Annual report 2005
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 2005
Financial report

The EBRD's Annual Report 2005 comprises two separate companion volumes: the Annual Review and the Financial Report, which includes the financial statements and the financial results commentary.

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

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Highlights

Financial results 2001-05

(€ million)	**2005**	2004[1]	2003[1]	2002[1]	2001[1]
Operating income [1]	**1,543.9**	658.6	538.1	330.7	379.5
Expenses and depreciation [1]	**(218.9)**	(189.8)	(198.6)	(218.5)	(206.7)
Operating profit before provisions	**1,325.0**	468.8	339.5	112.2	172.8
Provisions for impairment of loans and guarantees	**200.6**	(67.2)	(11.3)	(45.5)	(15.6)
Net profit for the year	**1,525.6**	401.6	328.2	66.7	157.2
Reserves and retained earnings	**4,656.1**	1,686.0	911.7	619.7	488.7
Provisions for impairment of loans and guarantees (cumulative)	**351.6**	539.5	505.4	570.3	617.5
Total reserves and provisions	**5,007.7**	2,225.5	1,417.1	1,190.0	1,106.2

[1] Amendments to and interpretations of the International Financial Reporting Standards in 2005 have resulted in a number of changes to the Bank's accounting policies as explained in the "accounting policies" section of the financial statements. The figures from previous years have been restated to conform to the new accounting policies.

Operational results

	2005	2004	2003	2002	2001	Cumulative 1991-2005
Number of projects	**151**	129	119	102	102	1,301
EBRD financing (€ million)	**4,277**	4,133	3,721	3,899	3,656	30,313
Resources mobilised (€ million)	**6,221**	8,799	5,307	4,862	6,212	64,095
Total project value (€ million)	**10,498**	12,932	9,028	8,761	9,868	94,408

Financial results

The EBRD recorded a net profit after provisions and financial reporting adjustments of €1.5 billion for 2005, compared with €401.6 million for 2004 (restated for changes in accounting policies in 2005). The principal factors contributing to this increase were significant realised gains from the sale of share investments and unrealised gains from the movement in the fair value of the Bank's associate share investments and high-risk equity funds, both areas that are variable by nature.

In 2005, the Bank revised its provisioning estimate for portfolio impairment provisions.[1] This was in response to developments in the best practice application of incurred loss provision models on a portfolio basis. This revision resulted in a €186.0 million reduction in the portfolio provision for the unidentified impairment of loan investments, which was released through the income statement. The Bank's net profit before unrealised gains on share investments and the impact of the revised provisioning estimate was €1.0 billion in 2005, compared with €275.6 million (restated) in 2004 on an equivalent basis.

The EBRD's general administrative expenses, before the deferral of direct costs relating to loan origination and commitment maintenance, were within the euro budget, reflecting continuing budgetary discipline and effective cost control. 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 £160.7 million, compared with £138.1 million in 2004. In euro terms expenses were €29.6 million higher than the previous year at €224.6 million (2004: €195.0 million).[2] The increase largely reflects a payment of €22.9 million (£15.3 million) in relation to the Bank's retirement plans. This was the result of adjustments to enhance the Bank's retirement plans to reflect the past service of personnel and a change to the actuarial estimate of the liabilities of the defined benefit scheme.

Banking operations achieved a net profit of €1.5 billion (2004 restated: €321.9 million) after the full allocation of expenses, provisions and the return on net paid-in capital. This reflected a year-on-year increase in realised gains from the sale of share investments, together with unrealised gains on the movement in fair value of the Bank's associate share investments and high-risk equity funds, and a decrease in portfolio provisions for loan investments and guarantees. Excluding the fair value movement on non-qualifying hedges, Treasury operations achieved a net profit of €56.4 million (2004: €74.9 million) after the full allocation of expenses and the return on net paid-in capital. After the €6.1 million impact of non-qualifying hedges, Treasury's reported net profit for the year totalled €62.5 million (2004: €79.7 million).

Successful work-outs, along with a general improvement in the performance of the Banking loan portfolio, resulted in a reduction in the value of impaired loans during 2005 with the upgrading of several projects. At 31 December 2005, the Bank had 11 impaired loans with operating assets totalling €35.0 million, compared with 17 such loans totalling €85.8 million at the end of 2004. Of this reduction, €32.7 million was the result of write-offs. Total provisions for Banking loan operations amounted to €323.5 million at the end of 2005 (2004: €507.5 million). Relative to operating assets,[3] this represented 0.7 per cent of sovereign loans (2004: 3.0 per cent) and 5.3 per cent of non-sovereign loans (2004: 7.9 per cent). The decrease in provisions was mainly a result of the revised provisioning estimate for portfolio impairment provisions.

In 2005, the Bank established a loan loss reserve to set aside an amount of retained earnings, within members' equity, equal to the difference between the impairment losses expected over the full life of the loan portfolio and the cumulative amount provisioned through the Bank's income statement. At 31 December 2005, the loan loss reserve totalled €292.0 million.

Prior to 2005, the Bank valued its unlisted share investments at historic cost, less any provisions for impairment at the balance sheet date. Following an enhancement to its valuation techniques, the Bank performed an assessment of the fair value of the unlisted share investment portfolio in 2005. On 1 January 2005, the Bank released the portfolio provision for the unidentified impairment and specific provisions for the identified impairment of unlisted share investments, and restated them to fair value. This resulted in a net increase in the Bank's reserves of €245.0 million.

The Bank's reserves increased from €1.7 billion (restated) at the end of 2004 to €4.7 billion at the end of 2005. This primarily reflected the net profit for the year and an increase in the fair value of the Bank's non-associate share investments (excluding high-risk equity funds). Some €2.5 billion of the Bank's total reserves represented unrealised gains from share investments and Treasury assets, €292.0 million represented the loan loss reserve and €187.6 million represented the special reserve, leaving unrestricted general reserves of €1.7 billion.

Banking operations

Annual business volume and portfolio

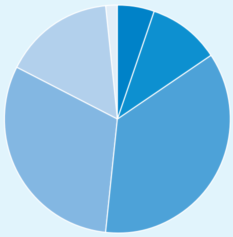
Annual business volume[4] amounted to €4.3 billion, comprising 151 projects in 2005 (2004: €4.1 billion, 129 projects). This is the highest level of annual commitments signed by the EBRD to date and represents an increase of 3 per cent over the level recorded in 2004 in volume terms, and 17 per cent in the number of transactions. Share investments and equity-linked transactions accounted for 16 per cent of the new business volume. The private sector share of the business volume was 76 per cent. Annual business volume included €131.4 million of restructured operations.

Net cumulative business volume reached €30.3 billion by the end of 2005 (2004: €25.3 billion). Including co-financing, this amounted to a total project value of €94.4 billion (2004: €78.5 billion). The portfolio of the Bank's net outstanding commitments grew from €15.3 billion at the end of 2004 to €16.8 billion at the end of 2005. Strong reflows, reflecting exceptionally liquid financial market conditions and a maturing portfolio, limited the portfolio impact of annual business volume, with portfolio growth reaching 10 per cent.

The number and volume of projects under development increased during 2005, with the Board approving 165 projects. These consisted of loans and share investments by the Bank totalling €4.8 billion, compared with 150 projects totalling €4.4 billion in 2004. The level of Board approvals in 2005 was the highest annual level to date. At the end of 2005, cumulative Board approvals, net of cancellations, totalled €33.8 billion (2004: €28.8 billion).

Credit quality of the Banking portfolio

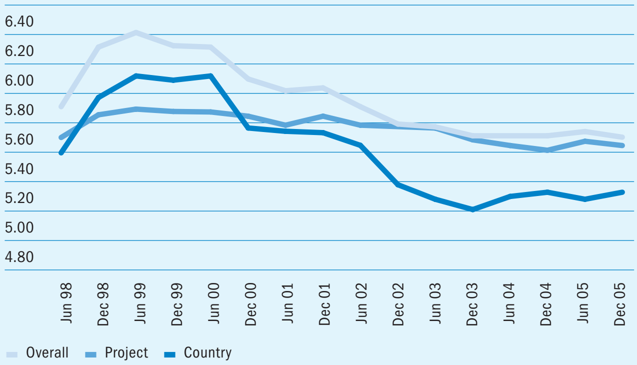
31 December 2005



Risk class	%
1, 2, 3	5.2
4	9.7
5	35.0
6	29.8
6W, 7	18.7
8, 9, 10	1.6

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

Facility, overall and country weighted average risk ratings



Gross disbursements totalled €2.2 billion in 2005, down from a record €3.4 billion in 2004. Operating assets amounted to €12.0 billion at the end of 2005 (2004 restated: €10.8 billion), comprising €7.8 billion of disbursed outstanding loans and €4.2 billion of disbursed outstanding share investments at fair value.

