Annual report 2004

Financial report

European Bank
for Reconstruction and Development

The European Bank for Reconstruction and Development invests in the businesses and banks that form the core of strong market economies in 27 countries from central Europe to central Asia. Our capital is provided by 60 governments and two international institutions.

The EBRD invests in virtually every kind of enterprise and financial institution, mainly in the form of loans and equity. Investments are designed to advance the transition to market economies and to set the highest standards of corporate governance. We do not finance projects that can be funded on equivalent terms by the private sector. In support of our investment activities, the EBRD conducts policy dialogue with governments to develop the rule of law and democracy.

Annual report 2004

Financial report

Contents

The EBRD's Annual Report 2004 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.
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Highlights

Financial results 2000-04

(€ million)	2004	2003	2002	2001	2000
Operating income[1]	**542.1**	557.9	471.8	501.5	519.2
Expenses and depreciation[1]	**(159.5)**	(158.0)	(177.1)	(206.7)	(192.1)
Operating profit before provisions	**382.6**	399.9	294.7	294.8	327.1
Provisions for impairment	**(84.9)**	(21.7)	(186.6)	(137.6)	(174.3)
Net profit for the year	**297.7**	378.2	108.1	157.2	152.8
Reserves and retained earnings	**1,786.0**	989.6	661.1	488.7	65.9
Provisions for impairment (cumulative)	**1,139.7**	1,169.6	1,291.0	1,224.2	1,212.1
Total reserves and provisions	**2,925.7**	2,159.2	1,952.1	1,712.9	1,278.0

1 In 2000 and 2001, operating income was reported before the deferral of front-end and commitment fees. Expenses and depreciation were reported before the deferral of direct costs relating to loan origination and commitment maintenance.

Operational results

	2004	2003	2002	2001	2000	Cumulative 1991–2004
Number of projects	**129**	119	102	102	95	1,140
EBRD financing (€ million)	**4,133**	3,721	3,899	3,656	2,673	25,323
Resources mobilised (€ million)	**8,799**	5,307	4,862	6,212	5,174	53,218
Total project value (€ million)	**12,932**	9,028	8,761	9,868	7,847	78,542

Financial results

The EBRD recorded a net profit after provisions and financial reporting adjustments of €297.7 million for 2004, compared with €378.2 million for 2003. The principal factors contributing to this decrease were a lower profit on the sale of share investments, an area that is variable by nature, and a significant increase in general portfolio provisions[1] as a result of the Bank's policy for providing on a portfolio basis.

The results for 2004 include a credit of €4.8 million representing the fair value movement on non-qualifying hedges (2003: credit of €10.3 million). This does not reflect the underlying economic performance of the Bank during the year. Excluding the impact of the fair value movement on non-qualifying hedges,[2] the Bank recorded a profit after provisions of €292.9 million (2003: €367.9 million). The Bank's reserves increased from €989.6 million at the end of 2003 to €1.79 billion at the end of 2004, primarily reflecting the net profit for the year and an increase in the fair value of the Bank's listed share investments.

Operating profit of €377.8 million before provisions and the fair value movement on non-qualifying hedges was 3 per cent below the €389.6 million operating profit of last year on an equivalent basis. The reduction in the value of impaired loans continued during 2004 with the upgrading of several projects. At 31 December 2004, the Bank had 17 impaired loans totalling €85.8 million, compared with 19 such loans totalling €125.2 million at the end of 2003. Of this reduction, only €13.5 million was the result of write-offs.

Successful work-outs, along with a generally improved Banking portfolio performance, resulted in releases of existing specific provisions totalling €76.9 million (2003: €89.7 million). These exceeded new specific provision charges of €58.9 million (2003: €55.4 million) and resulted in a net credit for the year of €18.0 million for specific provisions for the identified impairment of Banking assets (2003: net credit of €34.3 million). This partially offset €98.9 million in net new general portfolio provisions for the unidentified impairment of assets (2003: €50.8 million), and net specific provisions for the identified impairment of Treasury assets of €4.0 million (2003: €5.2 million).

Banking operations achieved a net profit of €218.0 million (2003: €311.9 million) after full allocation of expenses, provisions and return on net paid-in capital. This reflected a strong performance across all revenue areas, but also a year-on-year reduction in the net profit on the sale of share investments together with an increase in general portfolio provisions. Excluding the fair value movement on non-qualifying hedges, Treasury, after full allocation of expenses, provisions and return on net paid-in capital, achieved a net profit of €74.9 million (2003: €56.0 million). After the €4.8 million impact of non-qualifying hedges, Treasury's reported net profit for the year totalled €79.7 million (2003: €66.3 million).

1 Provisions for impairment of classes of similar assets that are not individually identified as impaired are calculated on a portfolio basis for loans and unlisted share investments. The methodology used for assessing such impairment is applied to net outstanding disbursements at the end of the month of disbursement.

2 See financial statements note 5.

The EBRD's general administrative expenses, before the deferral of direct costs relating to loan origination and commitment maintenance, were well within budget, reflecting continuing budgetary discipline and effective cost controls. While the Bank's reporting currency is the euro, the bulk of expenses are denominated in sterling. In sterling terms expenses, including depreciation and amortisation charges, amounted to £138.1 million compared with £132.8 million in 2003. As a result of the weakening of sterling against the euro during the year, in euro terms expenses were €8.2 million below the level of the previous year at €195.0 million (2003: €203.2 million).[3]

Total provisions for Banking operations amounted to €1.08 billion at the end of 2004 (2003: €1.10 billion). This reflected the EBRD's commitment to provide prudently for impairment. Relative to operating assets,[4] this represented 3.0 per cent of sovereign loans (2003: 3.0 per cent), 7.8 per cent of non-sovereign loans (2003: 8.5 per cent), 27.1 per cent of unlisted share investments (2003: 31.2 per cent) and 2.6 per cent of listed share investments[5] (2003: 5.6 per cent).

Banking operations

Annual business volume and portfolio

Annual business volume[6] amounted to €4.1 billion, representing 129 projects in 2004 (2003: €3.7 billion, 119 projects). This is the highest level of annual commitments signed by the EBRD to date and represents an increase of 11 per cent over the level recorded in 2003. Share investments and equity-linked transactions accounted for 21 per cent of the new business volume. The private sector share of the business volume was 86 per cent. Annual business volume included €77.7 million of restructured operations.

Net cumulative business volume reached €25.3 billion by the end of 2004 (2003: €22.7 billion). Including co-financing, this amounts to a total project value of €78.5 billion (2003: €68.5 billion). The portfolio of the Bank's net outstanding commitments grew from €14.8 billion at the end of 2003 to €15.3 billion at the end of 2004. Strong reflows from a maturing portfolio, together with the continued strengthening of the euro relative to the dollar, limited the portfolio impact of the €4.1 billion annual business volume and restricted portfolio growth to 3 per cent.

The number of projects under development increased during 2004 with the Board approving 150 projects. These consisted of loans and share investments by the Bank totalling €4.4 billion, compared with 133 projects totalling €4.0 billion in 2003. The level of Board approvals in 2004 was the highest annual level to date. At the end of 2004, cumulative Board approvals, net of cancellations, totalled €28.8 billion (2003: €26.2 billion).

Gross disbursements totalled €3.4 billion in 2004, the highest annual level achieved to date. This represents an increase of 62 per cent over the level recorded in 2003 (€2.1 billion). Operating assets amounted to €10.9 billion at the end of 2004 (2003: €9.4 billion), comprising €7.7 billion of disbursed outstanding loans and €3.2 billion of disbursed outstanding share investments.

The Bank attracted a significant additional amount of co-financing funds in 2004, which reached €5.4 billion. The Bank mobilised €3.5 billion from commercial co-financing institutions, €766 million from official co-financing, €613 million from international financial institutions and €466 million from export credit agencies. In addition, the Bank's activities continue to be strongly supported by donor funding including the Special Funds programme and technical and investment cooperation funds.

Risks

Internal rating procedures are discussed in detail under "Banking credit risk" in the risk management section of the financial statements. All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (low risk) to 10 (highest risk).

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 31 December 2004, 76 per cent of the loan and share investment portfolio was classed under risk ratings 4 to 6 (2003: 77 per cent).

The EBRD's portfolio continued to show improvement in the first half of 2004 and remained stable in the second half. This was due to the satisfactory economic performance in Russia, and from several countries of operations joining the European Union (EU), together with a generally resilient economic performance across the region. This trend led to the upgrading of several countries of operations' credit ratings by both the independent rating agencies and the Bank's own internal rating process. The size of the classified portfolio (loans and share investments in the risk rating categories 7 to 10), which had grown rapidly after the 1998 Russian crisis, remained unchanged, and for the fourth consecutive year there was a significant decline in the level of impaired assets. The value of impaired loans fell from €125.2 million to €85.8 million during the year. There was also a decrease in the level of impaired share investments from €366.2 million to €324.4 million.

3 The deferral of direct costs related to loan origination and commitment maintenance totalled €35.5 million during the year (2003: €45.2 million). This resulted in reported general administrative expenses for the year, including depreciation and amortisation, of €159.5 million (2003: €158.0 million).

4 Operating assets comprise net outstanding disbursements and fair value adjustments as applicable.

5 Listed share investments may be subject to specific provisions for identified impairment, but are not subject to general portfolio provisions for the unidentified impairment of assets as they are measured at fair value on the balance sheet.

6 The flow of commitments made by the Bank within a period (since the start of the year), less cancellations or sales of such commitments within the same time period.

Impaired assets

Where loan collectability is in doubt, impairment, which is the difference between the carrying value of the loan and the net present value of its expected future cash flows, is recognised in the income statement. Impaired share investments are defined as investments where it is judged that there has been a permanent diminution in the value of the investment and the future recoverability of the Bank's original investment is therefore in doubt. Although projects are usually reviewed for impairment every six months, certain events may trigger this process sooner and more frequently. In such cases, future collectability is considered and any necessary specific provision for impairment made.

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

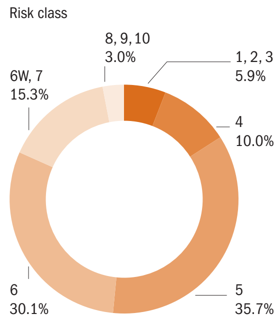
The Bank's impaired assets peaked in mid-2000, largely reflecting the after-effects of the Russian crisis of 1998. Since then, through the improvements in, or successful restructuring of, some projects and through some write-offs, the level of impaired assets has declined to 4.0 per cent of net outstanding disbursements at 31 December 2004, compared with 5.4 per cent at 31 December 2003. Net write-offs (after recoveries from previously written-off projects) were €76.5 million in 2004 (2003: €62.6 million).

Financial performance

Banking operations recorded a net profit (after fully allocated expenses, provisions and the allocation of the return on capital) of €218.0 million for 2004, compared with a net profit of €311.9 million on the same basis for 2003. Excluding the deferral of front-end and commitment fees, operating income of €490.5 million from the Banking business in 2004 was 5 per cent below the record €515.7 million achieved in 2003. This decrease was mainly attributable to a decrease in the net profit from the sale of share investments. This totalled €122.4 million in 2004, compared with €155.9 million in 2003. The contribution from the share investment sector to the Bank's income statement is expected to continue to show significant variability from year to year, given its dependence on the timing of share investment exits. These are mainly linked to the completion of the Bank's transition role in the specific operation and the opportunity, in the market or otherwise, to sell its holding.

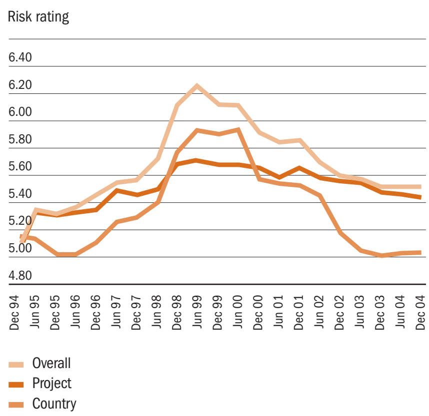
Credit quality of the Banking portfolio

31 December 2004

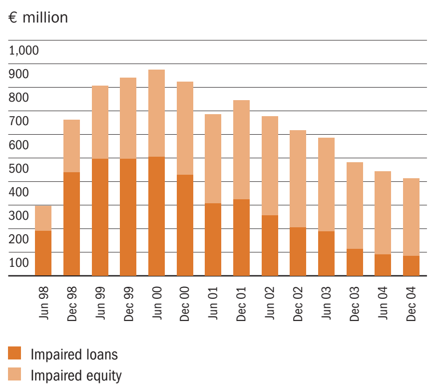


Note: Risk ratings range from 1 (low risk) to 10 (highest risk).

Facility, overall and country weighted average risk ratings



Impaired assets



Treasury operations

Portfolio

The value of assets under Treasury management was €8.6 billion at 31 December 2004 (2003: €9.6 billion), comprising €6.1 billion of debt securities, €1.8 billion of collateralised placements and €0.7 billion of placements with credit institutions (including repurchase agreements).

At the end of 2004, 4.1 per cent of Treasury assets were managed by a total of eight external asset managers. The externally managed portfolios comprised €15.3 million (2003: €9.4 million) in a euro-denominated interest rate trading programme,[7] and €334.5 million (2003: €299.4 million) in a US dollar-denominated triple-A-rated mortgage-backed securities programme. The funds are managed by independent managers in order to obtain specialised services and investment techniques and to establish third-party performance benchmarks. These independent managers are required to comply with the same investment guidelines that the Bank applies to its internally managed funds.

Risks

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

Market risk

At 31 December 2004, the aggregate Value-at-Risk (VaR)[8] of the Bank's Treasury portfolio, calculated by reference to a 99 per cent confidence level and over a ten-trading-day horizon, stood at €3.1 million[9] (2003: €3.6 million). The average VaR over the year was €4.0 million, while the lowest and highest values were €3.0 million and €5.8 million respectively.

The VaR values for month-end[10] denote a modest use of the Board-approved total VaR limit for all Treasury funds, which amounts to €18.0 million.

Within the overall market risk exposure, the VaR of the internally managed portfolios stood at €1.3 million at the end of 2004 (2003: €2.5million). The range during the year was between €1.1 million and €5.0 million, a reduction compared with last year. The size of the internally managed portfolio to which these figures relate was €8.2 billion at 31 December 2004 (2003: €9.2 billion).

In addition, market risks incurred on the externally managed portfolios exhibited a year-end VaR of €1.3 million (2003: €0.5 million) for the euro-denominated programme and €0.7 million (2003: €0.7 million) for the US dollar-denominated programme.[11]

The specific contribution from foreign exchange risk to the overall VaR stood at €0.09 million at year-end (2003: €0.03 million). As in previous years, this contribution was small throughout 2004 and never exceeded €1.8 million. Interest rate positioning thus continued to represent the majority of the Bank's market risk exposure.

Interest rate options were used more frequently than in previous years, and a number of long foreign exchange options positions were taken during the year. However, options VaR[12] represented only a small fraction of total VaR throughout the year; at year-end in particular, when options positions were modest compared with the early part of the year, options VaR stood at only €0.2 million (2003: €0.3 million).

