was approximately €694.4 million, the net incremental impact on the profit and loss account would be a profit of approximately €46.8 million (2001: €574.0 million and €46.1 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 €371.0 million (2001: €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 greater than or equal to 20 per cent of the investee share capital at 31 December 2002 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: Romania	38
Baring Vostok Private Equity Fund	32
Danone MPF – Danone Industria LLC	30
European Property Group	25
Lafarge: Polska	22
General Motors – VAZ JV	20

12. Analysis of operational activity

Analysis by country	**Outstanding disbursements 2002 € 000**	Outstanding disbursements 2001 € 000	**Undrawn commitments 2002 € 000**	Undrawn commitments 2001 € 000
Albania	**32,887**	30,696	**88,800**	62,237
Armenia	**57,593**	74,205	**24,198**	26,997
Azerbaijan	**164,270**	210,940	**101,631**	92,792
Belarus	**54,815**	75,654	**7,583**	13,665
Bosnia and Herzegovina	**76,427**	73,604	**135,018**	113,090
Bulgaria	**273,722**	323,080	**165,337**	42,110
Croatia	**525,094**	383,581	**373,084**	379,187
Czech Republic	**359,308**	376,532	**113,776**	139,823
Estonia	**230,679**	228,881	**23,931**	22,867
FR Yugoslavia	**48,877**	6,566	**312,046**	225,815
FYR Macedonia	**73,658**	114,587	**71,562**	74,214
Georgia	**95,833**	115,456	**49,692**	70,418
Hungary	**507,379**	492,555	**106,112**	135,583
Kazakhstan	**342,841**	306,120	**319,644**	329,228
Kyrgyz Republic	**72,422**	106,687	**1,587**	24,426
Latvia	**89,147**	112,292	**19,719**	48,669
Lithuania	**186,843**	209,555	**67,005**	89,745
Moldova	**92,271**	87,822	**22,585**	62,313
Poland	**1,411,194**	1,249,510	**535,949**	598,251
Romania	**950,037**	996,919	**423,942**	364,520
Russian Federation	**1,898,097**	1,724,770	**1,107,185**	764,791
Slovak Republic	**390,270**	382,649	**141,773**	83,990
Slovenia	**252,281**	202,981	**118,755**	11,190
Tajikistan	**9,327**	11,255	**18,989**	22,790
Turkmenistan	**82,509**	56,910	**54,853**	77,396
Ukraine	**467,652**	432,126	**388,812**	542,255
Uzbekistan	**235,476**	300,017	**196,367**	233,938
Regional	**462,595**	381,080	**484,082**	670,181
At 31 December	**9,443,504**	9,067,030	**5,474,017**	5,322,481

Analysis by instrument

Loans	**6,771,193**	6,652,604	**4,278,988**	4,008,212
Share investments	**2,619,569**	2,353,961	**669,368**	782,671
Debt securities	**52,742**	60,465	**–**	–
Guarantees	**–**	–	**525,661**	531,598
At 31 December	**9,443,504**	9,067,030	**5,474,017**	5,322,481

Analysis by sector

Commerce and tourism	**344,442**	213,194	**104,494**	111,949
Community and social services	**227,882**	160,251	**132,612**	151,193
Energy/power generation	**1,060,148**	1,042,309	**1,236,411**	1,499,977
Extractive industries	**522,775**	595,356	**282,723**	183,491
Finance	**3,302,277**	2,958,269	**1,581,523**	1,272,207
Manufacturing	**1,918,466**	2,039,655	**513,123**	755,453
Primary industries	**193,297**	139,031	**154,074**	150,736
Telecommunications	**834,335**	897,086	**192,855**	160,264
Transport and construction	**1,039,882**	1,021,879	**1,276,202**	1,037,211
At 31 December	**9,443,504**	9,067,030	**5,474,017**	5,322,481