The Bank attracted a significant additional amount of co-financing funds in 2005, which reached €2.6 billion. The Bank mobilised €1.9 billion from commercial co-financing institutions, €338 million from official co-financing, €326 million from international financial institutions and €42 million from export credit agencies. In addition, the Bank's activities continued to be strongly supported by donor funding, including the Special Funds programme and technical and investment cooperation funds. As a result, net cumulative business volume at 31 December 2005 reached €30.3 billion for a total project value of €94.4 billion.

Portfolio risks

Internal rating procedures are discussed in detail under "Banking credit risk" in the risk management policies section of the financial statements. All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (lowest 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 2005, 74.5 per cent of the loan and share investment portfolio was classed under risk ratings 4 to 6 (2004: 76.0 per cent).

The EBRD's portfolio continued to show improvement in 2005. This reflected the solid economic performance in Russia, the continuing integration of eight countries of operations within the European Union (EU) and 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 risk rating categories 7 to 10), which had risen rapidly in the wake of the 1998 crisis in financial markets, decreased by over 20 per cent. There was also a substantial decline in the level of impaired assets, continuing the sharp downward trend of the past four years.

Impaired assets

Where there is objective evidence that an asset is impaired, the difference between the historic cost 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 there is objective evidence that impairment has occurred 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 or fair value adjustment for impairment is made.

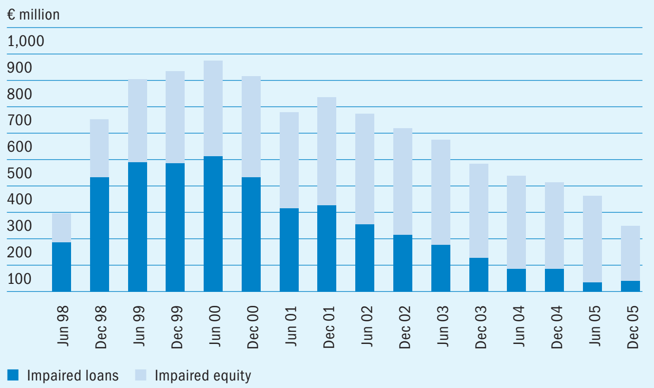
[1] Provisions for impairment of loan investments that are not individually identified as impaired are calculated on a portfolio basis. The methodology used for assessing such impairment is applied to net outstanding disbursements at the relevant reporting date.

[2] The deferral of direct costs relating to loan origination and commitment maintenance totalled €5.7 million during the year (2004 restated: €5.2 million). This resulted in reported general administrative expenses for the year, including depreciation and amortisation, of €218.9 million (2004 restated: €189.8 million).

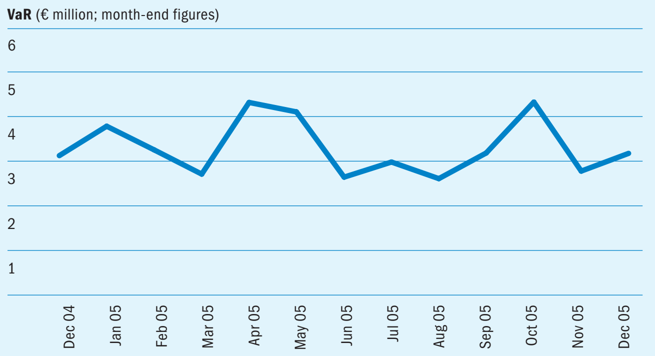
[3] Operating assets comprise net outstanding disbursements and fair value adjustments as applicable.

[4] 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



Total VaR – overall limit €18 million
(Ten trading days, 99% confidence level, BIS compliant dataset)



The chart above 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 crisis in Russia in 1998. Since then, through the improvements in, or successful restructuring of, a number of projects and through some write-offs, the level of impaired assets has substantially declined. At 31 December 2005, impaired assets amounted to 2.5 per cent of net outstanding disbursements, compared with 4.0 per cent at 31 December 2004 and 10.8 per cent at 31 December 2000. Net write-offs (after recoveries from previously written-off projects) were €56.5 million in 2005 (2004: €76.3 million).

Financial performance

Banking operations recorded a net profit (after fully allocated expenses, provisions and the allocation of the return on capital) of €1.5 billion for 2005, compared with a net profit of €321.9 million (restated) in 2004 on an equivalent basis. In 2005, the Bank revised its provisioning estimate for portfolio impairment provisions. This resulted in a €186.0 million reduction in the portfolio provision for the unidentified impairment of loan investments. Excluding the deferral of front-end and commitment fees, operating income of €1.5 billion from the Banking business in 2005 was significantly above the €611.0 million (restated) achieved in 2004. There were two principal factors that contributed to this increase: significant realised gains from the sale of share investments of €639.9 million, compared with €122.4 million in 2004; and unrealised gains from the movement in the fair value of the Bank's associate share investments and high-risk equity funds of €366.2 million.

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. Further variability is expected, with movements in the fair value of associate share investments and high-risk equity funds accounted for in the income statement.

Treasury operations

Portfolio

The value of assets under Treasury management was €12.9 billion at 31 December 2005 (2004 restated: €8.5 billion). This comprised €7.6 billion of debt securities, €1.5 billion of collateralised placements and €3.8 billion of placements with credit institutions (including repurchase agreements).

At the end of 2005, 3.6 per cent of Treasury assets was managed by a total of eight external asset managers. The externally managed portfolios comprised €20.4 million (2004: €15.3 million) in a euro-denominated interest rate trading programme[5] and €442.7 million (2004: €334.5 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.

Treasury risks

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

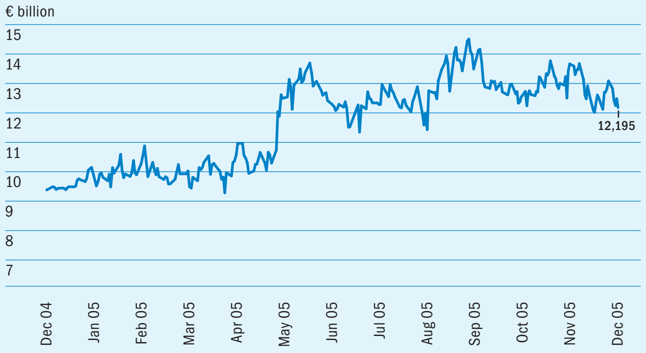
Market risk

At 31 December 2005, the aggregate Value-at-Risk (VaR)[6] 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 €3.2 million[7] (2004: €3.1 million). The average VaR over the year was €3.3 million, while the lowest and highest values were €2.7 million and €4.2 million respectively.

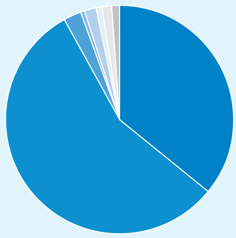
The month-end[8] VaR values denote a modest use of the Board-approved total VaR limit for all Treasury funds, which amounts to €18.0 million.

Within the overall market risk exposure, the VaR of the internally managed portfolios stood at €1.8 million at the end of 2005 (2004: €1.3 million). The range during the year was between €0.6 million and €4.7 million. The size of the internally managed portfolio to which these figures relate was €12.4 billion at 31 December 2005 (2004: €8.2 billion).

Evolution of the overall Treasury credit exposure in 2005



Credit quality of the Treasury portfolio
31 December 2005



Risk class	%
1.0 (AAA)	38.01
1.7-2.5 (AA+, AA, AA-)	57.24
2.7-3.3 (A+, A, A-)	2.00
4.0 (BBB)	0.03
5.3 (BB-)	1.34
6.0 (B)	0.18
7.0 (CCC)	0.93
9.0 (C)	0.27

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

Market risks incurred on the externally managed portfolios exhibited a year-end VaR of €0.7 million (2004: €1.3 million) for the euro-denominated programme and €0.8 million (2004: €0.7 million) for the US dollar-denominated programme.

The specific contribution from foreign exchange risk to the overall VaR stood at €0.1 million at year-end (2004: €0.1 million). As in previous years, this contribution was small throughout 2005 and never exceeded €0.9 million. Interest rate positioning continued to represent the majority of the Bank's market risk exposure.

Interest rate option exposure was substantially reduced throughout the year as most positions were either closed or expired. In addition, an equity index put option position was taken in the latter part of the year as an economic hedge. However, options VaR[9] represented only a small fraction of total VaR throughout the year and especially at the end of the year, where options VaR was negligible (2004: €0.2 million).