Credit risk

Treasury peak credit exposure decreased year-on-year, standing at €9.3 billion at 31 December 2004 compared with €10.9 billion at 31 December 2003. This decrease, which occurred mostly during the last quarter, was partly linked to the depreciation of the US dollar against the euro (a substantial proportion of Treasury's assets are denominated in US dollars, whereas credit exposure is reported in euros).

While the economic and financial environment improved further in 2004, the quality of the Treasury credit exposure deteriorated slightly. At the end of 2004, the average credit rating[13] weighted by peak counterparty exposure was 1.82, compared with the 2003 year-end average rating of 1.74. This mainly reflected lower short-term exposure to highly rated banks.

The evolution of other indicators was more positive. The weighted average rating of the 10 per cent worst rated exposure improved from 4.00 at the end of 2003 to 3.84 at the end of 2004.[14] The percentage of Treasury transactions of investment grade quality also improved (96.5 per cent at year-end 2004, compared with 95.8 per cent the previous year). Treasury became exposed to some below-investment-grade issuers due to the previous rating downgrades of a few asset-backed securities (ABS) investments that were originally rated triple-A by leading external rating agencies.

7 In the euro programme, managers are assigned notional amounts for interest rate positioning. At 31 December 2004, the notional value of the programme was €334.1 million.

8 Figures presented here are based on 99 per cent 10-day VaR, to enable comparisons between institutions. Market risk is, however, monitored daily for internal purposes in 95 per cent 1-day Expected Shortfall (eVaR) terms, with the limits set in corresponding units. The Board-approved Treasury and Treasury Risk Management Authority, dated 2 April 2004, adopted eVaR to replace VaR as the Bank's preferred methodology for measuring its exposure to interest rate and foreign exchange risks. Values of eVaR had been monitored for several years before being adopted for limit setting purposes; similarly VaR results continue to be produced and monitored on a daily basis (see the "risk management" section of this report for definitions).

9 This means that the Bank had a 1 per cent chance of experiencing a loss of at least €3.1 million over a horizon of ten trading days, due to adverse movements in interest rates and foreign exchange rates.

10 VaR is monitored on a daily basis for the internally managed portfolios and the euro-denominated externally managed portfolio. For the US dollar-denominated externally managed portfolio, VaR data is produced by an external risk-information provider on a weekly basis.

11 The VaR of the US dollar-denominated programme is computed by an external risk-information provider on a weekly basis.

12 Options VaR captures the non-linear aspects of the profit and loss of the options portfolio of the Bank.

13 Using the Bank's internal rating scale, where 1.70 is equivalent to an external rating of AA+/Aa1/AA+ with Standard & Poor's/Moody's/Fitch Ratings and 2.00 is equivalent to an external rating of AA/Aa2/AA.

14 That is, from BBB/Baa2/BBB to roughly midway between BBB/Baa2/BBB and BBB+/Baa1/BBB+.

Financial performance

Treasury operations, excluding the fair value movement on non-qualifying hedges, recorded an operating profit of €78.9 million for 2004. This was before provisions, but after fully allocated expenses and the allocation of the return on capital. This compared with an operating profit of €61.2 million on the same basis for 2003. During the year net specific provisions of €4.0 million (2003: €5.2 million) were made, giving a net profit after provisions of €74.9 million (2003: €56.0 million). After the €4.8 million fair value movement on non-qualifying hedges, Treasury's reported profit for the year totalled €79.7 million (2003: €66.3 million).

Funding

Capital

Paid-in capital totalled €5.2 billion at 31 December 2004 and at 31 December 2003. The number of the EBRD's subscribed shares stood at almost 2 million. The seventh instalment of the capital increase became due in April 2004, and paid-in capital received increased to €4.9 billion from €4.6 billion at the end of 2003. Paid-in capital receivable has been stated at its present value on the balance sheet to reflect future receipt by instalments.

The amount of overdue cash and promissory notes to be deposited totalled €18.1 million at the end of 2004 (2003: €16.9 million). A further €3.2 million of encashments of deposited promissory notes was also overdue (2003: €4.3 million). Of the €21.3 million total overdue, €14.9 million relates to the capital increase.

Borrowings

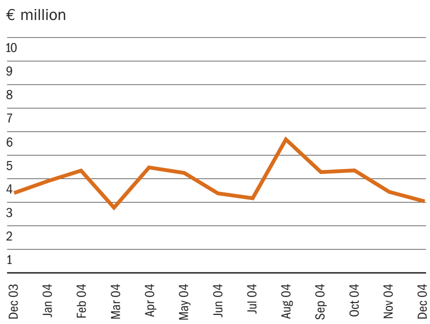
The EBRD's borrowing policy is governed by two key principles. First, it seeks to match the average maturity of the Bank's assets and liabilities to minimise refinancing risk. Secondly, it seeks to ensure the availability of long-term funds at optimum cost effectiveness for the Bank.

At 31 December 2004, total borrowings stood at €13.9 billion, a decrease of €0.3 billion compared with 2003. There were 96 new issues under the EBRD's medium to long-term borrowing programme at an average after-swap cost of Libor minus 37 basis points. These included the Bank's first ten-year global benchmark issue for an amount of US$1 billion. The average remaining life of medium to long-term debt decreased slightly during the year to 8.3 years at 31 December 2004 (2003: 8.8 years).

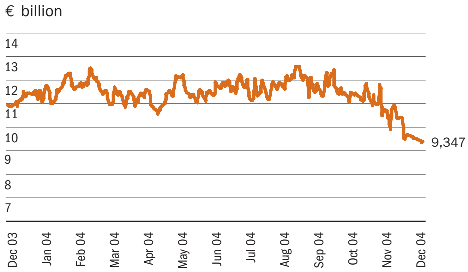
In addition to medium to long-term debt, the caption "debts evidenced by certificates" includes short-term debt issuances that the Bank raises for cash management purposes.

Total VaR – overall limit: €18 million

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

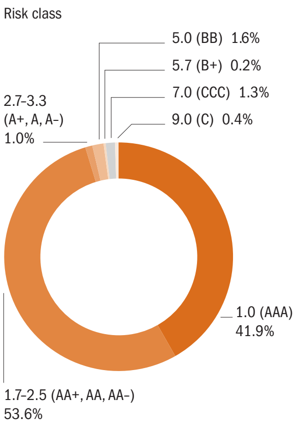


Evolution of the overall Treasury credit exposure in 2004



Credit quality of the Treasury portfolio

31 December 2004



Note: Risk ratings range from 1 (low risk) to 10 (highest risk).

Expenses

In sterling terms, general administrative expenditure, excluding depreciation and amortisation, amounted to £126.2 million in 2004. This was £2.6 million, or 2 per cent, higher than in 2003. Within this, expenditure was £3.8 million higher in 2004, as expenses in 2003 included a £5.4 million credit due to the surrender of the sublease of the Bank's London headquarters. However, 2004 expenditure reflects the full year impact of renegotiating the headquarters lease in June 2003. This lowered the Bank's rent costs and reduced sublet recovery following the surrender of the sublease. The ongoing annual impact of these arrangements has been to reduce the Bank's annual rent costs by £2.9 million, compared with rent costs at the start of 2003.

Personnel costs were £83.1 million, compared with £83.0 million in 2003.

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 and amortisation, were €195.0 million, a 4 per cent reduction from €203.2 million in 2003. This reflected the weakening of sterling against the euro during the year, as well as a sterling/euro hedging programme which resulted in hedging gains of €5.0 million.

During 2004, the Bank deferred €35.5 million of direct costs related to loan origination and commitment maintenance on the balance sheet, in accordance with IAS 18 (2003: €45.2 million). These costs, together with the corresponding front end and commitment fees of €48.0 million (2003: €45.2 million), will be recognised in interest income over the period from disbursement to repayment of the related loan. Therefore the reported figure for general administration expenses and depreciation and amortisation for the year was €159.5 million.

Provisions

The EBRD's general portfolio provisioning relating to the unidentified impairment of assets on non-sovereign exposures is based on a risk-rated approach. This is assessed by the Bank's Risk Management Vice Presidency 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 identified impairment of assets as required, after careful consideration on a case-by-case basis. Provisions are based on outstanding net disbursements at the relevant reporting date.

The consistent application of the EBRD's provisioning policy resulted in a charge of €84.9 million, compared with €21.7 million in 2003. The 2004 charge for Banking provisions of €80.9 million was split between general portfolio provisions for the unidentified impairment of assets, which totalled net €98.9 million compared with €50.8 million in 2003, and specific provisions for the identified impairment of assets, which amounted to a net credit of €18.0 million in 2004 compared with a credit of €34.3 million in 2003. Substantial asset recoveries following the restructuring of projects, and the consequent reversal of specific provisions totalling €76.9 million, offset new specific provision charges of €58.9 million during the year. The charge in 2004 included a Treasury net specific provisions charge of €4.0 million (2003: €5.2 million).

As a result, total provisions for Banking operations stood at €1.08 billion at the end of 2004 (2003: €1.10 billion). This, relative to operating assets, represented 3.0 per cent of sovereign loans (2003: 3.0 per cent), 7.8 per cent of non-sovereign loans (2003: 8.5 per cent), 27.1 per cent of unlisted share investments (2003: 31.2 per cent) and 2.6 per cent of listed share investments (2003: 5.6 per cent).

Outlook for 2005

The EBRD has budgeted for a solid profit in 2005. However, the Bank's results remain vulnerable to continued uncertainty in the economic environment and in financial markets.

Additional reporting and disclosures

The EBRD follows the significant reporting conventions of private sector financial institutions.

A separate section of this Financial Report relating to risk management disclosures is an integral part of the financial statements and includes commentary on credit, market and operational risk.

Corporate governance

The EBRD is committed to effective corporate governance. Responsibilities and related controls throughout the Bank are 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 states 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, which represents 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 with its work:

- the Audit Committee;
- the Budget and Administrative Affairs Committee; and
- the Financial and Operations Policies Committee.

The composition of these committees during 2004 is detailed in the separate Review section of the Annual Report.

During 2004, the Audit Committee further developed its activities. It had regular bilateral meetings with the Bank's external auditor as well as with management to review financial, accounting, risk management, project evaluation, compliance, internal control and audit matters. The Committee also continued to review the Bank's quarterly and annual financial statements prior to their release. The terms of reference of the Audit Committee were revised during the year to reflect internal and external developments on governance. The Board of Directors is responsible for evaluating the performance and effectiveness of the Audit Committee. For further details on the Committee, please see page 45.

During 2004, the Bank implemented a framework to certify internal controls over external financial reporting. The Bank's management signed an assertion in the financial statements that the Bank has maintained effective internal controls over external financial reporting. This assertion has been reviewed by the Bank's external auditors whose opinion is also included in the financial statements. As part of this project, the Bank carried out a wide-ranging self-assessment that led to the further development of the Bank's operational risk management function. For further details on this development, see the "risk management" section in the financial statements.

The Bank reviewed and compared the key features of a number of internal control frameworks before deciding to adopt the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). This framework has been, or is being, adopted by other international financial institutions. It also represents the broadest international best practice, particularly that evolving in the United States.

The certification of internal controls entailed identifying, documenting and recording key internal controls over financial reporting. This involved the whole Bank and was coordinated by the Finance Vice Presidency. Key departments involved in financial controls and reporting were identified following a review of the financial statements. Each department documented its processes and its key controls over financial reporting and then tested them to make sure they were operating effectively. This information was then used by management to make its assertion regarding the effectiveness of these controls. The external auditors then reviewed the testing conducted by management and the controls-related documentation before issuing their opinion on management's assertion. For further details, see the section entitled "responsibility for external financial reporting".

The President

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.

Executive Committee

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

Compliance

The Bank's Chief Compliance Officer also acts as the Bank's Anti-Money-Laundering Officer and is responsible for overseeing integrity issues and maintaining sound corporate practices. Financial and integrity due diligence is integrated into the Bank's normal approval of new business and the review of its existing transactions. The Bank screens all prospective clients and transactions to ensure that they do not represent a money laundering risk, and it reviews the anti-money-laundering policies and procedures that it requires its customers to maintain, especially when the clients are financial institutions. The Bank develops, reviews and takes measures to ensure that it is not dealing with or financing terrorists or terrorist activities. Even though the Bank is not a deposit-taking institution, it has extensive "know your customer" policies that include identifying specific integrity concerns and independently reviewing these risks. The Bank provides regular corporate integrity and anti-money-laundering training to its staff and to external bodies, in order to raise skill levels and to increase awareness of these concerns. It has also been agreed in principle that the Bank will produce and publish on its web site an anti-corruption report. This will be the responsibility of the Office of the Chief Compliance Officer.

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 its external 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, the execution of budgets and the effectiveness of financial controls.

External auditor

The key provisions of the Bank's policy regarding the independence of the external auditor are outlined below.

A new external auditor will be appointed every four years, unless the Board of Directors decides otherwise in the interest of the Bank. However, no firm of auditors can serve for more than two consecutive four-year terms.

The external auditor is prohibited from providing non-audit related services, subject to certain exceptions if it is judged to be in the interest of the Bank and if it is approved by the Audit Committee. However, the auditor can provide technical cooperation consultancy services relating to client projects. The following categories are not permitted as exceptions: outsourced internal audit work; implementing major financial systems; contracted-out accounting work; managing IT systems; providing valuation, actuarial or legal services; or providing management or human resources functions.

All audit fees and any consultancy fees paid to the external auditor (including those relating to technical cooperation fund contracts) are disclosed in the notes to the annual financial statements of the Bank.

The performance and independence of the external auditor will continue to be reviewed annually by the Audit Committee.

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, represent a limited percentage 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. The Board of Directors sets the Vice Presidents' remuneration.