13. Property, technology and office equipment

	Property € 000	Technology and office equipment € 000	Total € 000
Cost			
At 1 January 2002	67,501	96,791	164,292
Additions	362	17,022	17,384
Disposals	(386)	(789)	(1,175)
At 31 December 2002	**67,477**	**113,024**	**180,501**
Depreciation			
At 1 January 2002	40,523	78,895	119,418
Charge	4,836	13,741	18,577
Disposals	(328)	(728)	(1,056)
At 31 December 2002	**45,031**	**91,908**	**136,939**
Net book value			
At 31 December 2002	**22,446**	**21,116**	**43,562**
At 31 December 2001	26,978	17,896	44,874

There were no additions during the year for assets purchased under finance leases. The related minimum payments under finance leases amount to €0.5 million, of which €0.3 million are due within 12 months of the balance sheet date and €0.2 million are due after one year but within five years of the balance sheet date. These future payments are included in "Other liabilities".

14. Debts evidenced by certificates

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

	Principal at nominal value € 000	Fair value adjustment € 000	Adjusted principal value € 000	Currency swaps payable/ (receivable) € 000	**Net currency obligations 2002 € 000**	Net currency obligations 2001 € 000
Australian dollars	754,594	(58,286)	696,308	(696,308)	**–**	–
Canadian dollars	87,818	(33,010)	54,808	(54,808)	**–**	–
Czech koruna	158,806	(12,815)	145,991	(145,991)	**–**	–
Euro	1,473,285	323,681	1,796,966	437,202	**2,234,168**	3,231,384
Gold bullion	335,038	(49,899)	285,139	(285,139)	**–**	–
Hong Kong dollars	73,410	(68,478)	4,932	(4,932)	**–**	–
Hungarian forints	7,045	–	7,045	–	**7,045**	7,734
Japanese yen	2,008,992	715,557	2,724,549	(2,393,613)	**330,936**	441,219
New Taiwan dollars	741,961	723	742,684	(742,684)	**–**	–
Polish zloty	95,686	2,985	98,671	(70,858)	**27,813**	–
Russian roubles	5,284	–	5,284	–	**5,284**	14,233
Singapore dollars	82,426	(391)	82,035	(82,035)	**–**	–
Slovak koruna	14,693	7,388	22,081	(22,081)	**–**	–
South African rands	449,939	117,110	567,049	(567,049)	**–**	–
Sterling	2,663,250	77,605	2,740,855	(1,015,785)	**1,725,070**	2,134,434
Turkish lire	116,275	53,508	169,783	(169,783)	**–**	–
United States dollars	3,235,475	(617,799)	2,617,676	5,813,864	**8,431,540**	8,098,331
At 31 December	**12,303,977**	**457,879**	**12,761,856**	**–**	**12,761,856**	**13,927,335**

During the year the Bank redeemed €247.1 million of bonds and medium-term notes prior to maturity generating a net gain of €4.3 million.

15. Other liabilities

	2002 € 000	2001 € 000
Interest payable	**159,264**	126,018
Mark-to-market valuation of derivative assets	**94,492**	340,451
Treasury deals pending settlement	**218,528**	157,223
Other	**420,438**	202,626
At 31 December	**892,722**	826,318

16. Subscribed capital

	Number of shares 2002	2002 Total € 000	Number of shares 2001	2001 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**	986,975	9,869,750
Subscribed capital	**1,978,950**	**19,789,500**	1,978,950	19,789,500
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.

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:	2002 € 000	2001 € 000
Promissory notes issued by members:		
– not yet due for encashment	**333,643**	354,469
– due for encashment	**4,806**	9,090
Total promissory notes received	**338,449**	363,559
Paid-in subscribed capital:		
– amounts not yet due	**889,880**	1,107,099
– amounts due but not yet received	**19,398**	31,060
Total paid-in subscribed capital receivable	**909,278**	1,138,159
Paid-in capital receivable at 31 December	**1,247,727**	1,501,718

16. Subscribed capital (continued)

Statement of capital subscriptions

At 31 December 2002 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	68,000	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	391	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	791	10,000	7,370	2,630
Azerbaijan	2,000	985	20,000	14,750	5,250
Belarus	4,000	4,000	40,000	29,500	10,500
Bosnia and Herzegovina	3,380	3,380	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
FR Yugoslavia	9,350	9,350	93,500	68,960	24,540
FYR Macedonia	1,382	1,351	13,820	10,200	3,620
Georgia	2,000	742	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
Kyrgyz Republic	2,000	1,042	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	1,326	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	636	20,000	14,750	5,250
Turkmenistan	200	178	2,000	1,470	530
Ukraine	16,000	13,880	160,000	118,000	42,000
Uzbekistan	4,200	4,200	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**	**1,970,632**	**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 (2001: 1,978,950).