Credit risk

Treasury peak credit exposure increased year-on-year, standing at €12.2 billion at 31 December 2005 compared with €9.3 billion at 31 December 2004. This increase, which occurred mostly during the second quarter, was partly linked to the appreciation of the US dollar against the euro (a substantial proportion of Treasury's assets are denominated in US dollars, whereas credit exposure is measured in euros) and partly due to a switch from collateralised instruments (for example, reverse repurchase agreements) to cash instruments.[10]

Overall, the credit quality of the Treasury portfolio was stable: the average credit rating[11] weighted by peak counterparty exposure stood at 1.83 at 31 December 2005 compared with 1.82 at the end of the previous year.

The weighted average rating of the 10 per cent worst rated exposures improved from 3.84 at the end of 2004 to 3.58 at the end of 2005.[12] More significantly, the percentage of Treasury transactions of investment grade quality[13] also improved (97.3 per cent at year-end 2005, compared with 96.5 per cent the previous year), as the additional exposure was mostly to AAA-rated asset-backed securities (ABS) and AA-rated banks. Treasury is exposed to some below-investment-grade issuers due to the rating downgrades several years ago of a few ABS investments that were originally rated triple-A by leading external rating agencies.

Financial performance

Treasury operations recorded an operating profit of €56.4 million for 2005 after the full allocation of expenses and return on capital but before the fair value movement on non-qualifying hedges. This compared with an operating profit of €74.9 million on the same basis for 2004. After the €6.1 million fair value movement on non-qualifying hedges, the profit of Treasury operations for the year totalled €62.5 million (2004: €79.7 million).

[5] In the euro programme, managers are assigned notional amounts for interest rate positioning. At 31 December 2005, the notional value of the programme was €358.6 million.

[6] 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 one-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 policies" section of this report for definitions).

[7] This means that the Bank had a 1 per cent chance of experiencing a loss of at least €3.2 million over a horizon of ten trading days, due to adverse movements in interest rates and foreign exchange rates.

[8] Market risk 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, market risk data is produced by an external risk information provider on a weekly basis.

[9] Options VaR captures the non-linear aspects of the potential profit and loss distribution of the options portfolio of the Bank.

[10] Whereas exposure on collateralised instruments is based on a fraction of nominal, exposure on cash instruments is based on the full nominal.

[11] 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.

[12] That is, from roughly midway between BBB/Baa2/BBB and BBB+/Baa1/BBB+ to just above BBB+/Baa1/BBB+.

[13] That is, BBB-/Baa3/BBB- level or above.

Funding

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 2005, total borrowings stood at €16.9 billion, an increase of €3.0 billion compared with 2004. Of the €3.0 billion increase, approximately €1.5 billion was due to additional borrowing – the majority of which is short-term – while €1.5 billion was due to the influence of foreign exchange fluctuations and movements in fair values. There were 63 new issues in fully convertible new currencies under the EBRD's medium to long-term borrowing programme, at an average after-swap cost of Libor minus 40 basis points. The average remaining life of medium to long-term debt decreased slightly during the year to 7.8 years at 31 December 2005 (2004: 8.3 years). Some €141.5 million was also raised through the Bank's inaugural Rb 5 billion bond issue in Russia.

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.

Capital

Paid-in capital totalled €5.2 billion at 31 December 2005 and at 31 December 2004. The number of the EBRD's subscribed shares stood at almost 2 million. The eighth and final instalment of the capital increase became due in April 2005. 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 €24.4 million at the end of 2005 (2004: €18.1 million). A further €12.5 million of encashments of deposited promissory notes was also overdue (2004: €3.2 million). Of the €36.9 million total overdue, €29.5 million relates to the capital increase.

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 Establishing the Bank 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, the Board of Governors shall review the capital stock of the Bank at intervals of not more than five years. The Bank started a review of its capital stock during 2005 which will be finalised in 2006. This includes 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 is being reviewed and supplemented with a risk-based analysis using the revised 2004 Basel Capital Accord (Basel II) and the Bank's risk capital model. The initial analysis suggests that the Bank should have sufficient capital to implement its operational strategy over the 2006–2010 period within the stated risk and financial assumptions. The review also indicates that the Bank relies on a strong capital base and stressed the need for prudent financial policies that support conservative provisioning, strong liquidity and long-term profitability. This will enable the Bank to sustain its operational activity, taking account of significant medium-term risks arising from its projects, from uncertainty in some sectors and countries of operations, and from the volatility of the financial markets.

Expenses

In sterling terms, general administrative expenditure, excluding depreciation and amortisation, amounted to £148.3 million in 2005. This was £22.1 million, or 18 per cent, higher than in 2004.

Personnel costs were £102.9 million, or £19.8 million higher than in the previous year (2004: £83.1 million), due to a one-off expenditure of £15.3 million relating to a restructuring of the Bank's retirement plans. This included adjustments to enhance the Bank's retirement plans, reflecting the past service of personnel, and a change to the actuarial estimate of the liabilities of the defined benefit scheme.

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 €224.6 million. This was a 15 per cent increase from €195.0 million in 2004, reflecting increased personnel costs. A sterling/euro hedging programme for budget expenditure resulted in hedging gains of €7.7 million.

During 2005, the Bank deferred €5.7 million of direct costs related to loan origination and commitment maintenance on the balance sheet, in accordance with IAS 18 (2004 restated: €5.2 million). These costs, together with the corresponding front end and commitment fees of €38.2 million (2004: €48.0 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 €218.9 million (2004 restated: €189.8 million).

Provisions

Prior to 2005, the Bank valued its unlisted share investments at historic cost, less any provisions for impairment at the balance sheet date. Following an enhancement to its valuation techniques, the Bank performed an assessment of the fair value of the unlisted share investment portfolio in 2005. At 1 January 2005, the Bank released the portfolio provision for the unidentified impairment and specific provisions for the identified impairment of unlisted share investments, and restated them to fair value. This resulted in a net increase in the Bank's reserves of €245.0 million.

The EBRD's portfolio provisioning relating to the unidentified impairment of loan investments on non-sovereign exposures is based on a risk-rated approach. This is assessed by the Bank's Risk Management Vice Presidency and applied in the month of disbursement. A separate methodology is applied for all sovereign loan investments, which takes into account the Bank's preferred creditor status afforded by its members. The Bank recognises 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.

In response to developments in the best practice application of incurred loss provision models on a portfolio basis, the Bank revised its provisioning estimate in 2005. The Bank determined that a reduced emergence period for losses was appropriate for lower-risk rated loan investments (those rated 1 to 6) and increased provisioning was required for higher-risk rated loan investments (those rated 6 watch and 7). This resulted in a net decrease in portfolio provisions of €186.0 million.

In 2005 the Bank established a loan loss reserve to set aside an amount of retained earnings within members' equity. This amount is equal to the difference between the impairment losses expected over the full life of the loan portfolio and the cumulative amount provisioned through the Bank's income statement.

The 2005 release for Banking loan investment and guarantee provisions of €200.6 million was split between portfolio provisions for the unidentified impairment of loan investments and guarantees, which totalled net €187.2 million compared with a charge of €90.6 million in 2004, and specific provisions for the identified impairment of loan investments, which amounted to a net credit of €13.4 million in 2005 compared with a credit of €23.4 million in 2004. Substantial asset recoveries following the restructuring of projects, and the consequent reversal of specific provisions totalling €35.7 million, offset new specific provision charges of €22.3 million during the year.

As a result, total provisions for Banking loan operations stood at €323.5 million at the end of 2005 (2004: €507.5 million). This represented 0.7 per cent of sovereign loans (2004: 3.0 per cent) and 5.3 per cent of non-sovereign loans (2004: 7.9 per cent).

Outlook for 2006

The EBRD has budgeted for a robust profit in 2006. However, the Bank's results remain vulnerable to changes 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 and market risk.

Corporate governance

The EBRD is committed to the highest standards of 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 ("the Agreement"), 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 (BAAC); and
- the Financial and Operations Policies Committee (FOPC).

The composition of these committees during 2005 is detailed in the separate Review section of the Annual Report.

In April 2005, the Board approved the "Procedures and Terms of Reference of Board Committees". This encompassed changes to the workings of the Committees, taking account of recent developments in corporate governance, evolving practices in other international financial institutions and the revision of the Audit Committee's terms of reference, agreed in April 2004. These changes enhanced the corporate governance of the Bank by updating (i) the working procedures of the Board Steering Group and Board Committees and (ii) the terms of reference of the BAAC and FOPC.