Financial statements

Income statement

For the year ended 31 December 2004	Note	**Year to 31 December 2004 € million**	Year to 31 December 2003 € million
Interest and similar income			
From loans		**302.1**	297.4
From fixed-income debt securities and other interest		**236.9**	219.6
Interest expense and similar charges		**(222.9)**	(199.5)
Net interest income		**316.1**	317.5
Net fee and commission income	3	**17.6**	8.9
Dividend income from share investments		**53.2**	52.2
Financial operations			
Net profit on the sale of share investments		**122.4**	155.9
Net profit on dealing activities and foreign exchange	4	**28.0**	13.1
Fair value movement on non-qualifying hedges	5	**4.8**	10.3
Operating income		**542.1**	557.9
General administrative expenses	6	**(143.1)**	(141.8)
Depreciation and amortisation		**(16.4)**	(16.2)
Operating profit before provisions		**382.6**	399.9
Provisions for impairment	7	**(84.9)**	(21.7)
Net profit for the year		**297.7**	378.2

Balance sheet

At 31 December 2004	Note	€ million	31 December 2004 € million	€ million	31 December 2003 € million
Assets					
Placements with and advances to credit institutions		**684.5**		2,164.8	
Collateralised placements		**1,752.8**		1,464.6	
Debt securities	8	**6,125.7**		5,971.1	
			8,563.0		9,600.5
Other assets	9				
Derivative financial instruments		**2,622.0**		2,736.1	
Other		**709.6**		467.5	
			3,331.6		3,203.6
Loans and share investments	10				
Loans		**7,725.8**		6,803.4	
Less: Provisions for impairment	7	(**507.5**)		(465.1)	
			7,218.3		6,338.3
Share investments		**3,196.1**		2,611.2	
Less: Provisions for impairment	7	(**544.3**)		(593.3)	
			2,651.8		2,017.9
			9,870.1		8,356.2
Intangible assets	11		**18.1**		19.1
Property, technology and office equipment	12		**13.6**		18.4
Paid-in capital receivable	15		**567.7**		847.5
Total assets			**22,364.1**		22,045.3
Liabilities					
Borrowings					
Amounts owed to credit institutions		**913.3**		1,111.9	
Debts evidenced by certificates	13	**12,965.6**		13,111.2	
			13,878.9		14,223.1
Other liabilities	14				
Derivative financial instruments		**677.9**		926.0	
Other		**824.6**		709.9	
			1,502.5		1,635.9
Total liabilities			**15,381.4**		15,859.0
Members' equity					
Subscribed capital	15	**19,789.5**		19,789.5	
Callable capital	15	(**14,592.8**)		(14,592.8)	
Paid-in capital			**5,196.7**		5,196.7
Reserves and retained earnings	16		**1,786.0**		989.6
Total members' equity			**6,982.7**		6,186.3
Total liabilities and members' equity			**22,364.1**		22,045.3
Memorandum items					
Undrawn commitments			**5,179.2**		5,664.9

These financial statements have been approved for issue by the Board of Directors on 8 March 2005.

Statement of changes in members' equity

For the year ended 31 December 2004	Subscribed capital € million	Callable capital € million	Special reserve € million	General reserve Other reserves € million	General reserve Retained earnings € million	Total reserves and retained earnings € million	Total members' equity € million
At 31 December 2002	19,789.5	(14,592.8)	157.6	420.5	83.0	661.1	5,857.8
Internal tax for the year	–	–	–	4.4	–	4.4	4.4
Qualifying fees and commissions from the prior year	–	–	5.3	–	(5.3)	–	–
Net fair value movement of available-for-sale investments for the year	–	–	–	20.5	–	20.5	20.5
Net fair value movement of cash flow hedges for the year	–	–	–	(7.1)	–	(7.1)	(7.1)
Present value adjustment for paid-in capital receivable	–	–	–	(67.5)	–	(67.5)	(67.5)
Reserves transfer	–	–	–	30.2	(30.2)	–	–
Net profit for the year	–	–	–	–	378.2	378.2	378.2
At 31 December 2003	19,789.5	(14,592.8)	162.9	401.0	425.7	989.6	6,186.3
Internal tax for the year	–	–	–	4.6	–	4.6	4.6
Qualifying fees and commissions from the prior year	–	–	10.8	–	(10.8)	–	–
Net fair value movement of available-for-sale investments for the year	–	–	–	484.8	–	484.8	484.8
Net fair value movement of cash flow hedges for the year	–	–	–	9.3	–	9.3	9.3
Reserves transfer	–	–	–	14.9	(14.9)	–	–
Net profit for the year	–	–	–	–	297.7	297.7	297.7
At 31 December 2004	**19,789.5**	**(14,592.8)**	**173.7**	**914.6**	**697.7**	**1,786.0**	**6,982.7**

Statement of cash flows

For the year ended 31 December 2004	€ million	Year to 31 December 2004 € million	€ million	Year to 31 December 2003 € million
Cash flows from operating activities				
Operating profit for the year [1]	**297.7**		378.2	
Adjustments for:				
Unwinding of the discount relating to impaired identified assets	**(1.4)**		(2.4)	
Fair value movement on capital receivable and associated hedges [2]	**(21.3)**		(26.4)	
Deferral of front-end and commitment fees and related direct costs	**12.5**		–	
Internal taxation	**4.6**		4.4	
Realised gains on share investments	**(122.4)**		(155.9)	
Unrealised losses/(gains) on dealing securities	**10.7**		(2.8)	
Realised (gains)/losses on available-for-sale securities	**(2.3)**		0.7	
Foreign exchange (gains)/losses	**(1.0)**		1.4	
Profit on disposal of property, technology and office equipment	**(0.2)**		(0.1)	
Depreciation and amortisation	**16.4**		16.2	
Gross provisions for losses before recoveries from assets previously written off	**85.1**		24.8	
Operating profit before changes in operating assets	**278.4**		238.1	
Decrease/(increase) in operating assets:				
Interest receivable and prepaid expenses	**1,077.0**		(153.5)	
Fair value movement [2]	**(1,249.3)**		(439.5)	
Proceeds from repayments of loans [3]	**2,887.5**		2,166.6	
Proceeds from prepayments of loans [3]	**761.5**		185.7	
Funds advanced for loans [3]	**(4,835.6)**		(3,074.9)	
Proceeds from sale of share investments [3]	**513.3**		490.7	
Funds advanced for share investments [3]	**(572.2)**		(398.0)	
Increase in operating liabilities:				
Interest payable and accrued expenses	**252.4**		431.3	
Net cash used in operating activities		**(887.0)**		(553.5)
Cash flows from investing activities				
Proceeds from sale of available-for-sale securities	**1,749.5**		2,387.8	
Purchases of available-for-sale securities	**(2,160.0)**		(3,810.6)	
Proceeds from sale of property, technology and office equipment	**0.2**		0.1	
Purchase of property, technology and office equipment	**(10.6)**		(10.1)	
Net placements with credit institutions	**49.5**		(19.3)	
Net cash used in investing activities		**(371.4)**		(1,452.1)
Cash flows from financing activities				
Capital received	**301.0**		333.0	
Issue of debts evidenced by certificates	**5,002.0**		6,770.5	
Redemption of debts evidenced by certificates	**(4,960.1)**		(5,951.0)	
Net cash from financing activities		**342.9**		1,152.5
Net decrease in cash and cash equivalents		**(915.5)**		(853.1)
Cash and cash equivalents at beginning of year		**2,445.5**		3,298.6
Cash and cash equivalents at 31 December		**1,530.0**		2,445.5

Cash and cash equivalents comprise the following amounts maturing within three months:

	2004 € million	2003 € million
Placements with and advances to credit institutions	**680.5**	2,142.5
Collateralised placements	**1,752.8**	1,401.4
Amounts owed to credit institutions	**(903.3)**	(1,098.4)
Cash and cash equivalents at 31 December	**1,530.0**	2,445.5

1 Operating profit includes dividends of €53.2 million received for the year to 31 December 2004 (31 December 2003: €52.2 million).

2 The 2003 comparative fair value movement on capital receivable and associated hedges of €26.4 million, and fair value movement of €439.5 million, were together recorded as fair value movement totalling €465.9 million in the 2003 statement of cash flows.

3 These line items, including comparatives, have been reallocated from investing activities to operating activities in order to accurately reflect the nature of these transactions.

Accounting policies

A. Accounting convention

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale investment securities, financial assets and liabilities held for trading and all derivative contracts. In addition, financial assets and liabilities subject to amortised cost measurement, where they form part of qualifying hedge relationships, have been re-stated in line with hedge accounting rules – see "hedge accounting" under "derivatives" below.

B. Financial instruments

Financial instruments are categorised into financial assets, financial liabilities and derivatives.

Financial assets

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 independent market quotes with all changes in value reported in the income statement as they occur. Assets held in this category are accounted for at trade date.

Loans and receivables

Loans and receivables originated by the Bank are measured at amortised cost using the effective yield method less any provision for impairment or uncollectability, unless they form part of a qualifying hedging relationship with a derivative position. This principally 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. The change in value is then reported in the income statement as an offset to the change in value of the related swap. Loans are recognised at settlement date.

Available-for-sale

This category comprises assets that do not specifically belong to one of the other categories. For the Bank, this consists of its share investments and the majority of its Treasury portfolio. Such assets are measured at fair value on the balance sheet. The Bank records changes in fair value through reserves, as disclosed in the "statement of changes in members' equity", until the financial asset is sold or determined to be impaired. At this time the cumulative profit or loss previously recognised in reserves is included in the income statement.

Where an available-for-sale asset is the hedged item in a qualifying fair value hedge, the fair value gain or loss attributable to the risk being hedged is reported in the income statement 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 income statement. 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 bid market price on the balance sheet date. The Bank's unlisted share investments are held at historic cost less any provisions for impairment at the balance sheet date, as there are no quoted market prices available in an active market and their fair value cannot currently be reliably measured. Purchases and sales of share investments are recorded at trade date. Note 10 analyses listed and unlisted share investments, indicating purchases and sales.

Treasury portfolio

The fair value of available-for-sale assets in the Bank's Treasury portfolio is determined by bid quotes from third party sources or, where there is no active market, by the use of discounted cash flow models populated with observable market data. Collateralised placements are included in Treasury available-for-sale assets. These 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 therefore are a form of collateralised lending. Purchases and sales of Treasury's available-for-sale assets are recorded at trade date.

Financial liabilities

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 income statement as they occur.

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.

Derivatives

All derivatives are measured at fair value through the income statement unless they form part of a qualifying cash flow hedging relationship. In this case, the fair value of the derivative is taken to reserves to the extent that it is a perfect hedge of the identified risk. Any hedge ineffectiveness will result in that proportion of the fair value remaining in the income statement. Fair values are derived primarily from discounted cash-flow models, option-pricing models and from third party quotes. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. All hedging activity is explicitly identified and appropriately documented by the Bank's Treasury department.

Hedge accounting

Hedge accounting is designed to bring accounting consistency 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 be within 80 to 125 per cent, with any ineffectiveness within these boundaries recognised in the income statement.

Fair value hedges

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. Changes in the fair value of the effective portions of derivatives that are designated and qualify as fair value hedges, and that prove to be highly effective in relation to hedged risk, are recorded in the income statement, along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

Cash flow hedges

The Bank also engages in cash flow hedges, principally 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 used. Hedging is mainly through the purchase of sterling in the forward foreign exchange market, but currency options can also be used.

For further information on risk and related management policies, refer to the risk management section on page 19.

C. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, which are available for use at short notice and which are subject to insignificant risk of changes in value, less liabilities which are on demand. This definition includes local currency securities purchased under agreements to re-sell and balances of cash and current accounts with foreign banks.

D. Foreign currencies

In accordance with Article 35 of the Agreement, the Bank originally used the European Currency Unit (ECU) as the reporting currency for the presentation of its financial statements. Following the replacement of the ECU with the euro (€) from 1 January 1999, the reporting currency for the presentation of the financial statements became the euro.

Monetary assets and liabilities denominated in foreign currencies have been translated into euro at spot rates as at 31 December 2004. 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.

E. 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 US 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. The corresponding figure for capital receivable on the asset side of the balance sheet is, however, measured at current exchange rates and discounted to its present value.

In order to ensure that capital receipts due in US dollars or Japanese yen retain, at a minimum, their value as determined by the Agreement's fixed rates, the Bank's policy is to fix their euro value through foreign exchange hedge contracts. These hedge contracts are fair valued in accordance with IAS 39, with any gain or loss being recorded in the income statement.

F. 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. It has decided to apply 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 share investments are carried at cost, with disclosure in note 10 of their book value and of the impact on the income statement if equity accounting principles had been applied.

G. Provisions for impairment

Where the collectability of identified loans and advances and future cash flows from identified unlisted share investments is in doubt, specific provisions for impairment are recognised in the income statement. Impairment is defined as the difference between the carrying value of the asset and the net present value of expected future cash flows, determined using the instrument's original effective interest rate where applicable. If a specific provision for impairment is made for a share investment or Treasury asset, any change in fair value that had previously been recognised in reserves is taken to the income statement. The Bank's Risk Management Vice Presidency normally reviews assets for impairment every six months, and sometimes more frequently. Resulting adjustments include the unwinding of the discount in the income statement over the life of the asset, 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 and unlisted share investments. The effect of applying the Bank's 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 income statement under the caption "provisions for impairment", as summarised in note 7. When a loan is deemed uncollectable, or there is no possibility of recovering a share investment, the principal is written off against the related estimated impairment. Subsequent recoveries are credited to the income statement if previously written off.

H. Computer software development costs

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with identifiable and unique software products controlled by the Bank, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the staff costs of the software development team and an appropriate portion of relevant overheads.

Expenditure that enhances or extends the performance of computer software programmes beyond their original specifications is recognised as a capital improvement and added to the original cost of the software. Computer software development costs recognised as assets are amortised using the straight-line method over an estimated life of three years.

I. Property, technology and office equipment

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

Freehold property:	30 years
Improvements on leases of less than 50 years unexpired:	Unexpired periods
Technology and office equipment:	Three years

J. 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 income statement over the lease period to give a constant periodic change on the remaining balance of the liability. The equipment acquired under such leasing contracts is capitalised and depreciated in accordance with the provisions of policy I 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 income statement 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.

K. Interest, fees, commissions and dividends

Interest is recorded on an accruals basis using the effective yield method. Interest is recognised on impaired loans through unwinding the discount used in the present value calculations applied to expected future cash flows.

Front-end fees and commitment fees are deferred in accordance with IAS 18, together with the related direct costs of originating and maintaining the commitment. These are then recognised in interest income using the effective interest method 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.

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 classed as 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.

L. Staff retirement plan

The Bank has a defined contribution scheme and a defined benefit scheme to provide retirement benefits to 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.

The asset in respect of the defined benefit scheme is the fair value of plan assets minus the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognised actuarial gains/losses and past service cost. Independent actuaries calculate the defined benefit obligation at least every three years by using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows (relating to service accrued to the balance sheet date) using the yields available on high quality corporate bonds. For intermediate years, the defined benefit obligation is estimated using approximate actuarial roll-forward techniques that allow for additional benefit accrual, actual cash flows and changes in the underlying actuarial assumptions.

The Bank keeps all contributions to the schemes, and all other assets and income held for the purposes of the schemes, separately from all of its other assets. Actual contributions made to the defined contribution scheme are charged to the income statement and transferred to the schemes' independent custodians. The charge to the income statement 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 then transferred to the schemes' independent custodians.

M. 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.

N. Government grants

Government grants relating to fixed asset expenditure considered as part of the initial establishment of the Bank are recognised in the income statement 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 income statement is carried in the balance sheet as deferred income within "other liabilities".

O. Borrowing costs

Borrowings are recognised initially at "cost", defined as their issue proceeds net of any transaction costs incurred. They are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective yield method. Where borrowings have associated derivatives and qualify for hedge accounting in line with IAS 39, the amortised cost value is adjusted by the fair value of the hedged risks.

P. Comparatives

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

Risk management

A. 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. They provide 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: (i) provisioning; (ii) pricing; and (iii) liquidity.

(i) The provisioning policy provides the basis to determine the amount of general portfolio provisions and the principles for specific provisions to be applied to all assets. To provide a check on the appropriateness of the policy, total provisions are regularly reviewed against losses calculated by the use of the Bank's risk capital model. The provisioning policy is reviewed annually.

(ii) Pricing policies determine the considerations and parameters used to price loans, guarantees and share investments.