[2] Of paid-in capital, €4.3 billion has been received (2001: €4.1 billion). Some €0.9 billion is not yet due (2001: €1.1 billion), which relates primarily to the capital increase and is payable on or before 15 April 2005.

17. 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	226,709	687,890	29,231	11,399	34,978	**990,207**
Collateralised placements	1,270,727	1,374,460	–	–	287,256	**2,932,443**
Debt securities	554,958	3,738,591	318,839	572,733	12,003	**5,197,124**
Other assets	854,510	(287,731)	775,962	94,274	(5,398)	**1,431,617**
Loans	2,386,670	3,694,098	4,292	313	204,071	**6,289,444**
Share investments	–	–	–	–	1,980,074	**1,980,074**
Property, technology and office equipment	43,562	–	–	–	–	**43,562**
Paid-in capital receivable	666,300	453,675	127,752	–	–	**1,247,727**
Total assets	**6,003,436**	**9,660,983**	**1,256,076**	**678,719**	**2,512,984**	**20,112,198**
Liabilities and members' equity						
Amounts owed to credit institutions	(371,568)	(49,109)	(401)	(135,367)	(43,453)	(**599,898**)
Debts evidenced by certificates	(1,796,966)	(2,617,676)	(2,724,549)	(2,740,855)	(2,881,810)	(**12,761,856**)
Other liabilities	226,017	(838,565)	(150,316)	(88,038)	(41,820)	(**892,722**)
Members' equity	(5,904,966)	44,524	1,303	691	726	(**5,857,722**)
Total liabilities and members' equity	(**7,847,483**)	(**3,460,826**)	(**2,873,963**)	(**2,963,569**)	(**2,966,357**)	(**20,112,198**)
Net assets / (liabilities)	(**1,844,047**)	**6,200,157**	(**1,617,887**)	(**2,284,850**)	(**453,373**)	**–**
Derivative instruments	(219,331)	(6,097,237)	1,620,081	2,286,665	2,409,822	**–**
Currency position at 31 December 2002	(**2,063,378**)	**102,920**	**2,194**	**1,815**	**1,956,449**	**–**
Currency position at 31 December 2001	(1,760,019)	5,625	4,220	5,759	1,744,415	**–**

In addition to the Bank's functional currency, euro, currencies individually disclosed are those in which the Bank primarily raises funds (see note 14) and which expose the Bank to exchange rate risk. Amounts aggregated under "Other currencies" and which, after allowing for derivative 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 are not readily available.

18. 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	966,091	–	–	16,077	8,039	–	**990,207**
Collateralised placements	2,782,745	149,698	–	–	–	–	**2,932,443**
Debt securities	395,929	130,443	313,298	2,296,949	2,060,505	–	**5,197,124**
Other assets	869,161	(78,585)	272,743	55,178	313,120	–	**1,431,617**
Loans	365,944	443,738	1,161,442	3,108,889	1,563,884	(354,453)	**6,289,444**
Share investments	–	–	–	–	–	1,980,074	**1,980,074**
Property, technology and office equipment	–	–	–	–	–	43,562	**43,562**
Promissory notes received	–	–	132,227	199,628	473	6,121	**338,449**
Paid-in capital subscribed but not yet due	–	–	296,627	593,253	–	–	**889,880**
Overdue capital	–	–	–	–	–	19,398	**19,398**
Total assets	**5,379,870**	**645,294**	**2,176,337**	**6,269,974**	**3,946,021**	**1,694,702**	**20,112,198**
Liabilities and members' equity							
Amounts owed to credit institutions	(542,217)	(57,681)	–	–	–	–	(**599,898**)
Debts evidenced by certificates	(536,350)	(112,924)	(1,355,047)	(4,570,017)	(6,187,518)	–	(**12,761,856**)
Other liabilities	(390,953)	(31,541)	(201,355)	(104,702)	(72,679)	(91,492)	(**892,722**)
Members' equity	–	–	–	–	–	(5,857,722)	(**5,857,722**)
Total liabilities and members' equity	(**1,469,520**)	(**202,146**)	(**1,556,402**)	(**4,674,719**)	(**6,260,197**)	(**5,949,214**)	(**20,112,198**)
Net liquidity position at 31 December 2002	**3,910,350**	**443,148**	**619,935**	**1,595,255**	(**2,314,176**)	(**4,254,512**)	**–**
Cumulative net liquidity position at 31 December 2002	**3,910,350**	**4,353,498**	**4,973,433**	**6,568,688**	**4,254,512**	**–**	**–**
Cumulative net liquidity position at 31 December 2001	165,582	3,984,115	4,432,445	6,336,593	5,172,529	–	**–**