During 2005, the Audit Committee further developed its activities. During the year the Audit Committee held discussions that led to the Board approving the new status of the Evaluation Department, making it independent of management with sole responsibility to the Board of Directors. The Audit Committee had regular bilateral meetings with the Bank's external auditor as well as with management to review financial, accounting, risk management, project evaluation, compliance, and internal control and audit matters. The Committee also continued to review the Bank's quarterly and annual financial statements prior to their release. The Board of Directors is responsible for evaluating the performance and effectiveness of the Audit Committee.

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, which has been, or is being, adopted by other international financial institutions, also represents the broadest international best practice, particularly that evolving in the United States. On 1 January 2005 the COSO and Operational Risk Management (C&ORM) unit was formed to co-ordinate the annual certification process of internal controls over financial reporting and to further develop operational risk management. The unit reports directly to the Vice President, Finance, for the certification process, working on a day-to-day basis with the Controller. For operational risk management, the unit reports directly to the Vice President, Risk Management, working on a day-to-day basis with the Director, Risk Management.

The annual certification of internal controls entails identifying, documenting and recording key internal controls over financial reporting. This involves the whole Bank and is coordinated by the Finance Vice Presidency. Key departments involved in financial controls and reporting are identified following a review of the financial statements. Each department documents its processes and its key controls over financial reporting and then tests them to make sure they are operating effectively. This information is then used by management to make its assertion regarding the effectiveness of these controls. The external auditors review the testing conducted by management and the controls-related documentation before issuing their opinion on management's assertion.

The President

The President is elected by the Board of Governors and is the legal representative of the EBRD. Under the direction 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 has an independent Office of the Chief Compliance Officer ("the OCCO"), which is headed by a Chief Compliance Officer ("CCO") reporting directly to the President, and annually or as necessary to the Audit Committee. The CCO is mandated to promote good governance and ethical behaviour throughout all of the activities of the Bank in accordance with international best practices. The role of the CCO is broad and includes dealing with integrity due diligence issues, confidentiality, corporate governance, ethics, conflicts of interest, anti-money laundering, counter-terrorist financing and the prevention of fraudulent and corrupt practices. The OCCO is also responsible for investigating fraud, corruption and misconduct. It also trains and advises, as necessary, the Bank's nominee directors who are appointed to companies in which the Bank holds an equity interest. Financial and integrity due diligence is integrated into the Bank's normal approval of new business and the review of its existing transactions.

Moreover, the CCO has the specific responsibility for running the Bank's Independent Recourse Mechanism ("the IRM") which enhances the Bank's accountability by assessing and reviewing complaints about Bank-financed projects. It has also been agreed in principle that the Bank will produce and publish an anti-corruption report on its web site. This will be the responsibility of the OCCO.

In order to enhance the independence of the CCO, the officer holding that position can be dismissed by the President, in his capacity as the Bank's Chief of Staff, only in accordance with guidance given by the Board.

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. Risks include:

- 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.

Responsibility for developing the operational risk framework and for monitoring its implementation resides within the Risk Management Vice Presidency. In January 2005, the C&ORM unit was formed specifically to develop the management of operational risk and to provide the overall framework and structure to support line managers who control and manage operational risk as part of their day-to-day activities. In addition, the unit coordinates the certification of internal controls over the financial reporting process. This allows extensive information on financial controls to be leveraged for operational risk management purposes, and for duplication between the two functions to be minimised. The unit also drafts proposals for discussion and review to the Operational Risk Management Group (ORMG), which implements the operational risk management policies and techniques throughout the Bank.

The ORMG membership comprises senior managers across the EBRD who have been identified as potentially facing the most operational risk within their day-to-day activities. In 2005 the membership comprised: the Vice President of Risk Management, the Vice President of Finance, the General Counsel, the Chief Compliance Officer, the Director of Risk Management, the Controller, the Director of IT, the Treasurer, the Director of OpsCom Secretariat, the Director of Human Resources, the Corporate Director of Administration, Procurement and Consultancy Services, the Deputy Secretary General, the Director of Treasury Risk Management, the Head of Internal Communications, the Head of Internal Audit and the Head of COSO and Operational Risk Management. The ORMG's task is to develop and coordinate the EBRD's approach to managing operational risk, and to ensure that it is widely implemented across all areas of the EBRD.

The EBRD's current operational risk framework includes an agreed definition (see above), the categorisation of different loss type events to capture the EBRD's exposure to operational risk, a group of key risk indicators to measure such risks and the identification of specific operational risks through an annual self assessment exercise. Departments within the EBRD identified their operational risk exposures and evaluated the mitigating controls that help to reduce the inherent or pre-control 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. Following the conclusion of the self assessment exercise, a series of challenge meetings based on product or risk type lines and across departments were held to validate the results and to increase consistency between departments.

Reporting

The EBRD's corporate governance structure is supported by appropriate financial and management reporting. In 2004, the Bank completed a project, using internal and external resources, to be able to certify in the Annual Report: Financial Report as to the effectiveness of internal controls over external financial reporting, using the COSO internal control framework. This annual certification statement is signed by the President and Vice President, Finance, and is subject to a review and an attestation by the Bank's external auditors. The first certification was made for the 2004 Financial Report and this process is repeated annually. 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 closely monitor the implementation of business plans, the execution of budgets and the effectiveness of financial controls.

External auditor

The external auditors are appointed by the Board, on the recommendation of the President, for a four-year term. No firm of auditors can serve for more than two consecutive four-year terms. The external auditors perform an annual audit to enable them to express an opinion on whether the financial statements present fairly the financial position and the profit of the Bank. They also examine whether the statements have been presented in accordance with International Financial Reporting Standards and the overall principles of the EC Council Directive on Annual Accounts and Consolidated Accounts of Banks and other Financial Institutions. In addition, the external auditors review and offer their opinion on management's assertion as to the effectiveness of internal controls over financial reporting. This opinion is given as a separate report to the audit opinion. At the conclusion of their annual audit, the external auditors prepare a management letter for the Board of Directors, which is reviewed in detail and discussed with the Audit Committee, setting out the auditors' views and management's responses on the effectiveness and efficiency of internal controls and other matters. The performance and independence of the external auditor is subject to review on an annual basis by the Audit Committee.

There are key provisions of the Bank's policy regarding the independence of the external auditor. 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.

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.

EBRD remuneration

All EBRD personnel on fixed-term or regular contracts receive a salary. In addition, professional members of staff are eligible to receive bonus awards depending on individual performance.

All fixed-term and regular employees – as well as the Board of Directors, the President and Vice Presidents – are covered by medical insurance, participate in the Bank's retirement scheme and may be eligible to receive a mortgage subsidy. Professional staff who join Headquarters from outside the United Kingdom may receive allowances to assist with relocation, as well as an accommodation allowance which can be used either to defray the cost of renting or purchasing accommodation. Professional staff hired from abroad, and who are not British citizens, are eligible for an education allowance.

The salaries and emoluments of all EBRD personnel are subject to an internal tax, applied at rates which vary according to the individual's salary and personal circumstances. Since EBRD personnel are subject to this internal tax, their EBRD salaries and emoluments are exempt from national income tax in the United Kingdom.

President and Vice Presidents

The President is elected by the Board of Governors and typically receives a fixed-term contract of four years. His salary and benefits are approved by the Governors. The President is not eligible for bonus awards.

The Vice Presidents are appointed by the Board of Directors on the recommendation of the President and typically have fixed-term contracts of four years. Their salaries and benefits are approved by the Board of Directors. The Vice Presidents are not eligible for bonus awards.

The salary, net of internal tax, for each of these positions, as of December 2005, is as follows:

President	£223,834
First Vice President, Banking	£209,559
Vice President, Finance	£193,946
Vice President, Risk Management	£193,946
Vice President, Human Resources and Administration	£172,842

Board of Directors

Directors are elected by the Board of Governors and typically serve a term of three years. Directors appoint Alternate Directors. The salaries of Directors and Alternate Directors are approved by the Board of Governors. They can participate in the same benefit scheme as staff but are not eligible for bonus awards.

The most recently approved salaries, net of internal tax, for these positions are as follows:

Director	£105,177
Alternate Director	£87,297

Senior management

Senior management comprises members of the Bank's Executive Committee as well as Business Group Directors, Corporate Directors, the Treasurer, the Director of Risk Management, the Controller, the Director of Human Resources, the Head of Internal Audit and the Chief Compliance Officer. This group, excluding the President and Vice Presidents (for whom information is given above), consists of 17 individuals who received salaries, net of internal tax, in the range of £105,697 to £140,307, with an average bonus of 26 per cent in 2005.

Financial statements

These financial statements have been approved for issue by the Board of Directors on 7 March 2006.