(iii) The liquidity policy is reviewed annually and determines the amount of liquid assets required by the Bank, as well as its medium-term borrowing requirement for the following financial year. The annual review in 2004 confirmed the liquidity policy adopted in 2001 and reaffirmed liquidity as central to the Bank's financial strength.

Furthermore, the financial policies define capital utilisation and provide portfolio risk parameters for Banking operations, hedging policies, share investment valuation, exit procedures and strategies, underwriting, risk management and corporate governance policies. These policies are reviewed regularly in the light of experience and external developments.

The financial policies require that the Board of Directors approves a Treasury and Treasury Risk Management Authority (T&TRMA), which defines the risk parameters to be observed by Treasury in managing its exposures. Further to the internal re-organisation in 2003, which established the independent Risk Management Vice Presidency, the T&TRMA was reissued during 2004. This document covers all aspects of Treasury where financial risks are incurred and also all aspects of Treasury Risk Management in order to identify, measure, manage and mitigate the financial risks in Treasury. In addition, Treasury and Treasury Risk Management guidelines have been issued in respect of Treasury risk taking and Treasury Risk Management processes and procedures.

The T&TRMA is the document by which the Board of Directors delegates authority to the Vice President, Finance, to manage and the Vice President, Risk Management, to identify, measure, monitor and mitigate the Bank's Treasury exposures. The two Vice Presidents jointly interpret the Authority and notify the Board of Directors of any material interpretation. The Financial and Operations Policies Committee reviews the T&TRMA 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 Risk Management Vice Presidency has overall responsibility for the independent identification, measurement, monitoring and mitigation of all risks incurred by the Bank in both its Banking and Treasury operations. The Vice President, Risk Management, is a member of the Bank's Executive Committee, as are the First Vice President, Banking, and the Vice President, Finance, to whom Treasury reports. The Vice President, Risk Management, has overall responsibility for formulating the Bank's risk management strategy for both Banking and Treasury functions. Risk Management seeks to ensure that any risks are correctly identified and appropriately managed and mitigated through comprehensive and rigorous processes, which reflect best industry practice.

Banking risks are managed through the Operations Committee consisting of: the First Vice President; the Vice President, Finance; the Vice President, Risk Management; the Chief Economist; the General Counsel; and the Director, Risk Management. The Operations Committee meets weekly and is responsible for reviewing all Banking projects prior to their submission for Board approval. Projects are reviewed to ensure that they meet the Bank's criteria for sound banking, transition impact and additionality. The committee operates within authority delegated by the Board to approve projects within Board-approved framework operations. The committee is also responsible for overseeing Banking portfolio management, approving significant changes to existing operations and approving Risk Management's recommendations for portfolio and specific provisions.

Treasury risks are reviewed by the Treasury Exposure Committee, which was established as part of the internal reorganisation of the Bank during 2003, and which meets monthly. The committee members are: the Vice President, Finance; the Vice President, Risk Management; the Treasurer; the Director, Risk Management; the Deputy Treasurer; the Director, Treasury Risk Management; the Chief Economist; the General Counsel; the Deputy General Counsel; and the Business Group Director, Financial Institutions. The Treasury Exposure Committee is responsible for reviewing and monitoring the implementation of the T&TRMA and related guidelines. It assesses Treasury and Treasury Risk Management policy proposals for approval by the Board, monitors and reviews the asset/liability profile and risk return trade off in aggregate Treasury exposures, and evaluates new product proposals for Treasury exposures. Provisions for the impairment of Treasury exposures are recommended by Risk Management, assessed by the Treasury Exposure Committee and approved by the Vice Presidents of Finance and Risk Management.

B. Capital adequacy

The Bank's original authorised share capital was €10.0 billion. Under 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. This 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, share investments and guarantees made by the Bank in its countries of operations to the total amount of the Bank's unimpaired subscribed capital, reserves and surpluses, establishing a 1:1 gearing ratio. Article 12 also limits the total amount of disbursed share investments to the total amount of the Bank's unimpaired paid-in subscribed capital, surpluses and general reserve.

In accordance with the requirements of Article 5.3 of the Agreement, in 2001 the Bank completed a review of its capital utilisation. This was the Bank's second Capital Resources Review, covering the period 2001-05. It included an analysis 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 risk-based analyses using the 1988 Basel Capital Accord (Basel I) and the Bank's risk capital model.

In 2004, the Bank concluded a Capital Utilisation Technical Review, which examined potential options for the Bank's capital utilisation management framework. This considered historic and projected capital adequacy using a number of measures based on the existing statutory limits (as defined under Article 12), and by applying risk-based measures in accordance with the revised Basel Capital Accord (Basel II) and the Bank's risk capital model.

Capital utilisation was also reviewed in 2004 under both existing and risk-based measures as part of the Bank's Medium Term Strategy Update 2005-08. This update confirmed that the Bank should have sufficient capital to fulfil its medium-term objectives for the 2005-08 period within the stated risk and financial assumptions.

C. Credit risk

The EBRD is exposed to credit risk in both its Banking operations and its Treasury activities. Credit risk arises because 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. Projects 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.

Banking credit risk

The EBRD conducts regular reviews of individual exposures within its portfolio. Generally, projects are formally reviewed by Risk Management twice a year, with more frequent reviews for those that are perceived to be more vulnerable to possible default. Regular reviews continue after project completion for non-sovereign 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 (OAU) within Finance, which is responsible for checking compliance with project conditionality prior to disbursement. It also ascertains that correct procedures are followed in line with approved policy. The management of investments that are considered to be in jeopardy may be transferred from Banking to the Corporate Recovery Unit. This reports jointly to Risk Management and Banking, in order to manage the restructuring work-out process.

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 determined from the financial strength of the risk counterparty and the risk mitigation built into the project structure. The country rating is assessed internally taking into consideration the ratings assessed by external rating agencies. For non-sovereign operations, the overall rating is the numerically higher of the project and country rating. The exception to this is where the Bank has recourse to unconditional sponsor support from outside the country of operations, in which case the overall rating is the same as 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. This is designed to approximate incurred losses calculated on the basis of external indicators of loss, the Bank's experience, and project, sector and country risks.

The table below shows the distribution of Banking operating assets by country, instrument and sector.

Distribution of Banking operating assets, undrawn commitments and guarantees

Analysis by country	**Operating assets 2004 € million**	Operating assets 2003 € million	**Undrawn commitments and guarantees 2004 € million**	Undrawn commitments and guarantees 2003 € million
Albania	**69.4**	38.9	**106.1**	93.1
Armenia	**35.1**	44.1	**4.1**	3.8
Azerbaijan	**175.3**	134.0	**67.1**	25.7
Belarus	**46.1**	46.8	**11.5**	12.0
Bosnia and Herzegovina	**126.6**	81.5	**179.2**	146.5
Bulgaria	**318.0**	250.4	**228.0**	257.6
Croatia	**737.2**	559.8	**204.7**	284.4
Czech Republic	**427.1**	410.8	**49.3**	86.7
Estonia	**254.1**	199.2	**4.8**	6.2
FYR Macedonia	**90.9**	71.5	**152.3**	121.8
Georgia	**56.0**	59.6	**27.3**	36.4
Hungary	**688.3**	560.0	**92.9**	171.4
Kazakhstan	**513.2**	364.5	**214.9**	281.8
Kyrgyz Republic	**59.5**	54.3	**7.2**	2.1
Latvia	**72.1**	81.7	**7.5**	33.1
Lithuania	**186.3**	179.4	**51.4**	52.8
Moldova	**72.9**	78.4	**13.0**	20.1
Poland	**1,226.9**	1,263.3	**282.9**	547.9
Romania	**1,137.3**	920.9	**430.0**	558.6
Russian Federation	**2,192.6**	1,792.0	**1,317.7**	1,414.9
Serbia and Montenegro	**244.5**	120.2	**348.2**	367.2
Slovak Republic	**433.8**	518.2	**52.1**	123.5
Slovenia	**185.6**	235.1	**34.5**	23.0
Tajikistan	**18.2**	10.6	**8.0**	12.8
Turkmenistan	**63.7**	71.4	**24.6**	26.8
Ukraine	**539.5**	492.9	**329.1**	307.9
Uzbekistan	**153.3**	183.6	**123.4**	154.7
Regional	**798.4**	591.5	**807.4**	492.1
At 31 December	**10,921.9**	9,414.6	**5,179.2**	5,664.9

Analysis by instrument				
Loans	**7,669.8**	6,750.5	**4,033.5**	4,562.0
Share investments	**3,196.1**	2,611.2	**651.1**	515.3
Debt securities	**56.0**	52.9	**–**	–
Trade finance guarantees [1]	**–**	–	**214.1**	175.4
Other guarantees [2]	**–**	–	**280.5**	412.2
At 31 December	**10,921.9**	9,414.6	**5,179.2**	5,664.9

Analysis by sector				
Commerce and tourism	**345.1**	303.1	**244.3**	278.7
Community and social services	**223.8**	273.1	**187.6**	88.1
Energy/power generation	**763.2**	644.6	**745.2**	841.1
Extractive industries	**568.7**	420.3	**134.2**	151.7
Finance	**4,377.6**	3,525.4	**1,276.4**	1,185.1
Local authority services	**485.0**	418.6	**629.7**	736.9
Manufacturing	**1,680.3**	1,730.4	**522.0**	630.4
Primary industries	**326.4**	172.2	**212.9**	291.2
Telecommunications	**831.7**	779.5	**67.5**	206.6
Transport and construction	**1,320.1**	1,147.4	**1,159.4**	1,255.1
At 31 December	**10,921.9**	9,414.6	**5,179.2**	5,664.9

1 Trade finance guarantees represent standby letters of credit that are issued in favour of confirming banks undertaking the payment risk of the issuing banks in the Bank's countries of operations.

2 Other guarantees include unfunded full or partial risk participations.

Treasury 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 credit-worthiness, 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. This is different from settlement risk, which 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. The Bank also monitors 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.

Treasury Risk Management assigns internal credit ratings, determined by referring to approved credit rating agencies and by using an 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 T&TRMA 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, its internal outlook, or on sector considerations. Individual counterparty lines for banks, corporates and insurance companies are measured, monitored and reviewed by Treasury Risk Management on a regular basis.

The Bank's exposure measurement methodology for Treasury credit risk uses a Monte Carlo simulation technique that produces, to a high degree of confidence, maximum (in practice, 95 per cent eVaR[15]) exposure amounts at future points in time for each counterparty. This is across all transaction types and continues until the maturity of the longest dated transaction with that counterparty.

Diversification by country

At 31 December 2004, the portfolio's credit exposure covered 18 countries. The United States with a 46.9 per cent share (2003: 36.7 per cent) and the United Kingdom with 9.6 per cent (2003: 9.7 per cent) were the largest contributors. The exposure to any other country did not exceed 6 per cent of the portfolio credit exposure.

Diversification by counterparty type

Over half of the overall exposure was to banks, representing a 57.4 per cent share (2003: 59.3 per cent). Sovereigns were the second largest category with 15.8 per cent of the portfolio (13.4 per cent in 2003), while exposure to ABS fell to 8.5 per cent at the end of 2004 from 13.1 per cent at the end of 2003.

Use of derivatives

The EBRD's use of exchange-traded and over-the-counter (OTC) 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 are subject to overall market and credit risk limits, as well as to stress tests. 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.

In order to control credit risk in OTC derivative transactions, the EBRD's policy is to approve ex-ante each counterparty individually and to review its creditworthiness and eligibility regularly. Overall limits are allocated to each eligible counterparty in compliance with guidelines that set a maximum size and duration of exposure, based on the counterparty's internal credit rating and outlook. For those counterparties, typically banks, that are deemed eligible for foreign exchange and OTC derivatives, a maximum portion of the overall counterparty limit is allocated to these instruments. Utilisation of limits, whether overall counterparty limits or dedicated foreign exchange and OTC derivatives limits, is calculated using potential future exposure methodology. This is based on a Monte Carlo simulation-based model and is monitored daily for all counterparties, independently from risk takers.

[15] VaR is a statistical estimate of the maximum probable loss that can be incurred, due to adverse movements in major market drivers, over a given time horizon and estimated at a given confidence level. Expected Shortfall, or eVaR, is the average loss beyond the VaR level and is a more accurate measure of large potential losses.

For all capital markets transactions entered into by the Bank, OTC derivative transactions are normally limited to the highest-rated counterparties. Furthermore, the EBRD pays great attention to mitigating derivatives credit risks through systematic recourse to a variety of risk mitigation techniques. OTC derivatives transactions are systematically documented with Master Agreements (MAs), providing for close-out netting, and Credit Support Annexes (CSAs). These provide for the posting of collateral by the counterparty once the Bank's exposure exceeds a given threshold, as a function of the counterparty's perceived creditworthiness.

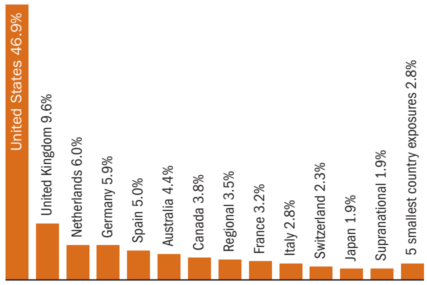
The Bank has also expanded the scope for applying risk mitigation techniques by documenting the widest possible range of instruments transacted with a given counterparty under a single MA and CSA, notably foreign exchange transactions.

The Bank also systematically resorts to unwinding-upon-credit-downgrading clauses and, for long-dated transactions, unilateral break clauses. Similarly, the Bank emphasises risk mitigation for repurchase and reverse repurchase agreements and related transaction types through MA documentation.

By the end of 2004, 92.19 per cent of the Bank's gross exposure to derivatives counterparties was with counterparties with whom an MA and CSA had been completed. As a result, 97.0 per cent of the Bank's exposure to foreign exchange and OTC 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 liquid, triple-A rated government securities.

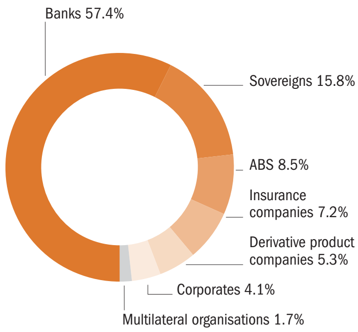
Diversification of Treasury peak exposure by country

31 December 2004



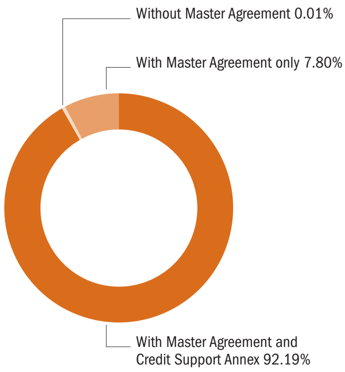
Exposure by counterparty type

31 December 2004



OTC derivatives and foreign exchange exposure

31 December 2004



The table below shows the nominal amounts of the Bank's derivative transactions outstanding at the end of 2004 and the associated fair values.