19. 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	966,091	–	–	16,077	8,039	–	**990,207**
Collateralised placements	2,777,816	154,627	–	–	–	–	**2,932,443**
Debt securities	1,834,752	1,395,092	486,582	855,291	465,731	159,676	**5,197,124**
Other assets	1,059,429	–	209,633	–	–	162,555	**1,431,617**
Loans	1,241,265	2,282,822	2,620,219	401,404	278,225	(534,491)	**6,289,444**
Non-interest-earning assets including paid-in capital receivable	–	–	–	–	–	3,271,363	**3,271,363**
Total assets	**7,879,353**	**3,832,541**	**3,316,434**	**1,272,772**	**751,995**	**3,059,103**	**20,112,198**
Liabilities and members' equity							
Amounts owed to credit institutions	(599,898)	–	–	–	–	–	**(599,898)**
Debts evidenced by certificates	(2,493,103)	(1,097,778)	(1,137,525)	(4,181,334)	(3,852,116)	–	**(12,761,856)**
Other liabilities	(411,116)	–	322,219	–	–	(803,825)	**(892,722)**
Members' equity	–	–	–	–	–	(5,857,722)	**(5,857,722)**
Total liabilities and members' equity	**(3,504,117)**	**(1,097,778)**	**(815,306)**	**(4,181,334)**	**(3,852,116)**	**(6,661,547)**	**(20,112,198)**
Net assets	4,375,236	2,734,763	2,501,128	(2,908,562)	(3,100,121)	(3,602,444)	**–**
Derivative financial instruments	(1,979,127)	(1,110,078)	(4,225,970)	3,313,247	4,001,928	–	**–**
Interest rate risk at 31 December 2002	**2,396,109**	**1,624,685**	**(1,724,842)**	**404,685**	**901,807**	**(3,602,444)**	**–**
Cumulative interest rate risk at 31 December 2002	**2,396,109**	**4,020,794**	**2,295,952**	**2,700,637**	**3,602,444**	**–**	**–**
Cumulative interest rate risk at 31 December 2001	4,281,177	6,680,180	4,145,953	3,923,225	2,845,093	–	**–**

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 2002, 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 €4.2 million (2001: €3.7 million), taking into account partial diversification effects.

20. Credit-related information on Treasury derivative financial instruments

	2002 € 000	2001 € 000
Credit derivatives [1]	**3,824,279**	4,005,656
Swaps and over-the-counter option agreements: [2]		
Pre netting/collateral agreements [3]	**2,121,531**	1,156,976
Post netting/collateral agreements [3]	**742,287**	298,668

[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.

[3] For pre netting/collateral agreements the proportion of exposure to triple-A rated counterparties was 24 per cent, while for post netting/collateral agreements this proportion was 43 per cent.