Income statement

For the year ended 31 December 2005	Note	Year to 31 December 2005 € million	Restated Year to 31 December 2004 € million
Interest and similar income			
From loans		**416.9**	310.3
From fixed-income debt securities and other interest		**363.3**	236.9
Interest expense and similar charges		**(410.0)**	(222.9)
Net interest income		**370.2**	324.3
Net fee and commission income	3	**19.4**	17.6
Dividend income		**97.8**	53.2
Net gains from share investments at fair value through profit or loss	4	**488.6**	126.0
Net gains from available-for-sale share investments	5	**552.5**	108.7
Net gains/(losses) from available-for-sale Treasury assets	6	**10.0**	(1.7)
Net (losses)/gains from dealing activities and foreign exchange	7	**(0.7)**	25.7
Fair value movement on non-qualifying hedges	8	**6.1**	4.8
Operating income		**1,543.9**	658.6
General administrative expenses	9	**(201.8)**	(173.4)
Depreciation and amortisation		**(17.1)**	(16.4)
Operating profit before provisions		**1,325.0**	468.8
Provisions for impairment of loan investments and guarantees	10	**200.6**	(67.2)
Net profit for the year		**1,525.6**	401.6

The notes on pages 18 to 52 are an integral part of these financial statements.

Balance sheet

At 31 December 2005	Note	€ million	31 December 2005 € million	€ million	Restated 31 December 2004 € million
Assets					
Placements with and advances to credit institutions		**3,800.1**		684.5	
Collateralised placements		**1,475.3**		1,645.1	
		5,275.4		2,329.6	
Debt securities	11				
Trading		**709.4**		832.3	
Available-for-sale		**6,908.0**		5,293.4	
		7,617.4		6,125.7	
			12,892.8		8,455.3
Other assets	12				
Derivative financial instruments		**2,318.2**		2,622.0	
Other		**1,137.3**		597.3	
			3,455.5		3,219.3
Loan investments	13				
Loans		**7,819.3**		7,613.3	
Less: Provisions for impairment	10	**(323.5)**		(507.5)	
		7,495.8		7,105.8	
Share investments	14				
Share investments at fair value through profit or loss		**1,550.0**		226.8	
Available-for-sale share investments		**2,629.3**		2,425.0	
		4,179.3		2,651.8	
			11,675.1		9,757.6
Intangible assets	15		**16.2**		18.1
Property, technology and office equipment	16		**12.3**		13.6
Paid-in capital receivable	19		**326.6**		567.7
Total assets			**28,378.5**		22,031.6
Liabilities					
Borrowings					
Amounts owed to credit institutions		**978.1**		913.3	
Debts evidenced by certificates	17	**15,929.4**		12,965.6	
			16,907.5		13,878.9
Other liabilities	18				
Derivative financial instruments		**356.6**		570.2	
Other		**1,261.6**		699.8	
			1,618.2		1,270.0
Total liabilities			**18,525.7**		15,148.9
Members' equity					
Subscribed capital	19	**19,789.5**		19,789.5	
Callable capital	19	**(14,592.8)**		(14,592.8)	
Paid-in capital			**5,196.7**		5,196.7
Reserves and retained earnings	20		**4,656.1**		1,686.0
Total members' equity			**9,852.8**		6,882.7
Total liabilities and members' equity			**28,378.5**		22,031.6
Memorandum items					
Undrawn commitments			**6,679.4**		5,179.2

The notes on pages 18 to 52 are an integral part of these financial statements.

Statement of changes in members' equity

For the year ended 31 December 2005	Subscribed capital € million	Callable capital € million	Special reserve € million	Loan loss 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 2003	19,789.5	(14,592.8)	162.9	–	401.0	425.7	989.6	6,186.3
Reserve transfer for the fair value movement of financial assets at fair value through profit or loss	–	–	–	–	13.5	(13.5)	–	–
Prior year restatement from changes in accounting policies (refer accounting policies note B)	–	–	–	–	–	(77.9)	(77.9)	(77.9)
At 1 January 2004 as restated	19,789.5	(14,592.8)	162.9	–	414.5	334.3	911.7	6,108.4
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
Transfer of fair value movement of financial assets at fair value through profit or loss to the income statement	–	–	–	–	(126.0)	–	(126.0)	(126.0)
Reserves transfer	–	–	–	–	14.9	(14.9)	–	–
Restated net profit for the year	–	–	–	–	–	401.6	401.6	401.6
At 31 December 2004 as restated	19,789.5	(14,592.8)	173.7	–	802.1	710.2	1,686.0	6,882.7
Transitional restatement of opening balance for fair value of financial assets at fair value through profit or loss (refer accounting policies note B)	–	–	–	–	(84.8)	–	(84.8)	(84.8)
At 1 January 2005 as restated	19,789.5	(14,592.8)	173.7	–	717.3	710.2	1,601.2	6,797.9
Transitional revaluation of opening balance for fair value of available-for-sale share investments (refer accounting policies note B)	–	–	–	–	329.8	–	329.8	329.8
Transitional revaluation of opening balance for fair value of equity derivatives (refer accounting policies note B)	–	–	–	–	42.7	–	42.7	42.7
At 1 January 2005 as revalued	19,789.5	(14,592.8)	173.7	–	1,089.8	710.2	1,973.7	7,170.4
Internal tax for the year	–	–	–	–	4.3	–	4.3	4.3
Qualifying fees and commissions from the prior year	–	–	13.9	–	–	(13.9)	–	–
Net fair value movement of available-for-sale investments for the year	–	–	–	–	1,152.1	–	1,152.1	1,152.1
Net fair value movement of cash flow hedges for the year	–	–	–	–	0.4	–	0.4	0.4
Reserves transfer	–	–	–	292.0	7.7	(299.7)	–	–
Net profit for the year	–	–	–	–	–	1,525.6	1,525.6	1,525.6
At 31 December 2005	**19,789.5**	**(14,592.8)**	**187.6**	**292.0**	**2,254.3**	**1,922.2**	**4,656.1**	**9,852.8**

The notes on pages 18 to 52 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2005	€ million	Year to 31 December 2005 € million	€ million	Restated Year to 31 December 2004 € million
Cash flows from operating activities				
Operating profit for the period [1]	**1,525.6**		401.6	
Adjustments for:				
Unwinding of the discount relating to impaired identified assets	**(0.5)**		(1.4)	
Fair value movement on capital receivable and associated hedges	**(10.6)**		(21.3)	
Net deferral and amortisation of fees and direct costs	**19.9**		34.6	
Internal taxation	**4.3**		4.6	
Realised gains from share investments	**(639.9)**		(122.4)	
Unrealised gains from share investments	**(374.8)**		(126.0)	
Impairment (gains)/losses from share investments [2]	**(26.4)**		13.7	
Unrealised (gains)/losses from dealing activities	**(1.5)**		10.7	
Realised gains from available-for-sale Treasury assets	**(3.3)**		(2.3)	
Foreign exchange losses/(gains)	**0.9**		(1.0)	
Profit on disposal of property, technology and office equipment	**(0.1)**		(0.2)	
Depreciation and amortisation	**17.1**		16.4	
Impairment (gains)/losses from available-for-sale Treasury assets [2]	**(6.7)**		4.0	
Gross provisions for loan losses before recoveries from loans previously written off [2]	**(196.4)**		67.4	
Operating profit before changes in operating assets	**307.6**		278.4	
Decrease/(increase) in operating assets:				
Interest receivable and prepaid expenses	**103.9**		964.7	
Fair value movement	**887.2**		(679.2)	
Proceeds from repayments of loans	**2,569.5**		2,887.5	
Proceeds from prepayments of loans	**784.3**		761.5	
Funds advanced for loans	**(3,008.4)**		(4,848.1)	
Proceeds from sale of share investments	**1,277.5**		513.3	
Funds advanced for share investments	**(378.3)**		(572.2)	
Increase/(decrease) in operating liabilities:				
Interest payable and accrued expenses	**22.2**		(300.6)	
Net cash from/(used in) operating activities		**2,565.5**		(994.7)
Cash flows from investing activities				
Proceeds from sale of available-for-sale securities	**872.3**		1,749.5	
Purchases of available-for-sale securities	**(2,042.0)**		(2,160.0)	
Proceeds from sale of property, technology and office equipment	**0.1**		0.2	
Purchase of property, technology and office equipment	**(14.0)**		(10.6)	
Net placements with credit institutions	**1.0**		49.5	
Net cash used in investing activities		**(1,182.6)**		(371.4)
Cash flows from financing activities				
Capital received	**251.7**		301.0	
Issue of debts evidenced by certificates	**6,640.2**		5,002.0	
Redemption of debts evidenced by certificates	**(5,419.4)**		(4,960.1)	
Net cash from financing activities		**1,472.5**		342.9
Net increase/(decrease) in cash and cash equivalents		**2,855.4**		(1,023.2)
Cash and cash equivalents at beginning of year		**1,422.3**		2,445.5
Cash and cash equivalents at 31 December [3]		**4,277.7**		1,422.3

[1] Operating profit includes dividends of €97.8 million received for the year to 31 December 2005 (31 December 2004: €53.2 million).