Derivative transactions

	Nominal 2004 € million	Fair value 2004 € million	Nominal 2003 € million	Fair value 2003 € million
Foreign currency products				
OTC				
Currency swaps	**8,663.4**	**2,157.4**	9,874.2	2,106.5
Spot and forward currency transactions	**1,307.2**	**(27.3)**	1,224.7	(44.8)
Total	**9,970.6**	**2,130.1**	11,098.9	2,061.7
Interest rate products				
OTC				
Interest rate swaps	**10,053.9**	**(79.3)**	9,837.0	(239.5)
Forward rate agreements	**904.0**	**–**	3,555.4	2.1
Caps/floors	**325.7**	**(0.1)**	319.6	–
Exchange traded				
Interest-rate futures	**6,364.5**	**–**	5,611.6	–
Interest-rate options	**2,864.8**	**–**	151.3	–
Total	**20,512.9**	**(79.4)**	19,474.9	(237.4)
Other				
OTC				
Credit derivatives	**3,041.5**	**(106.6)**	1,977.2	(14.2)
Total OTC products	**24,295.7**	**1,944.1**	26,788.1	1,810.1
Total exchange-traded products	**9,229.3**	**–**	5,762.9	–

Credit exposure arises when the Bank has an overall positive fair value with individual counterparties. At year-end 2004, this amounted to €2,052.9 million (2003: €2,205.9 million). Against this, the Bank held collateral of €1,581.2 million (2003: €1,505.7 million), thereby reducing its net credit exposure to €471.7 million (2003: €700.2 million).

D. Market risk

Market risk is the potential loss that could result from adverse market movements. The drivers of market risk are currently 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 broken down 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. Similarly, foreign exchange rate risks are split into risk emanating from changes in the level of foreign exchange rates, and volatility risk, which is inherent to foreign exchange options.

The EBRD's main market risk exposure arises from the fact 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 as far as possible through active asset and liability management.

Interest rate risks are managed by synthetically matching the interest rate profiles of assets and liabilities, mainly through the use of exchange-traded and OTC derivatives for hedging purposes. Exposures to foreign currency and interest rate risks are measured and monitored daily by Treasury Risk Management, independently of Treasury, to ensure compliance with authorised limits.

The Bank monitors its exposure to market risk in its Treasury portfolio through a combination of limits, based on Monte Carlo simulation-based eVaR, and a variety of additional risk measures. The Bank's overall eVaR limit is laid down in the Board-approved T&TRMA. Foreign exchange transactions are further constrained by an eVaR sub-limit dedicated to foreign exchange exposures.

Treasury Risk Management computes eVaR and monitors compliance with limits on a daily basis. Additional eVaR measures are communicated to senior management, in particular for drilling down from aggregate eVaR measures to individual market factors (marginal eVaR and VaR sensitivities). For the options portfolio, dedicated options eVaR computations are performed, in order to factor in the non-linear behaviour of option instruments.

For internal monitoring purposes, eVaR is defined as the average potential loss that could be incurred, due to adverse fluctuations in interest rates and foreign exchange rates, over a one-day trading horizon and computed with a 95 per cent confidence level. Notwithstanding the adoption of eVaR as the Bank's preferred methodology, parametric[16] VaR numbers continue to be calculated for the entire portfolio on a daily basis, although they are no longer associated to any formal limit. Also, for enhanced comparability across institutions, numbers displayed in the Financial Report are VaR-based and scaled up to a 99 per cent confidence level over a ten-trading-day horizon. The average VaR over the year was €4.0 million, while the lowest and highest values were €3.0 million and €5.8 million respectively.

A number of other risk measures are employed to complement eVaR and VaR data, with numbers produced using a different set of assumptions. This is to ensure 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) producing stress tests covering the entire Treasury portfolio based on historical scenarios; and (iv) specific stress tests aimed at quantifying the impact of a breakdown in correlation patterns.

E. Currency risk

Net currency position	Euro € million	United States dollars € million	Sterling € million	Japanese yen € million	Other currencies € million	**Total € million**
Assets						
Placements with and advances to credit institutions	66.1	521.8	1.4	91.9	3.3	**684.5**
Collateralised placements	1,041.8	221.4	–	–	489.6	**1,752.8**
Debt securities	2,678.0	2,592.8	427.7	422.6	4.6	**6,125.7**
Derivative financial instruments	(153.0)	(5,051.8)	2,667.5	2,675.9	2,483.4	**2,622.0**
Other assets	173.7	456.6	44.1	4.6	30.6	**709.6**
Loans	3,516.0	3,867.0	0.6	–	342.2	**7,725.8**
Provisions for impairment of loans	(204.1)	(284.0)	(0.1)	–	(19.3)	**(507.5)**
Share investments	3,196.1	–	–	–	–	**3,196.1**
Provisions for impairment of share investments	(544.3)	–	–	–	–	**(544.3)**
Intangible assets	18.1	–	–	–	–	**18.1**
Property, technology and office equipment	13.6	–	–	–	–	**13.6**
Paid-in capital receivable	325.8	182.6	–	59.3	–	**567.7**
Total assets	**10,127.8**	**2,506.4**	**3,141.2**	**3,254.3**	**3,334.4**	**22,364.1**
Liabilities and members' equity						
Amounts owed to credit institutions	(806.6)	(54.8)	(5.5)	(13.5)	(32.9)	**(913.3)**
Debts evidenced by certificates	(1,045.9)	(3,444.1)	(2,711.8)	(3,016.1)	(2,747.7)	**(12,965.6)**
Derivative financial instruments	(1,035.5)	1,391.3	(299.1)	(198.2)	(536.4)	**(677.9)**
Other liabilities	(208.9)	(440.6)	(121.0)	(24.9)	(29.2)	**(824.6)**
Members' equity	(6,976.6)	(6.1)	–	–	–	**(6,982.7)**
Total liabilities and members' equity	**(10,073.5)**	**(2,554.3)**	**(3,137.4)**	**(3,252.7)**	**(3,346.2)**	**(22,364.1)**
Currency position at 31 December 2004	**54.3**	**(47.9)**	**3.8**	**1.6**	**(11.8)**	**–**
Currency position at 31 December 2003	(92.3)	2.4	70.9	(6.0)	25.0	–

In addition to the Bank's reporting currency, the euro, currencies individually disclosed are those in which the Bank primarily raises funds (see note 13) and which expose the Bank to exchange rate risk.

16 While computationally effective, parametric VaR methods require stringent assumptions about the statistical behaviour of market drivers that can be relaxed when using Monte Carlo simulation methodology. In contrast to parametric methods, Monte Carlo based measures can also incorporate the non-linear behaviour of instruments such as options.

F. 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 € million	Over 1 month and up to and including 3 months € million	Over 3 months and up to and including 1 year € million	Over 1 year and up to and including 5 years € million	Over 5 years € million	Non-interest-bearing funds € million	**Total € million**
Assets							
Placements with and advances to credit institutions	680.5	4.0	–	–	–	–	**684.5**
Collateralised placements	741.3	1,011.5	–	–	–	–	**1,752.8**
Debt securities	2,130.3	3,580.7	414.7	–	–	–	**6,125.7**
Derivative financial instruments	598.8	1,301.0	700.7	21.5	–	–	**2,622.0**
Other assets	459.3	50.1	27.7	0.2	–	172.3	**709.6**
Loans	1,390.3	2,971.0	3,286.7	20.9	–	56.9	**7,725.8**
Provisions for impairment of loans	(11.5)	(1.5)	(5.7)	–	–	(488.8)	**(507.5)**
Share investments	–	–	–	–	–	3,196.1	**3,196.1**
Provisions for impairment of share investments	–	–	–	–	–	(544.3)	**(544.3)**
Non-interest-earning assets including paid-in capital receivable	–	–	–	–	–	599.4	**599.4**
Total assets	**5,989.0**	**8,916.8**	**4,424.1**	**42.6**	**–**	**2,991.6**	**22,364.1**
Liabilities and members' equity							
Amounts owed to credit institutions	(898.4)	(4.9)	(10.0)	–	–	–	**(913.3)**
Debts evidenced by certificates	(2,493.7)	(5,561.5)	(4,910.4)	–	–	–	**(12,965.6)**
Derivative financial instruments	(256.1)	(369.1)	(52.7)	–	–	–	**(677.9)**
Other liabilities	(374.2)	(120.6)	(60.7)	–	–	(269.1)	**(824.6)**
Members' equity	–	–	–	–	–	(6,982.7)	**(6,982.7)**
Total liabilities and members' equity	**(4,022.4)**	**(6,056.1)**	**(5,033.8)**	**–**	**–**	**(7,251.8)**	**(22,364.1)**
Interest rate risk at 31 December 2004	**1,966.6**	**2,860.7**	**(609.7)**	**42.6**	**–**	**(4,260.2)**	**–**
Cumulative interest rate risk at 31 December 2004	**1,966.6**	**4,827.3**	**4,217.6**	**4,260.2**	**4,260.2**	**–**	**–**
Cumulative interest rate risk at 31 December 2003	2,309.3	4,182.0	3,853.8	3,863.1	3,858.3	–	–

The Bank's interest rate risk measurement is complemented by accepted market techniques including VaR, spread risk and volatility risk, on which frequent management reporting takes place.

Effective interest rates

The table below gives indicative levels of average interest rates on the Bank's interest-yielding assets and liabilities for the principal currencies in which the Bank operates. Trading securities are not included in this analysis, as the intention in holding such securities is not for generating net interest margins but rather capital gains from short-term price fluctuations.

	2004 EUR %	**2004 US$ %**	**2004 JPY %**	**2004 GBP %**	2003 EUR %	2003 US$ %	2003 JPY %	2003 GBP %
Assets								
Placements with and advances to credit institutions	**2.17**	**2.44**	**0.35**	**–**	2.10	1.10	0.42	3.84
Collateralised placements	**2.39**	**3.04**	**–**	**–**	2.48	1.43	–	–
Debt securities	**2.36**	**3.02**	**0.16**	**5.01**	2.31	1.57	0.30	4.30
Loans	**3.82**	**5.23**	**–**	**6.88**	3.61	3.46	2.99	–
Liabilities								
Amounts owed to credit institutions	**(2.06)**	**(1.47)**	**–**	**(4.82)**	(2.00)	(0.94)	–	(3.69)
Debts evidenced by certificates	**(1.93)**	**(2.44)**	**0.31**	**(4.53)**	(1.87)	(0.86)	0.33	(3.77)

G. Liquidity risk

Liquidity is the availability of sufficient funds to meet deposit withdrawals and other financial commitments as they fall due. The Bank is committed to maintaining a strong liquidity position. To ensure this, the Bank requires 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. In addition, 25 per cent of the Bank's net Treasury investments must mature within one year. This policy is implemented by maintaining liquidity in a target zone of 90 per cent of the next three years' net cash requirements – above the required minimum level.

The table below provides an analysis of assets, liabilities and members' equity placed into relevant maturity groupings, based on the remaining period from the balance sheet date to the contractual maturity date. It presents the most prudent 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 € million	Over 1 month and up to and including 3 months € million	Over 3 months and up to and including 1 year € million	Over 1 year and up to and including 5 years € million	Over 5 years € million	Maturity undefined € million	**Total € million**
Assets							
Placements with and advances to credit institutions	680.5	–	–	4.0	–	–	**684.5**
Collateralised placements	741.3	1,011.5	–	–	–	–	**1,752.8**
Debt securities	131.1	86.7	265.1	2,572.9	3,031.8	38.1	**6,125.7**
Derivative financial instruments	38.8	150.5	451.8	913.3	1,067.6	–	**2,622.0**
Other assets	438.6	39.3	46.6	66.9	118.2	–	**709.6**
Loans	158.8	371.4	1,166.3	4,159.6	1,799.1	70.6	**7,725.8**
Provisions for impairment of loans	(11.9)	(24.9)	(83.1)	(246.8)	(112.9)	(27.9)	**(507.5)**
Share investments	–	–	–	–	–	3,196.1	**3,196.1**
Provisions for impairment of share investments	–	–	–	–	–	(544.3)	**(544.3)**
Intangible assets	–	–	–	–	–	18.1	**18.1**
Property, technology and office equipment	–	–	–	–	–	13.6	**13.6**
Paid-in capital receivable	–	–	248.4	298.0	–	21.3	**567.7**
Total assets	**2,177.2**	**1,634.5**	**2,095.1**	**7,767.9**	**5,903.8**	**2,785.6**	**22,364.1**
Liabilities and members' equity							
Amounts owed to credit institutions	(898.4)	(4.9)	(10.0)	–	–	–	**(913.3)**
Debts evidenced by certificates	(110.9)	(474.2)	(1,645.6)	(3,529.3)	(7,205.6)	–	**(12,965.6)**
Derivative financial instruments	(105.8)	(162.3)	(161.2)	(167.7)	(80.9)	–	**(677.9)**
Other liabilities	(322.7)	(27.8)	(259.6)	(52.9)	(128.4)	(33.2)	**(824.6)**
Members' equity	–	–	–	–	–	(6,982.7)	**(6,982.7)**
Total liabilities and members' equity	**(1,437.8)**	**(669.2)**	**(2,076.4)**	**(3,749.9)**	**(7,414.9)**	**(7,015.9)**	**(22,364.1)**
Net liquidity position at 31 December 2004	**739.4**	**965.3**	**18.7**	**4,018.0**	**(1,511.1)**	**(4,230.3)**	**–**
Cumulative net liquidity position at 31 December 2004	**739.4**	**1,704.7**	**1,723.4**	**5,741.4**	**4,230.3**	**–**	**–**
Cumulative net liquidity position at 31 December 2003	1,735.3	2,632.8	2,480.2	6,332.2	4,147.2	–	–

H. Fair values of financial assets and liabilities

The Bank's balance sheet approximates to fair value in all financial asset and liability categories, with the exception of Banking fixed rate loans where interest rate risk has been hedged on a portfolio basis. As a result, the Bank does not hedge account for such loans and therefore the underlying changes to the fair value of these assets are not recognised on the balance sheet. At 31 December 2004, the fair value of these loans was €29.8 million above the current balance sheet value (2003: €34.1 million).

I. Operational risk

The EBRD defines operational risk as all aspects of risk-related exposure other than those falling within the scope of credit and market risk. This includes the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and reputational risk. This includes the risk of loss that could occur through:

- errors or omissions in the processing and settlement of transactions, whether in the areas of execution, booking or settlement or due to inadequate legal documentation;
- errors in the reporting of financial results or failures in controls, such as unidentified limit excesses or unauthorised trading/trading outside policies;
- dependency on a limited number of key personnel, inadequate or insufficient staff training or skill levels;
- errors or failures in transaction support systems and inadequate disaster recovery planning, including errors in the mathematical formulae of pricing or hedging models or in the computation of the fair value of transactions;
- external events; and
- damage to the EBRD's name and reputation, either directly by adverse comments or indirectly.

The EBRD has a low tolerance for material losses arising from operational risk exposures. Where material operational risks are identified (that is, those that may lead to material loss if not mitigated), appropriate mitigation and control measures are put in place after a careful weighing of the risk/return trade off. Maintaining the EBRD's reputation is of paramount importance and reputational risk has therefore been included in the Bank's definition of operational risk. The EBRD will always try to take all reasonable and practical steps to safeguard its reputation.