21. Average balance sheet

	2002 € 000	2002 € 000	2001 € 000	2001 € 000
Assets				
Placements with and advances to credit institutions	**2,172,841**		2,397,501	
Collateralised placements	**3,044,281**		2,403,867	
Debt securities	**5,724,767**		7,364,961	
		10,941,889		12,166,329
Other assets		**614,681**		958,569
Loans and share investments				
Loans	**6,112,325**		5,564,671	
Share investments	**1,810,834**		1,633,521	
		7,923,159		7,198,192
Property, technology and office equipment		**47,135**		39,770
Paid-in capital receivable		**1,331,329**		1,597,465
Total assets		**20,858,193**		21,960,325
Liabilities and members' equity				
Borrowings				
Amounts owed to credit institutions	**1,177,612**		735,009	
Debts evidenced by certificates	**12,976,929**		13,039,578	
		14,154,541		13,774,587
Other liabilities		**863,324**		2,547,176
Subscribed capital	**19,789,500**		19,793,908	
Callable capital	**(14,592,845)**		(14,590,058)	
Paid-in capital		**5,196,655**		5,203,850
Reserves and profit for the year		**643,673**		434,712
Members' equity		**5,840,328**		5,638,562
Total liabilities and members' equity		**20,858,193**		21,960,325
Memorandum items				
Undrawn commitments		**5,225,531**		4,722,113

The average balance sheet is based on daily averaging.

22. 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 Bank's 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 and was effective from 25 December 2001. 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 €18.0 million at 31 December 2002 (31 December 2001: €22.1 million). Income from sub-lease payments for the year amounted to €5.2 million (31 December 2001: €4.2 million).

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

Payable:	**2002 € 000**	2001 € 000
Not later than one year	**31,695**	34,858
Later than one year and not later than five years	**84,191**	121,617
At 31 December	**115,886**	156,475

23. Staff retirement schemes

Defined benefit scheme

A full actuarial valuation of the defined benefit scheme is performed at least every three years by a qualified actuary using the projected unit method. For IAS 19 purposes this is rolled forward annually to 31 December. The most recent valuation was as at 30 June 2002. 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:

	2002 € 000	2001 € 000
Fair value of plan assets	**69,784**	73,174
Present value of the defined benefit obligation	(**73,261**)	(69,332)
	(**3,477**)	3,842
Unrecognised actuarial losses [1]	**42,845**	25,683
Prepayment at 31 December	**39,368**	29,525

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

At 1 January	**29,525**	25,419
Exchange differences	(**1,828**)	543
Contributions paid	**22,849**	13,069
Total expense as below	(**11,178**)	(9,506)
At 31 December	**39,368**	29,525

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

Current service cost	(**11,756**)	(11,180)
Interest cost	(**4,368**)	(3,957)
Expected return on assets	**6,147**	5,770
Amortisation of actuarial loss	(**1,201**)	(139)
Total included in staff costs	(**11,178**)	(9,506)

[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	**5.50%**	5.75%
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 €6.1 million (2001: €5.9 million) and is included in "General administrative expenses".

24. Other fund agreements

In addition to the Bank's ordinary 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 2002 the Bank administered 81 technical cooperation fund agreements (2001: 74) for an aggregate of €785.1 million (2001: €768.0 million) which includes €300.9 million for the Tacis and Phare programmes of the European Commission under the Bangkok and Investment Preparation Facilities. Of this pledged amount, funds received at 31 December 2002 totalled €680.4 million. The total uncommitted balance of the funds at 31 December 2002 was €141.4 million. In addition, the Bank administered 73 project-specific technical cooperation agreements for an aggregate amount of €48.5 million.

The Bank also administered 12 investment cooperation fund agreements for an aggregate amount of €63.0 million and two EU Pre-accession Preparation Funds for an aggregate amount of €34.8 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 (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 2002, 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 (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 2002, 23 contributors had made pledges up to a total amount of €548.6 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 the 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 2002, 16 contributors had made pledges to the Ignalina IDSF up to a total amount of €147.5 million, 10 contributors had made pledges to the Kozloduy IDSF up to a total amount of €97.9 million and seven contributors had made pledges to the Bohunice IDSF up to a total amount of €117.9 million, using the fixed exchange rates defined in the Rules of Funds.