[2] The 2004 comparative impairment (gains)/losses from share investments of €13.7 million, impairment (gains)/losses from available-for-sale Treasury assets of €4.0 million, and gross provisions for loan losses before recoveries from loans previously written off of €67.4 million, were together recorded as gross provisions for losses before recoveries from assets previously written off totalling €85.1 million in the 2004 statement of cash flows.

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

	31 December 2005 € million	Restated 31 December 2004 € million
Placements with and advances to credit institutions	**3,768.1**	680.5
Collateralised placements	**1,475.3**	1,645.1
Amounts owed to credit institutions	**(965.7)**	(903.3)
Cash and cash equivalents at 31 December	**4,277.7**	1,422.3

The notes on pages 18 to 52 are an integral part of these financial statements.

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 financial assets, financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts. In addition, financial assets and liabilities subject to amortised cost measurement, where they form part of a qualifying hedge relationship, have been accounted for in accordance with hedge accounting rules – see "hedge accounting" under "derivatives" below.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed below in "significant accounting policies" and "critical accounting estimates and judgements".

B. Significant changes in the financial statements

Interpretations and amendments to published standards effective in 2005

The following amendments and interpretations to standards are mandatory for the Bank's accounting periods beginning on or after 1 January 2005. The Bank has assessed the relevance of these amendments and interpretations and concluded that they do not result in changes to the Bank's accounting policies:

- IAS 39 (Amendment), The fair value option;
- IAS 39 (Amendment), How to determine fair value;
- IFRIC 2, Members' shares in co-operative entities and similar instruments; and
- SIC 12 (Amendment), Consolidation – special purpose entities.

The following amendments and interpretations to standards, mandatory for accounting periods beginning on or after 1 January 2005, have resulted in changes to the Bank's accounting policies:

- IAS 28 (Amendment), Investments in associates;
- IAS 39 (Amendment), De-recognition of a financial asset; and
- IAS 39 (Amendment), Definitions relating to recognition and measurement.

The impact of the above amendments on the Bank's financial statements is explained in the following section.

Changes in critical accounting policies

IAS 28 (Amendment), Investments in associates

Prior to 2005, all associate share investments were accounted for as available-for-sale financial assets as the Bank did not issue consolidated financial statements under the requirements of the previous IAS 28. As of 1 January 2005, the Bank applied the exemption for venture capital organisations under IAS 28 (Amendment). This permitted the Bank to designate share investments, previously held as available-for-sale and measured at cost less impairment, as financial assets at fair value through profit or loss. The Bank has chosen to designate all associate share investments and high-risk equity funds as financial assets at fair value through profit or loss with changes in fair value included in the income statement. All remaining non-associate share investments (excluding high-risk equity funds) continue to be designated as available-for-sale financial assets.

Prior to 2005, the Bank had concluded that it could not reliably measure the fair value of its unlisted share investments. It was therefore impracticable to restate 2004 comparatives for unlisted associate share investments and high-risk equity funds. Following an enhancement to its valuation techniques, the Bank performed an assessment of the fair value of the unlisted share investment portfolio as at 1 January 2005 and 31 December 2005 and restated its unlisted share investments to fair value. The effect of restating associate share investments and high-risk equity funds to fair value at 1 January 2005 was a decrease in the revaluation reserve by €84.8 million.

As the Bank has always carried listed share investments at fair value, the 2004 comparatives have been restated to account for listed associate share investments as financial assets at fair value through profit or loss. At 31 December 2003, the fair value of the listed associate share investments was €13.5 million below cost. The Bank's financial statements were therefore restated to increase the 2004 opening revaluation reserve by €13.5 million and reduce opening retained earnings by the same amount. The fair value movement in 2004 of €126.0 million has been included in the restated 2004 income statement. The overall effect of restating listed associate share investments to financial assets at fair value through profit or loss was to reduce the opening revaluation reserve in 2005 by €112.5 million, and to increase opening retained earnings by the same amount.

IAS 39 (Amendment), De-recognition of a financial asset

Collateralised placements represent transactions where the Bank has purchased assets for which the market risk exposure remains with the seller. This risk transference is achieved through the use of a concurrent total return swap transacted with the seller. In 2004, the Bank carried both the swap and underlying assets at fair value. Under the new de-recognition rules in IAS 39 (Amendment), the swap and underlying assets are no longer recognised on the balance sheet and the transaction has been accounted for as a loan held at amortised cost. The 2004 comparatives have been restated, resulting in a decrease in collateralised placements of €107.7 million, with an offsetting decrease in other liabilities-derivative financial instruments.

IAS 39 (Amendment), Definitions relating to recognition and measurement

IAS 39 (Amendment) contains clarification on the transaction costs that could be deferred under IAS 18. The effect of this was to restrict the types of costs which qualify for deferral. The Bank has retrospectively applied IAS 39 (Amendment). The effect of the restatement was to increase general administrative expenses in 2004 by €30.3 million, to increase interest income from loans by €8.2 million and to decrease loan investments by the net amount of €22.1 million. In addition, the Bank's opening retained earnings at 1 January 2004 decreased by €77.9 million.

Changes in critical accounting estimates and judgements

Fair valuation of unlisted share investments

Prior to 2005, the Bank valued its unlisted share investments at historic cost, less any provisions for impairment at the balance sheet date. Following an enhancement to its valuation techniques, the Bank performed an assessment of the fair value of the unlisted share investment portfolio as at 1 January 2005 and 31 December 2005 and revalued its unlisted share investments to fair value.

As fair value could not be reliably measured prior to 2005, it was impracticable to restate 2004 comparatives for unlisted share investments. The effect of revaluing unlisted non-associate share investments (excluding high-risk equity funds) to fair value at 1 January 2005 was an increase in the revaluation reserve of €329.8 million. The fair value movement during 2005 of €1.1 billion was included in the general reserve as part of "revaluation reserve – available-for-sale assets".

Fair valuation of equity-related derivatives

The enhancement of the Bank's valuation techniques in 2005 enabled the Bank to fair value its equity-related derivatives. All derivatives are measured at fair value through the income statement in accordance with the "derivatives" accounting policy explained below. As fair value could not be reliably measured prior to 2005, it was impracticable to restate the 2004 comparatives. An adjustment was made to opening retained earnings of €42.7 million to reflect the fair value of these derivatives at 1 January 2005. During 2005, the fair value movement of €8.6 million was included in the income statement as part of "net gains from share investments at fair value through profit or loss".

Revision of portfolio provision estimates

In response to developments in the best practice application of incurred loss provision models on a portfolio basis, the Bank revised its provisioning estimate in 2005. The Bank determined that a shorter emergence period for losses was appropriate for lower-risk rated loan investments (those rated 1 to 6) and greater provisioning was required for higher-risk rated loan investments (those rated 6 watch and 7). This resulted in a net decrease in portfolio provisions of €186.0 million. In addition, the Bank created a loan loss reserve to set aside an amount of retained earnings, within members' equity, equal to the difference between the impairment losses expected over the full life of the loan portfolio and the amount recognised through the Bank's income statement. At 31 December 2005, the loan loss reserve totalled €292.0 million.

Restructuring of the Bank's retirement plans

In 2005 the Bank restructured its retirement plans. The restructuring enhanced the Bank's retirement plans, reflecting the past service of personnel and a change to the actuarial estimate of the liabilities of the defined benefit scheme. The impact of the enhancement was an exceptional expense of €22.9 million (£15.3 million) in 2005, recorded within general administrative expenses.

Standards, interpretations and amendments to published standards not yet effective

The following new standards, amendments and interpretations to existing standards were published in 2005 and are mandatory for the Bank's accounting periods beginning on or after 1 January 2006.

IAS 39 and IFRS 4 (Amendment), Financial guarantee contracts (effective from 1 January 2006)

This amendment requires issued financial guarantees to be initially recognised at their fair value, and subsequently measured at the higher of the unamortised balance of the related fees received and deferred, and the expenditure required to settle the commitment at the balance sheet date. The Bank will apply this amendment from annual periods beginning 1 January 2006.