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

- the EBRD's Code of Conduct;
- disaster recovery/contingency planning;
- the Public Information Policy;
- client and project integrity due diligence procedures, including anti-money-laundering measures;
- procedures for reporting and investigating suspected staff misconduct, including fraud;
- information management policy; and
- procurement and purchasing policies, including the detection of corrupt practices in procurement.

Operational risk at the EBRD is managed within the Risk Management Vice Presidency, and coordinated throughout the Bank by the Operational Risk Management Group (ORMG). The ORMG comprises: the Vice President, Risk Management; the Vice President, Finance; the General Counsel; the Chief Compliance Officer; the Director, Risk Management; the Head of Operations, IT and OAU; the Treasurer; the Head of Internal Audit; and other senior managers from Finance, Banking, Administration and Human Resources. The ORMG's task is to develop and coordinate the Bank's approach to operational risk management, and to ensure that it is widely implemented across all areas of the Bank. The ORMG has previously focused on agreeing definitions and determining different loss type events to capture the Bank's exposure to operational risk, as well as developing a group of key risk indicators to measure such risks.

During 2004, the EBRD further developed its operational risk management through an operational risk self-assessment exercise. This was in conjunction with the framework to certify internal controls over financial reporting. During this process, the Bank developed a replicable framework which it can subsequently use to conduct future self-assessments without external assistance. Most departments within the EBRD had to identify their operational risk exposures, and to evaluate the mitigating controls that help to reduce the inherent risk. Each risk (both inherent and post control) was assessed for its impact, according to a defined value scale and the likelihood of occurrence, based on a frequency by time range.

The ORMG reviewed all the self-assessments via a series of challenge meetings based on product or risk type lines and across departments. In addition, work was started to extend the key operational risk indicators to include significant post-control risks. As part of the exercise, risk management training was provided for relevant senior managers and staff.

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 2004, 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 with the Bank in the United Kingdom are defined in the Headquarters Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Bank ("Headquarters Agreement"). The Headquarters Agreement was signed in London at the start of the Bank's operations on 15 April 1991.

2. Segment information

Business segments

For management purposes, the business of the Bank comprises primarily 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 2004 € million	**Treasury 2004 € million**	**Aggregated 2004 € million**	Banking 2003 € million	Treasury 2003 € million	Aggregated 2003 € million
Interest income	**302.1**	**215.6**	**517.7**	297.4	193.2	490.6
Other income	**193.2**	**28.0**	**221.2**	217.0	13.1	230.1
Fair value movement on paid-in capital receivable and associated hedges [1]	**19.2**	**2.1**	**21.3**	23.8	2.6	26.4
Total segment revenue	**514.5**	**245.7**	**760.2**	538.2	208.9	747.1
Less interest expenses and similar charges [2]	**(172.4)**	**(162.1)**	**(334.5)**	(167.9)	(143.0)	(310.9)
Allocation of the return on capital [1, 2]	**100.4**	**11.2**	**111.6**	100.2	11.2	111.4
Fair value movement on non-qualifying hedges	**–**	**4.8**	**4.8**	–	10.3	10.3
Less general administrative expenses	**(128.1)**	**(15.0)**	**(143.1)**	(126.8)	(15.0)	(141.8)
Less depreciation and amortisation	**(15.5)**	**(0.9)**	**(16.4)**	(15.3)	(0.9)	(16.2)
Segment result before provisions	**298.9**	**83.7**	**382.6**	328.4	71.5	399.9
Provisions for impairment	**(80.9)**	**(4.0)**	**(84.9)**	(16.5)	(5.2)	(21.7)
Net profit for the year	**218.0**	**79.7**	**297.7**	311.9	66.3	378.2
Segment assets	**10,129.8**	**11,666.6**	**21,796.4**	8,573.5	12,624.3	21,197.8
Paid-in capital receivable			**567.7**			847.5
Total assets			**22,364.1**			22,045.3
Segment liabilities						
Total liabilities	**260.8**	**15,120.6**	**15,381.4**	232.3	15,626.7	15,859.0
Capital expenditure	**10.0**	**0.6**	**10.6**	9.5	0.6	10.1

1 Fair value movement on paid-in capital receivable and associated hedges amounted to €21.3 million (2003: €26.4 million). Allocation of the return on capital amounted to €111.6 million (2003: €111.4 million). Together, these total €132.9 million (2003: €137.8 million), which is the Bank's return on net paid-in capital used in segmental results.

2 Interest expenses and similar charges and the allocation of the return on capital total €222.9 million (2003: €199.5 million). This is the Bank's "interest expenses and similar charges" as reported in the income statement.

Secondary reporting format – geographical segment:
The Bank's activities are divided into four regions for internal management purposes.

	Segment revenue 2004 € million	Segment revenue 2003 € million	**Segment assets 2004 € million**	Segment assets 2003 € million
Advanced countries [1]	**222.5**	301.4	**4,238.8**	4,000.8
Early/Intermediate countries [2]	**180.0**	222.9	**3,777.0**	2,749.6
Russian Federation	**112.0**	13.9	**2,114.0**	1,823.1
OECD (Treasury operations)	**245.7**	208.9	**11,666.6**	12,624.3
Total	**760.2**	747.1	**21,796.4**	21,197.8

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, Former Yugoslav Republic of Macedonia, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Romania, Serbia and Montenegro, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

3. Net fee and commission income

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

	2004 € million	2003 € million
Guarantee fees	**4.0**	6.5
Trade finance fees	**4.3**	4.2
Syndication fees	**3.9**	1.2
Appraisal fees	**3.7**	1.2
Other	**8.5**	2.8
Equity fund fee expenses	**(6.8)**	(7.0)
Net fee and commission income	**17.6**	8.9

Front-end and commitment fees of €48.0 million (2003: €45.2 million) received in 2004, together with related direct costs of €35.5 million (2003: €45.2 million), have been deferred on the balance sheet. They will be recognised in interest income over the period from disbursement to repayment of the related loan, in accordance with IAS 18.

4. Net profit on dealing activities and foreign exchange

	2004 € million	2003 € million
Debt buy-backs	**24.9**	13.4
Available-for-sale portfolio	**2.3**	(0.7)
Foreign exchange	**1.0**	(1.4)
Dealing portfolio	**(0.2)**	1.8
Net profit on dealing activities and foreign exchange	**28.0**	13.1

For the available-for-sale portfolio, the realised gains and losses arose on disposal of debt securities in that portfolio. For the dealing portfolio, net profit includes both realised and unrealised gains or losses, together with associated interest income and expense.

5. Fair value movement on non-qualifying hedges

The fair value movement 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 income statement. Where derivatives are hedging non-derivative financial assets or liabilities, the latter can also be re-measured to fair value for the specific risks hedged and reported through the income statement. Hedge accounting, as this process is known, can only be used where hedge relationships can be specifically identified and close correlation proven. Interest rate hedging on a portfolio basis is carried out against the Bank's fixed-rate loan book. Derivatives are used to exchange the fixed rate flows on the loan assets in return for floating interest payments, primarily through the use of swap contracts. The swaps are subject to fair value accounting, but the fixed rate loan assets are not. As the Bank is paying fixed rates of interest in these contracts, increases in the relevant interest rates, primarily the US dollar and the euro, will result in fair value gains on these contracts, while the converse will happen if rates fall. In 2004, euro rates fell while US dollar rates rose, resulting in a net loss of €1.7 million for the year (2003: gain of €9.0 million).

While hedge accounting can be applied to most of the Bank's derivative positions due to one-to-one hedging relationships, it may not be possible to achieve 100 per cent hedge effectiveness where the change in value of the derivative is exactly matched by the change in value of the hedged asset or liability. Any ineffectiveness in the offsetting valuations must be recognised in the income statement. In 2004, this figure amounted to a gain of €6.5 million (2003: loss of €2.8 million).

During the year, the fair value movement of €7.0 million (2003: €7.3 million) on swaps hedging the Bank's capital receivable in US dollars and Japanese yen was reported in net interest, along with the discounting effect on the capital receivable. In 2003, this movement, along with associated foreign exchange of €3.2 million, was reported under "fair value movement on non-qualifying hedges" and resulted in a net credit of €4.1 million.

6. General administrative expenses

	2004 € million	2003 € million
Personnel costs [1]	**118.9**	126.8
Overhead expenses net of government grants [2, 3]	**59.7**	60.2
General administrative expenses [4]	**178.6**	187.0
Deferral of direct costs related to loan origination and commitment maintenance [5]	**(35.5)**	(45.2)
Net general administrative expenses	**143.1**	141.8

1 The average numbers of staff included in personnel costs during the year were: 964 headquarters staff (2003: 960), 233 locally hired staff in Resident Offices (2003: 227), 105 contract staff (comprising special contract staff, interns/short-term staff and locally hired general service contract staff), and 83 Board of Directors personnel. Of these, 92 were externally funded.

Staff numbers at 31 December 2004 consisted of: 965 headquarters staff (comprising regular and analyst staff in Bank Departments and Board support staff) (2003: 964), 237 locally hired staff in Resident Offices (2003: 228), 102 contract staff (comprising 34 special contract staff, 46 interns/short-term staff and 22 locally hired general service contract staff), and 77 Board of Directors personnel. Of these, 91 were externally funded.

In addition, 89 Project Bureau staff (2003: 64) were engaged by the Russia Small Business Fund on projects in the Russian Federation.

2 During the year, government grants of €2.1 million (2003: €2.1 million) were taken to the income statement.

3 The following fees for work performed by the Bank's external auditors were included in overhead expenses:

	2004 € 000	2003 € 000
Audit and assurance services		
Services as auditors of the Bank	**236**	231
Pension audit	**21**	20
Internal controls framework assurance	**158**	–
Other assurance services	**7**	7
	422	258
Other services		
Consultancy services – countries of operations	**–**	7
	422	265

4 Sterling general administrative expenses totalled £126.2 million (2003: £123.6 million).

5 Direct costs of €35.5 million (2003: €45.2 million) relating to loan origination and commitment maintenance in 2004, together with received front-end and commitment fees of €48.0 million (2003: €45.2 million), have been deferred on the balance sheet in accordance with IAS 18. These figures will be recognised in interest income over the period from disbursement to repayment of the related loan.

7. Provisions for impairment

Charge/(release) for the year	Loans € million	Share investments € million	Total loans and share investments € million	Guarantees € million	Treasury impairment € million	**2004 Total € million**	2003 Total € million
Portfolio provision for the unidentified impairment of assets:							
Non-sovereign risk assets	99.6	8.3	107.9	–	–	**107.9**	41.8
Sovereign risk assets	(0.7)	–	(0.7)	–	–	**(0.7)**	4.5
Guarantees	–	–	–	(8.3)	–	**(8.3)**	4.5
Specific provisions for the identified impairment of assets [1]	(23.4)	5.4	(18.0)	–	4.0	**(14.0)**	(29.1)
For the year ended 31 December 2004	**75.5**	**13.7**	**89.2**	**(8.3)**	**4.0**	**84.9**	
For the year ended 31 December 2003	6.8	5.2	12.0	4.5	5.2		21.7

[1] During the year new specific provisions for the identified impairment of assets of €73.7 million (2003: €90.1 million) were made, and €87.7 million (2003: €119.2 million) were released, resulting in a net release to the income statement of €14.0 million (2003: €29.1 million).

Movement in provisions and impairment	Loans € million	Share investments € million	Total loans and share investments € million	Guarantees € million	Treasury impairment € million	**2004 Total € million**	2003 Total € million
At 1 January 2004	465.1	593.3	1,058.4	40.3	70.9	**1,169.6**	1,291.0
Charge/(release) for the year	75.5	13.7	89.2	(8.3)	4.0	**84.9**	21.7
Unwinding of the discount relating to the identified impairment of assets [1]	(0.6)	–	(0.6)	–	(0.8)	**(1.4)**	(2.4)
Foreign exchange adjustments	(18.8)	–	(18.8)	–	(5.0)	**(23.8)**	(77.9)
Release against amounts written off	(13.7)	(62.7)	(76.4)	–	(13.2)	**(89.6)**	(62.8)
At 31 December 2004	**507.5**	**544.3**	**1,051.8**	**32.0**	**55.9**	**1,139.7**	1,169.6
Analysed between							
Portfolio provisions for the unidentified impairment of assets:							
Non-sovereign risk assets	377.8	335.8	713.6	–	–	**713.6**	619.0
Sovereign risk assets	57.7	–	57.7	–	–	**57.7**	61.5
Specific provisions for the identified impairment of assets	72.0	208.5	280.5	–	55.9	**336.4**	448.8
Deducted from assets	507.5	544.3	1,051.8	–	55.9	**1,107.7**	1,129.3
Included in other liabilities	–	–	–	32.0	–	**32.0**	40.3
At 31 December 2004	**507.5**	**544.3**	**1,051.8**	**32.0**	**55.9**	**1,139.7**	1,169.6

[1] Included in interest income is €1.4 million (2003: €2.4 million) relating to the unwinding of the net present value discount.

8. Debt securities

Analysis by issuer	**2004 € million**	2003 € million
Governments	**23.1**	229.1
Public bodies	**257.8**	201.5
Other borrowers	**5,844.8**	5,540.5
At 31 December	**6,125.7**	5,971.1

Analysis by portfolio

Available-for-sale portfolio	**5,293.4**	5,263.8
Dealing portfolio		
Internally managed funds	**473.0**	323.0
Externally managed funds	**359.3**	384.3
	832.3	707.3
At 31 December	**6,125.7**	5,971.1

9. Other assets

	2004 € million	2003 € million
Fair value of derivatives	**2,622.0**	2,736.1
Treasury deals pending settlement	**415.0**	181.1
Interest receivable	**117.8**	138.4
Other	**176.8**	148.0
At 31 December	**3,331.6**	3,203.6

10. Loans and share investments

Operating assets	Sovereign loans € million	Non-sovereign loans € million	Total loans € million	Unlisted share investments € million	Listed share investments € million	Total share investments € million	**Total loans and share investments € million**
At 1 January 2004	2,052.1	4,751.3	6,803.4	1,747.2	864.0	2,611.2	**9,414.6**
Movement in fair value revaluation	(1.5)	(2.4)	(3.9)	–	466.4	466.4	**462.5**
Disbursements	500.3	4,335.3	4,835.6	484.5	87.7	572.2	**5,407.8**
Repayments, prepayments and disposals	(526.9)	(3,122.1)	(3,649.0)	(287.7)	(103.2)	(390.9)	**(4,039.9)**
Foreign exchange movements	(98.9)	(147.9)	(246.8)	–	–	–	**(246.8)**
Written off	–	(13.5)	(13.5)	(56.6)	(6.2)	(62.8)	**(76.3)**
At 31 December 2004	**1,925.1**	**5,800.7**	**7,725.8**	**1,887.4**	**1,308.7**	**3,196.1**	**10,921.9**
Impairment at 31 December 2004	(57.7)	(449.8)	(507.5)	(510.4)	(33.9)	(544.3)	**(1,051.8)**
Total operating assets net of impairment at 31 December 2004	**1,867.4**	**5,350.9**	**7,218.3**	**1,377.0**	**1,274.8**	**2,651.8**	**9,870.1**
Total operating assets net of impairment at 31 December 2003	1,990.6	4,347.7	6,338.3	1,202.5	815.4	2,017.9	8,356.2

At 31 December 2004, the Bank categorised 17 loans as impaired, totalling €85.8 million (2003: 19 loans totalling €125.2 million). Specific provisions on these assets amounted to €72.0 million (2003: €112.0 million). At the same date the Bank categorised 49 share investments as impaired, totalling €324.4 million (2003: 53 share investments totalling €366.2 million). Specific provisions on these assets amounted to €208.5 million (2003: €265.9 million). The unwinding of the net present value discount relating to provisions for the impairment of identified assets has added €0.6 million (2003: €1.5 million) of income to the income statement in interest income from loans.