In 2001, the Nordic Investment Bank hosted a meeting with participants from Belgium, Finland, Sweden, the European Commission and international financial institutions with activities in the Northern Dimension Area (NDA) at which it was agreed to establish the Northern Dimension Environmental Partnership to strengthen and co-ordinate financing of important environmental projects with cross-border effects in the NDA. On 11 December 2001, the Bank's Board of Directors approved the Rules of the Northern Dimension Environmental Partnership Support Fund and the role of the Bank as Fund Manager. At 31 December 2002, six contributors had made pledges up to a total of €100.0 million.

Audit fees payable to the Bank's auditors in respect of the 2002 audits of the technical cooperation and nuclear safety funds totalled €191,000 (2001: €176,500). Services as auditors have been recorded on an accruals basis. In addition, during 2002 the Bank's auditors, on a global basis, earned €0.7 million (2001: €1.9 million) in respect of due diligence and general business consultancy services funded by the technical cooperation funds. This represents approximately 1.0 per cent of the 2002 (2001: 2.3 per cent) total spend by the technical cooperation funds on services from consultancy providers in support of the Bank's investments in the countries of operations. These consultancy contracts are awarded in accordance with the Bank's standard procurement rules. Payments to the auditors for consulting and advisory services during the period of audit appointment are recorded on a cash basis and reflect payments to Arthur Andersen in 2001 and for the period from 1 January 2002 to 31 July 2002 and to Deloitte & Touche for the period from 1 August 2002 to 31 December 2002. Deloitte & Touche entered into an agreement with Arthur Andersen under which partners and staff of Arthur Andersen joined Deloitte & Touche as of 1 August 2002. The Bank appointed Deloitte & Touche as auditors in succession to Arthur Andersen with effect from that date.

25. Post balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements. On 18 March 2003, 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 5 May 2003.

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 2002, the Bank administered 11 Special Funds: eight Investment Special Funds and three Technical Cooperation Special Funds. In addition, the activities of one Investment Special Fund were completed during the year and the Fund was terminated. 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. Audit fees payable to the Bank's auditors relating to the 2002 audit of the Special Funds totalled €74,500 (2001: €61,000). Deloitte & Touche entered into an agreement with Arthur Andersen under which partners and staff of Arthur Andersen joined Deloitte & Touche as of 1 August 2002. The Bank appointed Deloitte & Touche as auditors in succession to Arthur Andersen with effect from that date.

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 Fund was terminated in 2002 following the successful completion of the activities.

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, FR Yugoslavia, FYR 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, FR Yugoslavia, FYR Macedonia and Romania.

The Central Asia Risk Sharing Special Fund:
To provide a risk-sharing facility for SME credit lines, micro finance programmes, the Direct Investment Facility and the Trade Facilitation Programme in the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

Investment Special Funds

Extract from the profit and loss account for the year ended 31 December 2002	The Baltic Investment Special Fund € 000	The Russia Small 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 Central Asia Risk Sharing Special Fund € 000	Aggregated Investment Special Funds € 000
Operating profit/(loss) before provisions	259	(5,374)	(1,067)	(779)	(16,140)	(1,170)	(10,049)	(267)	(34,587)
(Charge)/release for provisions for losses	(555)	5,485	(396)	(237)	(180)	–	(646)	–	3,471
(Loss)/profit for the year	**(296)**	**111**	**(1,463)**	**(1,016)**	**(16,320)**	**(1,170)**	**(10,695)**	**(267)**	**(31,116)**
Extract from the balance sheet at 31 December 2002									
Loans	8,415	26,512	3,869	2,804	–	–	2,119	–	43,719
Provisions for losses	(203)	(1,694)	(507)	(363)	–	–	(247)	–	(3,014)
	8,212	24,818	3,362	2,441	–	–	1,872	–	40,705
Share investments	7,894	3,058	2,452	2,729	1,906	–	–	–	18,039
Provisions for losses	(2,932)	(1,529)	(578)	(885)	(333)	–	–	–	(6,257)
	4,962	1,529	1,874	1,844	1,573	–	–	–	11,782
Placements and other assets	26,499	21,546	4,853	10,730	4,581	13,286	17,891	6,911	106,297
Contributions not yet received	–	–	3,817	–	86,000	–	1,880	689	92,386
Total assets	**39,673**	**47,893**	**13,906**	**15,015**	**92,154**	**13,286**	**21,643**	**7,600**	**251,170**
Other liabilities and provisions for losses	7	6,936	16	6	4,282	1,275	2,634	128	15,284
Contributions	41,500	59,351	14,015	13,435	110,000	13,152	32,336	7,739	291,528
Reserves and (loss)/profit for the year	(1,834)	(18,394)	(125)	1,574	(22,128)	(1,141)	(13,327)	(267)	(55,642)
Total liabilities and contributors' resources	**39,673**	**47,893**	**13,906**	**15,015**	**92,154**	**13,286**	**21,643**	**7,600**	**251,170**
Undrawn commitments and guarantees	9,685	76,973	947	840	33,015	17,653	11,761	14,735	165,609