IFRS 7, Financial instruments: Disclosures, and IAS 1 (Amendment), Presentation of financial statements – capital disclosures (effective from 1 January 2007)

IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including an analysis of sensitivity to market risk. It replaces IAS 30, Disclosures in the financial statements of banks and similar financial institutions, and the disclosure requirements in IAS 32, Financial instruments: Disclosure and presentation. IAS 1 (Amendment) introduces disclosures about the level of an entity's capital and how it manages capital. The Bank assessed the impact of IFRS 7 and IAS 1 (Amendment) and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by IAS 1 (Amendment). The Bank will apply IFRS 7 and IAS 1 (Amendment) from annual periods beginning 1 January 2007.

IAS 19 (Amendment), Employee benefits (effective from 1 January 2006)

This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Bank does not intend to change its accounting policy for recognising actuarial gains and losses and does not participate in any multi-employer plans, adopting this amendment will only have an impact on the format and extent of disclosures presented in the accounts. The Bank will apply this amendment from annual periods beginning 1 January 2006.

The following new standards, amendments and interpretations to existing standards will not result in changes to the Bank's accounting policies:

- IAS 39 (Amendment), Cash flow hedge accounting of forecast intragroup transactions (effective from 1 January 2006);
- IFRS 1 (Amendment), First-time adoption of International Financial Reporting Standards (effective from 1 January 2006);
- IFRS 6 (Amendment), Exploration for and evaluation of mineral resources (effective from 1 January 2006);
- IFRIC 4, Determining whether an arrangement contains a lease (effective from 1 January 2006);
- IFRIC 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds (effective from 1 January 2006); and
- IFRIC 6, Liabilities arising from participating in a specific market – waste electrical and electronic equipment (effective from 1 December 2005).

C. Significant accounting policies

Financial assets

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.

Collateralised placements are carried at amortised cost. 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 are a form of collateralised lending.

Financial assets at fair value through profit or loss

This category includes the Bank's associate share investments and high-risk equity funds. Such assets are carried at fair value on the balance sheet with changes in fair value included in the income statement in the period in which they arise. The basis of fair value for listed financial assets at fair value through profit or loss in an active market is the quoted bid market price on the balance sheet date. The basis of fair value for financial assets at fair value through profit or loss that are either unlisted or listed in an inactive market is determined using valuation techniques appropriate to the market and industry of each investment. Purchases and sales of share investments are recorded at trade date. Financial assets at fair value through profit or loss are analysed in note 14.

This category also includes assets acquired for the purpose of generating profits from short-term price fluctuations. Such assets are accounted for at fair value on the basis of independent market quotes, with all changes in value recorded through the income statement as they occur. Assets held in this category are accounted for at trade 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 non-associate share investments (excluding high-risk equity funds) and the majority of its Treasury portfolio. Such assets are carried at fair value on the balance sheet. Changes in fair value are recognised directly in reserves, as disclosed in the "statement of changes in members' equity", until the financial asset is sold or impaired. At this time the cumulative gain or loss previously recognised in reserves is removed and included in the income statement.

Share investments are impaired when there is objective evidence that the future recoverability is in doubt. This could be indicated by a significant or prolonged decline in the fair value of a share investment below its cost. The Bank also evaluates factors such as country, industry and sector performance, changes in technology and operational and financial performance.

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.

The basis of fair value for available-for-sale share investments listed in an active market is the quoted bid market price on the balance sheet date. The basis of fair value for available-for-sale share investments that are unlisted or listed in an inactive market is determined using valuation techniques appropriate to the market and industry of each investment. Purchases and sales of share investments are recorded at trade date. Available-for-sale share investments are analysed in note 14.

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. 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 that 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.

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 the relevant 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 documented by the Bank's Treasury department.

Hedge accounting

Hedge accounting is designed to bring accounting consistency to financial instruments that 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.

The Bank documents the relationship between hedging instruments and hedged items at the inception of the transaction. The Bank also documents its assessment, on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

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 included 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 the fact that its future administrative expenses are 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. The movement in the fair value of cash flow hedges is recognised directly in reserves.

For further information on risk and related management policies, refer to the risk management section on page 25.

Provisions for impairment of loan investments and guarantees

Where there is objective evidence that an identified loan is impaired, 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. It is determined using the instrument's original effective interest rate where applicable, and is often indicated by a significant or prolonged decline in the value of the asset below cost. 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. The methodology used for assessing such impairment is based on a risk-rated approach for non-sovereign assets applied in the month of disbursement. A separate methodology is applied for all sovereign risk assets which takes into account the Bank's preferred creditor status afforded by its members. The effect of applying the Bank's methodology is considered to be approximate to calculating impairment on an incurred loss basis, as it is 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 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 and is included in "other liabilities" on the balance sheet.

Impairment, less any amounts reversed during the year, is charged to the income statement under the caption "provisions for impairment of loan investments and guarantees", as summarised in note 10. When a loan or the underlying assets of a guarantee is deemed uncollectable the principal is written off against the related estimated impairment. Subsequent recoveries are credited to the income statement if previously written off.

D. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Preparing financial statements in conformity with IFRS requires the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts included in the income statement during the reporting period.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

- fair value of available-for-sale share investments and financial assets at fair value through profit or loss; and
- provisions for impairment of loan investments and guarantees.

These estimates are highly dependent on a number of variables including interest rates, exchange rates and retained earnings multiples which reflect the economic environment and financial markets of the Bank's countries of operations. Information on the Bank's countries of operations can be found in the Annual Report 2005: Annual Review.

E. 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.

F. Foreign currencies

In accordance with Article 35 of the Agreement Establishing the Bank, 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.

Foreign currency transactions are initially translated into euro using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at the year-end exchange rate of monetary assets and liabilities denominated in foreign currencies, are included in the income statement, except when deferred in reserves as qualifying cash flow hedges. Translation differences on non-monetary items, such as share investments held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as share investments classified as available-for-sale financial assets, are included in the fair value reserve in equity.

G. 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 contracts. These derivatives are fair valued in accordance with IAS 39, with any gain or loss being recorded in the income statement.

H. Intangible assets

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 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 scheme's 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 scheme's 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. Borrowings

Borrowings are recognised initially at fair value, 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. Comparative figures have been restated where appropriate, as disclosed in "significant changes in the financial statements".

Risk management policies

Principles of financial management and risk management

The financial policies require the EBRD to follow the guiding principles of sound financial management, building on the Agreement Establishing the Bank. They provide the financial framework within which the Bank is required to pursue 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 2005 resulted in changes to the liquidity policy adopted in 2001. These changes included the introduction of a framework under which the Bank's liquidity in non-convertible or not fully convertible local currency will be managed.

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.

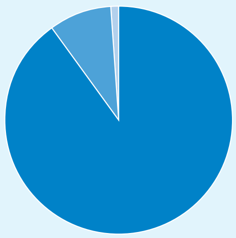
The financial policies require that the Board of Directors approves a Treasury and Treasury Risk Management Authority (T&TRMA), which defines the risk parameters to be observed by Treasury in managing its exposures. This document is updated annually by the Finance and Risk Management Vice Presidencies and approved by the Board. It 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 of Finance to manage, and the Vice President of 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 annually 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 annually 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 of Risk Management is a member of the Bank's Executive Committee, as are the First Vice President of Banking, and the Vice President of Finance, to whom Treasury reports. The Vice President of 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.

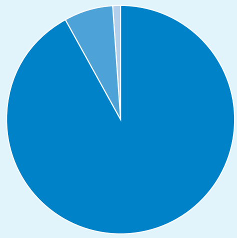
OTC derivatives and foreign exchange exposure

31 December 2005



	%
With Master Agreement and Credit Support Annex	90.48
With Master Agreement only	9.51
Without Master Agreement	0.01

31 December 2004



	%
With Master Agreement and Credit Support Annex	92.19
With Master Agreement only	7.80
Without Master Agreement	0.01

Banking risks are managed through the Operations Committee. In 2005, the membership comprised: the First Vice President, the Vice President of Finance, the Vice President of Risk Management, the Chief Economist, the General Counsel, the Director of Risk Management and a Business Group Director. 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 provisions for the impairment of assets.

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 of Finance, the Vice President of Risk Management, the Treasurer, the Director of Risk Management, the Deputy Treasurer, the Director of Treasury Risk Management, the Chief Economist, the General Counsel, the Deputy General Counsel and the Business Group Director of 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, and monitors and reviews the asset/liability profile and risk return trade off in aggregate Treasury exposures. It also 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.

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.

The 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 tenor 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 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 measured and monitored daily for all counterparties, independently from risk takers.