Of the €122.4 million (2003: €155.9 million) net profit on sale of share investments, €81.1 million (2003: €77.6 million) relates to profit on the sale of unlisted share investments. These were held at a cost of €122.3 million (2003: €126.8 million) at the time of sale, because their fair value could not be reliably measured.

As the Bank has no subsidiaries, it does not prepare consolidated financial statements. If the Bank had 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 2004, was €884.4 million – the net incremental impact on the income statement would be a profit of €97.3 million (2003: €762.9 million and €23.1 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 €463.6 million (2003: €320.5 million). Due to the time delay in obtaining audited financial statements that have been prepared in accordance with IFRS 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 2004, 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.

	% Ownership
Lafarge: Romania	38
Dalkia Lodz Cogeneration Privatisation	35
Regional Europolis Portfolio	35
Baring Vostok Private Equity Fund	32
Danone MPF – Danone Industria LLC	30
UNIQA TU Equity	30
Advent Central & Eastern Europe II – Regional Fund	27
Emerging Europe Capital Investors LDC	24
Polish Enterprise Fund IV	23
Privredna Banka	21

11. Intangible assets

	Computer software development costs € million
Cost	
At 1 January 2004	**73.3**
Additions	**8.3**
Write-offs	**(26.7)**
At 31 December 2004	**54.9**
Amortisation	
At 1 January 2004	**54.2**
Charge	**9.3**
Write-offs	**(26.7)**
At 31 December 2004	**36.8**
Net book value	
At 31 December 2004	**18.1**
At 31 December 2003	19.1

12. Property, technology and office equipment

	Property € million	Technology and office equipment € million	**Total € million**
Cost			
At 1 January 2004	67.0	48.9	**115.9**
Additions	0.4	1.9	**2.3**
Disposals	(2.7)	(18.2)	**(20.9)**
At 31 December 2004	**64.7**	**32.6**	**97.3**
Depreciation			
At 1 January 2004	52.1	45.4	**97.5**
Charge	4.8	2.3	**7.1**
Disposals	(2.7)	(18.2)	**(20.9)**
At 31 December 2004	**54.2**	**29.5**	**83.7**
Net book value			
At 31 December 2004	**10.5**	**3.1**	**13.6**
At 31 December 2003	14.9	3.5	18.4

13. Debts evidenced by certificates

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

	Principal at nominal value € million	Fair value adjustment € million	Adjusted principal value € million	Currency swaps payable/ (receivable) € million	**Net currency obligations 2004 € million**	Net currency obligations 2003 € million
Australian dollars	1,141.9	(14.0)	1,127.9	(1,127.9)	**–**	–
Canadian dollars	30.8	2.5	33.3	(33.3)	**–**	–
Czech koruna	131.6	(51.6)	80.0	(80.0)	**–**	–
Euro	1,279.1	(233.2)	1,045.9	374.4	**1,420.3**	1,556.3
Gold bullion	205.4	–	205.4	(205.4)	**–**	–
Hungarian forints	84.5	3.9	88.4	(83.8)	**4.6**	5.4
Japanese yen	2,808.2	207.8	3,016.0	(2,623.5)	**392.5**	572.0
New Taiwan dollars	463.2	11.7	474.9	(474.9)	**–**	–
New Zealand dollars	50.3	1.9	52.2	(52.2)	**–**	–
Polish zloty	57.3	11.9	69.2	(23.3)	**45.9**	53.2
Slovak koruna	15.8	4.6	20.4	(20.4)	**–**	–
South African rands	1,172.3	(576.0)	596.3	(596.3)	**–**	–
Sterling	2,532.6	179.2	2,711.8	(999.7)	**1,712.1**	1,745.2
United States dollars	2,711.7	732.2	3,443.9	5,946.3	**9,390.2**	9,179.1
At 31 December	**12,684.7**	**280.9**	**12,965.6**	**–**	**12,965.6**	13,111.2

During the year the Bank redeemed €358.0 million of bonds and medium-term notes prior to maturity (2003: €463.0 million), generating a net gain of €24.9 million (2003: €13.4 million).

14. Other liabilities

	2004 € million	2003 € million
Fair value of derivatives	**677.9**	926.0
Treasury deals pending settlement	**314.7**	118.7
Interest payable	**131.8**	179.3
Other	**378.1**	411.9
At 31 December	**1,502.5**	1,635.9

15. Subscribed capital

	2004 Number of shares	2004 Total € million	2003 Number of shares	2003 Total € million
Authorised share capital	**2,000,000**	**20,000.0**	2,000,000	20,000.0
of which				
Subscriptions by members – initial capital	**991,975**	**9,919.8**	991,975	9,919.8
Subscriptions by members – capital increase	**986,975**	**9,869.7**	986,975	9,869.7
Subtotal – subscribed capital	**1,978,950**	**19,789.5**	1,978,950	19,789.5
Unallocated shares [1]	**6,050**	**60.5**	6,050	60.5
Authorised and issued share capital	**1,985,000**	**19,850.0**	1,985,000	19,850.0
Not yet subscribed	**15,000**	**150.0**	15,000	150.0
At 31 December	**2,000,000**	**20,000.0**	2,000,000	20,000.0

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 states that payment of the amount subscribed to the callable capital is subject to call by the Bank, 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 states that in the event of the termination of the Bank's operations, the liability of all members for all uncalled subscriptions to the capital stock will continue until all claims of creditors, including all contingent claims, have been discharged. If a member withdraws from the Bank, share capital is repayable to the extent it is not needed to settle the direct obligations and contingent liabilities of the member to the Bank as long as any part of the loans, equity investments or guarantees contracted before it ceased to be a member are outstanding.

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. 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 are proportionately reduced until payment is made.

Summary of paid-in capital receivable:

	2004 € million	2003 € million
Paid-in subscribed capital:		
cash and promissory note encashments not yet due	**546.4**	826.3
cash and promissory notes due but not yet received	**18.1**	16.9
promissory note encashments due but not yet received	**3.2**	4.3
Paid-in capital receivable at 31 December	**567.7**	847.5

Paid-in capital receivable has been stated at its present value on the balance sheet to reflect future receipt by instalments.

15. Subscribed capital *(continued)*

Statement of capital subscriptions
At 31 December 2004

	Total shares (number)	Resulting votes[1] (number)	Total capital € million	Callable capital € million	Paid-in capital[2] € million
Members					
Albania	2,000	1,522	20.0	14.8	5.2
Armenia	1,000	643	10.0	7.4	2.6
Australia	20,000	20,000	200.0	147.5	52.5
Austria	45,600	45,600	456.0	336.3	119.7
Azerbaijan	2,000	1,216	20.0	14.8	5.2
Belarus	4,000	4,000	40.0	29.5	10.5
Belgium	45,600	45,600	456.0	336.3	119.7
Bosnia and Herzegovina	3,380	3,380	33.8	24.9	8.9
Bulgaria	15,800	15,800	158.0	116.5	41.5
Canada	68,000	68,000	680.0	501.5	178.5
Croatia	7,292	7,292	72.9	53.8	19.1
Cyprus	2,000	2,000	20.0	14.8	5.2
Czech Republic	17,066	17,066	170.7	125.8	44.9
Denmark	24,000	24,000	240.0	177.0	63.0
Egypt	2,000	1,750	20.0	14.8	5.2
Estonia	2,000	2,000	20.0	14.8	5.2
European Community	60,000	60,000	600.0	442.5	157.5
European Investment Bank	60,000	60,000	600.0	442.5	157.5
Finland	25,000	25,000	250.0	184.4	65.6
Former Yugoslav Republic of Macedonia	1,382	1,382	13.8	10.2	3.6
France	170,350	170,350	1,703.5	1,256.3	447.2
Georgia	2,000	492	20.0	14.8	5.2
Germany	170,350	170,350	1,703.5	1,256.3	447.2
Greece	13,000	13,000	130.0	95.8	34.2
Hungary	15,800	15,800	158.0	116.5	41.5
Iceland	2,000	2,000	20.0	14.8	5.2
Ireland	6,000	6,000	60.0	44.2	15.8
Israel	13,000	13,000	130.0	95.8	34.2
Italy	170,350	170,350	1,703.5	1,256.3	447.2
Japan	170,350	170,350	1,703.5	1,256.3	447.2
Kazakhstan	4,600	4,600	46.0	33.9	12.1
Korea, Republic of	20,000	20,000	200.0	147.5	52.5
Kyrgyz Republic	2,000	792	20.0	14.8	5.2
Latvia	2,000	2,000	20.0	14.8	5.2
Liechtenstein	400	400	4.0	2.9	1.1
Lithuania	2,000	2,000	20.0	14.8	5.2
Luxembourg	4,000	4,000	40.0	29.5	10.5
Malta	200	200	2.0	1.5	0.5
Mexico	3,000	3,000	30.0	21.0	9.0
Moldova	2,000	1,076	20.0	14.8	5.2
Mongolia	200	200	2.0	1.5	0.5
Morocco	1,000	1,000	10.0	7.0	3.0
Netherlands	49,600	49,600	496.0	365.8	130.2
New Zealand	1,000	1,000	10.0	7.0	3.0
Norway	25,000	25,000	250.0	184.4	65.6
Poland	25,600	25,600	256.0	188.8	67.2
Portugal	8,400	8,400	84.0	61.9	22.1
Romania	9,600	9,312	96.0	70.8	25.2
Russian Federation	80,000	80,000	800.0	590.0	210.0
Serbia and Montenegro	9,350	9,350	93.5	68.9	24.6
Slovak Republic	8,534	8,534	85.3	62.9	22.4
Slovenia	4,196	4,196	42.0	30.9	11.1
Spain	68,000	68,000	680.0	501.5	178.5
Sweden	45,600	45,600	456.0	336.3	119.7
Switzerland	45,600	45,600	456.0	336.3	119.7
Tajikistan	2,000	386	20.0	14.8	5.2
Turkey	23,000	23,000	230.0	169.6	60.4
Turkmenistan	200	152	2.0	1.5	0.5
Ukraine	16,000	14,000	160.0	118.0	42.0
United Kingdom	170,350	170,350	1,703.5	1,256.3	447.2
United States of America	200,000	199,845	2,000.0	1,475.0	525.0
Uzbekistan	4,200	4,200	42.0	30.9	11.1
Capital subscribed by members	**1,978,950**	**1,969,336**	**19,789.5**	**14,592.8**	**5,196.7**
Unallocated shares	6,050		60.5		
Authorised and issued share capital	**1,985,000**		**19,850.0**		

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 (2003: 1,978,950).

2 Of paid-in capital, €4.9 billion has been received (2003: €4.6 billion). Some €0.3 billion is not yet due (2003: €0.6 billion), which relates primarily to the capital increase and is payable on or before 15 April 2005.

16. Reserves and retained earnings

	2004 € million	2003 € million
Revaluation reserve – available-for-sale investments		
At 1 January	**291.6**	271.1
Net gains from changes in fair value	**523.4**	93.4
Net losses transferred to net profit due to impairment	**–**	13.0
Net gains transferred to net profit on disposal	**(38.6)**	(85.9)
At 31 December	**776.4**	291.6
Hedging reserve – cash flow hedges		
At 1 January	**(9.7)**	(2.6)
Net gains/(losses) from changes in fair value	**9.3**	(7.1)
At 31 December	**(0.4)**	(9.7)
Other		
At 1 January	**119.1**	152.0
Internal tax for the year	**4.6**	4.4
Present value adjustment for paid-in capital receivable	**–**	(67.5)
Transferred from retained earnings	**14.9**	30.2
At 31 December	**138.6**	119.1
Retained earnings		
At 1 January	**425.7**	83.0
Qualifying fees and commissions from the prior year	**(10.8)**	(5.3)
Transferred to other	**(14.9)**	(30.2)
Net profit for the year	**297.7**	378.2
At 31 December	**697.7**	425.7
Total general reserve	**1,612.3**	826.7
Special reserve		
At 1 January	**162.9**	157.6
Qualifying fees and commissions from the prior year	**10.8**	5.3
At 31 December	**173.7**	162.9
Total reserves and retain earnings	**1,786.0**	989.6

The **general reserve** includes the retention of internal tax paid in accordance with Article 53 of the Agreement Establishing the Bank. This requires that all Directors, Alternate Directors, officers and employees of the Bank be 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 €52.7 million (2003: €48.1 million). Included in the general reserve is an adjustment to restate the Bank's paid-in capital receivable to a present value basis. Capital receivable and reserves will be accreted back to their future value by 2009 when the final capital instalment is due. The unwinding of the balance sheet reduction will be recognised in the income statement during this period and a transfer from retained earnings to general reserves processed to reflect this.

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 decides that the size of the special reserve is adequate. In accordance with the Agreement, €13.9 million (2003: €10.8 million) of qualifying fees and commissions recognised in the income statement will be appropriated in 2005 from the profit for 2004 and set aside to the special reserve.

17. 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. The last review was concluded in March 2002 and was effective from 25 December 2001. Following the 2001 rent review, the Bank re-examined its facilities requirements and entered into negotiations with the current landlord. This culminated in April 2003 in an agreement which included:

- eliminating the break clause in 2006;
- the extension of the lease from 2016 to 2022;
- obtaining a rent-free period until 25 November 2006;
- eliminating the reinstatement requirement at the expiry of the lease.

Minimum future lease payments under long-term non-cancellable operating leases, and payments made under such leases during the year are shown below.