Technical Cooperation Special Funds

Extract from the statement of movement in fund balance and balance sheet for the year ended 31 December 2002	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	4,790	9,554	87	14,431
Contributions received	1,400	2,980	182	4,562
Interest and other income	106	3,911	5	4,022
Disbursements	(2,241)	(2,390)	(79)	(4,710)
Other operating expenses	(77)	(2,045)	(5)	(2,127)
Balance of fund available	**3,978**	**12,010**	**190**	**16,178**
Cumulative commitments approved	23,474	65,608	1,056	90,138
Cumulative disbursements	(20,263)	(61,065)	(873)	(82,201)
Allocated fund balance	3,211	4,543	183	7,937
Unallocated fund balance	767	7,467	7	8,241
Balance of fund available	**3,978**	**12,010**	**190**	**16,178**

Special Fund contributions pledged by donor country

	The Baltic Investment Special Fund € 000	The Russia Small 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 Central Asia Risk Sharing 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	–	–	–	–	110,000	–	–	–	–	–	–	110,000
Finland	8,629	–	–	–	–	–	–	–	1,411	–	–	10,040
France	–	7,686	–	–	–	–	–	–	–	4,980	–	12,666
Germany	–	9,843	–	–	–	2,250	–	2,389	–	3,025	–	17,507
Iceland	427	–	–	–	–	–	–	–	69	–	–	496
Italy	–	8,401	–	13,435	–	–	–	–	–	1,360	–	23,196
Japan	–	21,162	–	–	–	–	–	–	–	3,295	–	24,457
Netherlands	–	–	–	–	–	1,546	–	–	–	–	–	1,546
Norway	7,732	–	–	–	–	1,145	–	–	1,256	–	–	10,133
Sweden	15,772	–	–	–	–	–	–	–	2,564	–	–	18,336
Switzerland	–	2,360	–	–	–	4,218	–	5,350	–	1,244	–	13,172
Taipei China	–	–	12,278	–	–	1,495	–	–	–	–	–	13,773
United Kingdom	–	–	–	–	–	–	–	–	–	12,824	247	13,071
United States of America	–	7,192	1,737	–	–	–	32,336	–	–	27,657	–	68,922
Total at 31 December 2002	**41,500**	**59,351**	**14,015**	**13,435**	**110,000**	**13,152**	**32,336**	**7,739**	**6,750**	**58,694**	**247**	**357,219**

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 2002 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Cash Flows, the Statement of Changes in Members' Equity and the related Notes 1 to 25. 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.

This report is made solely to the Bank's Board of Governors, as a body, in accordance with Article 24 of the Agreement Establishing the Bank. Our audit work has been undertaken so that we might state to the Bank's Board of Governors those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and its Board of Governors as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of management and auditors

Management is responsible for the preparation of the financial statements in accordance with International Financial Reporting Standards and the overall principles of the European Community's Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions. Our responsibility is to audit the financial statements in accordance with 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 the other information contained in the Financial Report section of the Annual Report for the above year as described in the contents section and 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 unless we specifically indicate in writing otherwise.

Basis of audit 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 as at 31 December 2002 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.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants
London

18 March 2003

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