Payable:	**2004 € million**	2003 € million
Not later than one year	**1.7**	2.2
Later than one year and not later than five years	**85.1**	58.7
Later than five years	**348.9**	375.4
At 31 December	**435.7**	436.3
Expenditure	**25.5**	29.7

The Bank has entered into sub-lease arrangements for one floor of its headquarters building and a portion of its Moscow Resident Office. The total minimum future lease payments expected to be received under these sub-leases and income received during the year are shown below:

Receivable:	**2004 € million**	2003 € million
Not later than one year	**3.1**	3.1
Later than one year and not later than five years	**0.8**	3.8
At 31 December	**3.9**	6.9
Income	**4.4**	12.7

18. Staff retirement schemes

Defined benefit scheme

A qualified actuary performs a full actuarial valuation of the defined benefit scheme at least every three years using the projected unit method. For IAS 19 purposes this is rolled forward annually to 31 December. The most recent valuation date was 30 June 2002. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Amounts recognised in the balance sheet are as follows:

	2004 € million	2003 € million
Fair value of plan assets	**101.4**	84.2
Present value of the defined benefit obligation	(**89.6**)	(75.3)
	11.8	8.9
Unrecognised actuarial losses [1]	**25.3**	27.3
Prepayment at 31 December	**37.1**	36.2

Movement in the prepayment (included in "other assets"):		
At 1 January	**36.2**	39.4
Exchange differences	**–**	(3.2)
Contributions paid	**12.8**	12.3
Total expense as below	(**11.9**)	(12.3)
At 31 December	**37.1**	36.2

The amounts recognised in the income statement are as follows:

Current service cost	(**12.5**)	(11.0)
Interest cost	(**4.8**)	(4.2)
Expected return on assets [2]	**6.7**	5.1
Amortisation of actuarial loss	(**1.3**)	(2.2)
Total included in staff costs	(**11.9**)	(12.3)

1 These unrecognised actuarial losses represent the cumulative effect of the historical differences between the actuarial assumptions used in the production of these disclosures and the actual experience of the plan. The primary historical causes of the losses were a lower than expected investment return on plan assets, and a decline in the discount rate used to value the plan's liabilities.

2 The actual return on assets during the year was €10.3 million (2003: €15.7 million).

Principal actuarial assumptions used:

Discount rate	**5.30%**	5.50%
Expected return on plan assets	**7.00%**	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 (2003: €5.8 million) and is included in "general administrative expenses".

19. 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 2004, the Bank administered 105 technical cooperation fund agreements (2003: 90) amounting to an aggregate of €811.5 million (2003: €776.4 million). This includes €304.5 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 2004 totalled €756.1 million. The total uncommitted balance of the funds at 31 December 2004 was €97.1 million. In addition, the Bank administered 79 project-specific technical cooperation agreements totalling €49.5 million.

For the specific purpose of co-financing EBRD projects, the Bank also administered 18 investment cooperation fund agreements totalling €114.7 million, and two EU Pre-accession Preparation Funds totalling €34.8 million.

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 2004, 15 contributors had made pledges totalling €267.6 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 EU 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. It 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 2004, 23 contributors had made pledges totalling €591.6 million using the fixed exchange rates defined in the rules of the CSF.

In 1999, in pursuit of their policy to accede to the EU, Lithuania, Bulgaria and the Slovak Republic gave firm commitments to close and decommission their nuclear power plant units with RBMK and VVER 440/230 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 to help carry out the first phase of decommissioning the designated reactors. They will also finance measures to facilitate the necessary restructuring, upgrading and modernisation of the energy production, transmission and distribution sectors and improvements in energy efficiency which are a consequence of the closure decisions. At 31 December 2004, 16 contributors had made pledges to the Ignalina IDSF totalling €334.3 million; 11 contributors had made pledges to the Kozloduy IDSF totalling €169.8 million; and nine contributors had made pledges to the Bohunice IDSF totalling €134.3 million, using the fixed exchange rates defined in the rules of the 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 this meeting, participants agreed to establish the Northern Dimension Environmental Partnership to strengthen and coordinate 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 2004, 11 contributors had made pledges totalling €196.2 million.

Audit fees payable to the Bank's auditors for the 2004 audits of the technical cooperation and nuclear safety funds totalled €245,000 (2003: €191,000). In addition, during 2004 the Bank's auditors, on a global basis, earned €0.6 million (2003: €0.9 million) in respect of due diligence and general business consultancy services funded by the technical cooperation funds. This represents 0.8 per cent of the total spend in 2004 (2003: 1.2 per cent) 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 PricewaterhouseCoopers.

20. Post-balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements. On 8 March 2005, 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 22 May 2005.

Summary of Special Funds

Special Funds are established in accordance with Article 18 of the Agreement Establishing the Bank and are administered under the terms of rules and regulations approved by the Bank's Board of Directors. At 31 December 2004, the Bank administered 12 Special Funds: nine Investment Special Funds and three Technical Cooperation Special Funds. Extracts from the financial statements of the Special Funds are summarised in the following tables, together with a summary of contributions pledged by donor country. Financial statements for each Special Fund have been separately audited. The audited financial statements are available on application to the Bank. Audit fees payable to the Bank's auditors for the 2004 audit of the Special Funds totalled €70,000 (2003: €67,800).

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 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, Former Yugoslav Republic of Macedonia, Romania and Serbia and Montenegro.

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, Former Yugoslav Republic of Macedonia, Romania and Serbia and Montenegro.

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.

The Municipal Finance Facility Special Fund:
To alleviate the financing problems of municipalities and their utility companies for small infrastructure investments in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

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

Accounting convention – Technical Cooperation Special Funds:
The financial statements for the Technical Cooperation Special Funds have been prepared under the historical cost convention. Contributions and disbursements are accounted for on a cash basis. Interest income and operating expenses are accounted for on an accruals basis.

Investment Special Funds

Extract from the income statement for the year ended 31 December 2004	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Aggregated Investment Special Funds € 000
Operating profit/(loss) before provisions	415	(824)	121	84	(18,885)	(223)	(3,889)	(46)	33	(23,214)
(Charge)/release for provisions for impairment and payments under guarantees	(725)	550	(221)	(4,180)	111	–	(213)	(824)	–	(5,502)
(Loss)/profit for the year	**(310)**	**(274)**	**(100)**	**(4,096)**	**(18,774)**	**(223)**	**(4,102)**	**(870)**	**33**	**(28,716)**

Extract from the balance sheet at 31 December 2004	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Aggregated Investment Special Funds € 000
Loans	857	16,878	4,511	7,663	–	–	6,927	–	–	36,836
Provisions for impairment	(12)	(2,951)	(968)	(925)	–	–	(852)	–	–	(5,708)
	845	13,927	3,543	6,738	–	–	6,075	–	–	31,128
Share investments	7,605	4,583	1,266	2,031	2,062	–	–	–	–	17,547
Provisions for impairment	(3,732)	(1,704)	(704)	(2,031)	(609)	–	–	–	–	(8,780)
	3,873	2,879	562	–	1,453	–	–	–	–	8,767
Placements and other assets	35,305	20,584	13,606	14,378	29,607	10,801	3,662	8,962	7,033	143,938
Contributions receivable	–	–	2,931	–	70,000	–	1,559	–	23,000	97,490
Total assets	**40,023**	**37,390**	**20,642**	**21,116**	**101,060**	**10,801**	**11,296**	**8,962**	**30,033**	**281,323**
Other liabilities and provisions for impairment and payments under guarantees	8	13,177	14	2,534	4,212	209	3,339	872	–	24,365
Contributions	41,500	59,351	22,608	21,935	155,000	12,766	35,386	9,443	30,000	387,989
Reserves and retained earnings	(1,485)	(35,138)	(1,980)	(3,353)	(58,152)	(2,174)	(27,429)	(1,353)	33	(131,031)
Total liabilities and contributors' resources	**40,023**	**37,390**	**20,642**	**21,116**	**101,060**	**10,801**	**11,296**	**8,962**	**30,033**	**281,323**
Undrawn commitments and guarantees	7,089	46,067	1,768	158	38,325	9,461	5,268	8,252	8,050	124,438

Technical Cooperation Special Funds

Extract from the statement of movement in fund balance and balance sheet for the year ended 31 December 2004	Baltic Technical Assistance Special Fund € 000	Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	Aggregated Technical Cooperation Special Funds € 000
Balance of fund brought forward	2,672	9,036	108	11,816
Contributions received	–	2,038	–	2,038
Interest and other income	22	96	1	119
Disbursements	(1,090)	(2,474)	(28)	(3,592)
Other operating expenses	(6)	(339)	(1)	(346)
Balance of fund available	**1,598**	**8,357**	**80**	**10,035**
Cumulative commitments approved	23,530	68,021	1,066	92,617
Cumulative disbursements	(22,706)	(65,244)	(1,007)	(88,957)
Allocated fund balance	824	2,777	59	3,660
Unallocated fund balance	774	5,580	21	6,375
Balance of fund available	**1,598**	**8,357**	**80**	**10,035**

Special Fund contributions pledged by donor country

	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Baltic Technical Assistance Special Fund € 000	Russia Small Business Technical Cooperation Special Fund € 000	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	–	–	–	–	155,000	–	–	–	30,000	–	–	–	185,000
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	–	21,935	–	–	–	–	–	–	1,360	–	31,696
Japan	–	21,162	–	–	–	–	–	–	–	–	3,295	–	24,457
Netherlands	–	–	9,500	–	–	1,160	–	–	–	–	–	–	10,660
Norway	7,732	–	–	–	–	1,145	–	–	–	1,256	–	–	10,133
Sweden	15,772	–	–	–	–	–	–	–	–	2,564	–	–	18,336
Switzerland	–	2,360	–	–	–	4,218	–	7,054	–	–	1,244	–	14,876
Taipei China	–	–	11,392	–	–	1,495	–	–	–	–	–	–	12,887
United Kingdom	–	–	–	–	–	–	–	–	–	–	12,824	247	13,071
United States of America	–	7,192	1,716	–	–	–	35,386	–	–	–	29,695	–	73,989
Total at 31 December 2004	**41,500**	**59,351**	**22,608**	**21,935**	**155,000**	**12,766**	**35,386**	**9,443**	**30,000**	**6,750**	**60,732**	**247**	**455,718**

Responsibility for external financial reporting

Management's responsibility

Management's report regarding the effectiveness of internal controls over external financial reporting

The management of the European Bank for Reconstruction and Development ("the Bank") is responsible for the preparation, integrity, and fair presentation of its published financial statements and all other information presented in this Financial Report. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board and in accordance with the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

The financial statements have been audited by an independent accounting firm, which has been given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees of the Board. Management believes that all representations made to the external auditors during their audit were valid and appropriate. The external auditors' report accompanies the audited financial statements.

Management is responsible for establishing and maintaining effective internal control over external financial reporting for financial presentations in conformity with IFRS. The system of internal control contains monitoring mechanisms, and actions are taken to correct deficiencies identified. Management believes that internal controls for external financial reporting, which are subject to scrutiny and testing by management and internal audit, and are revised as considered necessary, support the integrity and reliability of the financial statements.

There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention of overriding controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statements. Furthermore, the effectiveness of an internal control system can change with circumstances.

The Bank's Board of Directors has appointed an Audit Committee, which assists the Board in its responsibility to ensure the soundness of the Bank's accounting practices and the effective implementation of internal controls that management has established relating to finance and accounting matters. The Audit Committee is comprised entirely of members of the Board of Directors. A member of the Audit Committee joins, as an observer, the panel assembled for the selection of the Bank's external auditors. The Audit Committee meets periodically with management in order to review and monitor the financial, accounting and auditing procedures of the Bank and related financial reports. The external auditors and the internal auditors regularly meet with the Audit Committee, with and without other members of management being present, to discuss the adequacy of internal controls over financial reporting and any other matters which they believe should be brought to the attention of the Audit Committee.

The Bank assessed its internal controls over external financial reporting for 2004. Management's assessment includes the Special Funds and other fund agreements referred to in pages 41–44 of the Financial Report, and the pension plans. However, the nature of the assessment is restricted to the controls over the reporting and disclosure of these funds, rather than the operational, accounting and administration controls in place for each fund.

The Bank's assessment was based on the criteria for effective internal control over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based upon this assessment, management asserts that, at 31 December 2004, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Report for 2004.

The Bank's external auditors have provided an audit opinion on the fairness of the financial statements presented within the Financial Report. In addition, they have issued an attestation report on management's assessment of the Bank's internal control over financial reporting, as set out on page 46.

Jean Lemierre
President

Steven Kaempfer
Vice President, Finance

European Bank for Reconstruction and Development
London

8 March 2005

Responsibility for external financial reporting

Report of the independent auditors

To the Governors of the European Bank for Reconstruction and Development

We have audited management's assessment that the European Bank for Reconstruction and Development ("the Bank") maintained effective internal controls over financial reporting as contained in the Bank's Financial Report for 2004, based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission. Management is responsible for maintaining effective internal controls over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assertion over the effectiveness of the Bank's internal control over financial reporting based on our review.

We conducted our review in accordance with the International Standard on Assurance Engagements (ISAE) 3000 (revised). Our review included obtaining an understanding of internal control over financial reporting, evaluating the management's assessment and performing such other procedures as we considered necessary in the circumstances. We believe that our work provides a reasonable basis for our opinion.

A bank's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A bank's internal controls over financial reporting include those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the bank; (2) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the bank are being made only in accordance with authorisations of management of the bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

In our opinion, management's assertion that the Bank maintained effective internal control over financial reporting, as contained in the Bank's Financial Report for 2004, is fairly stated, in all material respects, based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission.

We have also audited, in accordance with International Statements on Auditing, the financial statements of the Bank and, in our report dated 8 March 2005, we have expressed an unqualified opinion.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

8 March 2005

Note: The maintenance and integrity of the Bank's web site is the responsibility of the President; the work carried out by the independent auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

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 ("the Bank") for the year ended 31 December 2004 which comprise the income statement, the balance sheet, the statement of changes in members' equity, the statement of cash flows and the related notes to financial statements (the "financial statements").

Respective responsibilities of the President and auditors

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

Our responsibility is to audit the financial statements in accordance with the International Statements on Auditing. This report, including the opinion, has been prepared for, and only for, the Board of Governors as a body in accordance with Article 24 of the Agreement Establishing the Bank dated 29 May 1990, and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements are presented fairly in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. We also report to you if, in our opinion, the financial results section of the Financial Report is not consistent with the financial statements, if the Bank has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Financial Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the highlights, financial results and summary of Special Funds.

Basis of opinion

We conducted our audit in accordance with the International Statements 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 financial position of the Bank at 31 December 2004 and its profit for the year then ended and have been properly prepared in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

8 March 2005

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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 (the "Bank") for the year ended 31 December 2003 which comprise the income statement, the balance sheet, the statement of changes in members' equity, the statement of cash flows and the related notes to financial statements (the "financial statements").

Respective responsibilities of the President and auditors

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

Our responsibility is to audit the financial statements in accordance with the International Statements on Auditing. This report, including the opinion, has been prepared for and only for the Board of Governors as a body in accordance with Article 24 of the Agreement Establishing the Bank dated 29 May 1990 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements are presented fairly in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. We also report to you if, in our opinion, the financial results section of the Annual Report is not consistent with the financial statements, if the Bank has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the highlights, financial results and summary of special funds.

Basis of audit opinion

We conducted our audit in accordance with the International Statements 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 financial position of the Bank at 31 December 2003 and its profit for the year then ended and have been properly prepared in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

2 March 2004

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Published by the
European Bank for Reconstruction and Development

Edited by the Publishing Unit, Communications Department.
French, German and Russian language versions translated by the Translation Unit.
Designed and produced by the Design Unit.

Printed in England by Stabur Graphics, using environmental waste and paper recycling programmes.

Cover and interior printed on PhoeniXmotion Xenon that is acid free and Totally Chlorine Free (TCF).
These papers are environmentally responsible and have low emissions during production.

ref: 6291

Cover: Market, Kyrgyz Republic.
Photographer: Vladimir Pirogov.

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