For 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 the credit risk of derivatives through systematic recourse to a variety of risk mitigation techniques. OTC derivatives transactions are systematically documented with a Master Agreement ("MA"), providing for close-out netting, and a

Credit Support Annex ("CSA"). 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.

As at 31 December 2005, 90.5 per cent of the Bank's gross exposure to derivatives counterparties was with counterparties with whom an MA and CSA had been completed. All the Bank's Treasury 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.

The table below shows the nominal amounts of the Bank's derivative transactions outstanding at the end of 2005 and the associated fair values.

Derivative transactions

	2005 Nominal € million	**2005 Fair value € million**	2004 Nominal € million	Restated 2004 Fair value € million
Foreign currency products				
OTC				
Currency swaps	**9,028.5**	**1,677.8**	8,663.4	2,157.4
Spot and forward currency transactions	**1,238.0**	**3.0**	1,307.2	(27.3)
Total	**10,266.5**	**1,680.8**	9,970.6	2,130.1
Interest rate products				
OTC				
Interest rate swaps	**9,527.3**	**228.8**	10,053.9	(79.3)
Forward rate agreements	**81.4**	**–**	904.0	–
Caps/floors	**147.9**	**–**	325.7	(0.1)
Exchange traded [1]				
Interest-rate futures	**3,351.5**	**na**	6,364.5	na
Interest-rate options	**28.4**	**na**	2,864.8	na
Total	**13,136.5**	**228.8**	20,512.9	(79.4)
Credit products				
OTC				
Credit default swaps	**1,561.6**	**0.7**	1,393.9	1.1
Total	**1,561.6**	**0.7**	1,393.9	1.1
Banking products				
Equity derivatives	**107.0**	**51.3**	na	na
Total	**107.0**	**51.3**	na	na
Total OTC products	**21,584.7**	**1,910.3**	22,648.1	2,051.8
Total exchange-traded products	**3,379.9**	**–**	9,229.3	–
Total equity derivatives	**107.0**	**51.3**	–	–

[1] Exchange-traded instruments are cash-settled each day and thus do not have open fair values.

Credit exposure arises when the Bank has an overall positive fair value with individual counterparties. At 31 December 2005, the aggregate positive fair value amounted to €2.0 billion (2004: €2.1 billion). Against this, the Bank held collateral of €1.7 billion (2004: €1.6 billion), thereby reducing its net credit exposure to €0.3 billion (2004: €0.5 billion).

Financial risk factors

A. 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 promptly identify any changes required in the assigned risk ratings, and any actions required to mitigate this 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 once or twice a year depending on risk, or more frequently 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 equity investments, fair value. For underperforming projects, the review examines the level of impairment and corresponding specific provisions. Control of disbursement is managed by the Operation Administration Unit within the Office of the General Counsel, which is responsible for checking compliance with project conditionality prior to disbursement. The Unit also checks that correct procedures are followed in line with approved policy. The management of investments 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 (lowest 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, portfolio provisions are established according to a matrix. This is designed to approximate incurred losses calculated on the basis of objective evidence of impairment, 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 2005 € million**	Restated operating assets [1] 2004 € million	**Undrawn commitments and guarantees 2005 € million**	Undrawn commitments and guarantees 2004 € million
Albania	**121.5**	68.7	**115.3**	106.1
Armenia	**32.7**	34.7	**11.0**	4.1
Azerbaijan	**162.4**	173.5	**239.6**	67.1
Belarus	**68.9**	45.6	**21.6**	11.5
Bosnia and Herzegovina	**149.3**	125.3	**241.4**	179.2
Bulgaria	**299.8**	314.7	**360.7**	228.0
Croatia	**780.6**	729.6	**123.3**	204.7
Czech Republic	**299.6**	422.7	**52.5**	49.3
Estonia	**59.3**	251.5	**–**	4.8
FYR Macedonia	**118.8**	90.0	**138.6**	152.3
Georgia	**90.1**	55.4	**47.3**	27.3
Hungary	**581.0**	681.2	**92.3**	92.9
Kazakhstan	**632.9**	507.9	**390.5**	214.9
Kyrgyz Republic	**78.2**	58.9	**5.0**	7.2
Latvia	**60.5**	71.4	**25.3**	7.5
Lithuania	**155.4**	184.4	**43.4**	51.4
Moldova	**62.4**	72.1	**25.4**	13.0
Poland	**1,107.7**	1,214.3	**390.2**	282.9
Romania	**1,951.5**	1,125.6	**716.0**	430.0
Russian Federation	**2,662.7**	2,170.0	**1,612.0**	1,317.7
Serbia and Montenegro	**312.0**	242.0	**404.7**	348.2
Slovak Republic	**305.4**	429.3	**59.6**	52.1
Slovenia	**207.4**	183.7	**32.5**	34.5
Tajikistan	**22.9**	18.0	**19.5**	8.0
Turkmenistan	**58.9**	63.0	**33.3**	24.6
Ukraine	**579.9**	534.0	**544.7**	329.1
Uzbekistan	**146.9**	151.7	**139.7**	123.4
Regional	**889.9**	790.2	**794.0**	807.4
At 31 December	**11,998.6**	10,809.4	**6,679.4**	5,179.2

Analysis by instrument				
Loans	**7,751.4**	7,557.3	**5,371.0**	4,033.5
Share investments at fair value	**4,179.3**	3,196.1	**843.8**	651.1
Debt securities	**67.9**	56.0	**–**	–
Trade finance guarantees [2]	**–**	–	**316.9**	214.1
Other guarantees [3]	**–**	–	**147.7**	280.5
At 31 December	**11,998.6**	10,809.4	**6,679.4**	5,179.2

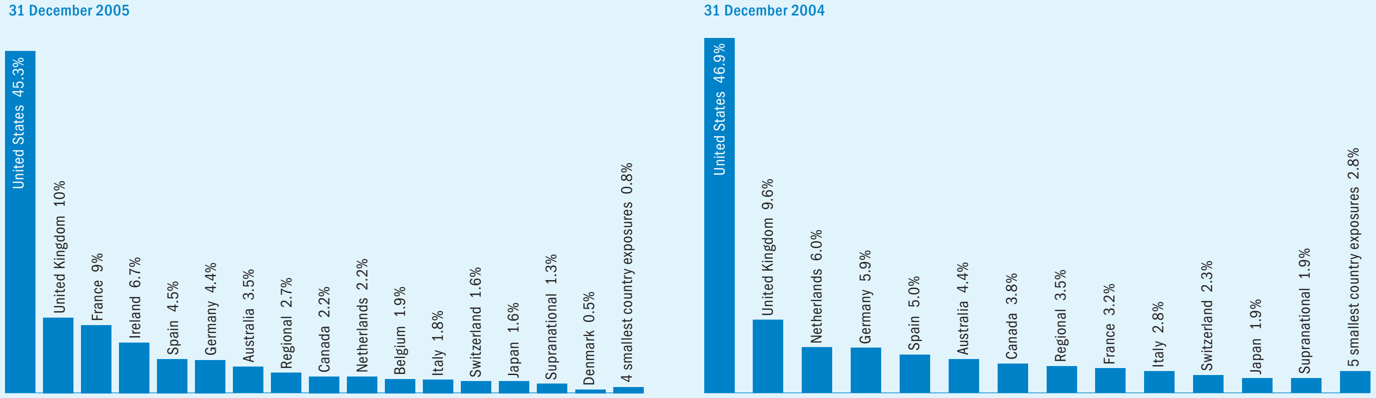
Analysis by sector				
Commerce and tourism	**383.5**	341.5	**253.5**	244.3
Community and social services	**266.2**	221.5	**153.6**	187.6
Energy/power generation	**755.2**	755.3	**1,191.6**	745.2
Extractive industries	**630.2**	562.8	**98.5**	134.2
Finance	**5,250.5**	4,332.5	**1,695.2**	1,276.4
Local authority services	**525.9**	480.0	**664.3**	629.7
Manufacturing	**1,604.7**	1,663.0	**521.5**	522.0
Primary industries	**363.2**	323.1	**205.5**	212.9
Telecommunications	**569.4**	823.2	**111.0**	67.5
Transport and construction	**1,649.8**	1,306.5	**1,784.7**	1,159.4
At 31 December	**11,998.6**	10,809.4	**6,679.4**	5,179.2

[1] 2004 operating assets excludes provisions for impairment.

[2] Trade finance guarantees represent standby letters of credit, issued in favour of confirming banks who undertake the payment risk of the issuing banks in the Bank's countries of operations.

[3] Other guarantees include unfunded full or partial risk participations.

Diversification of Treasury peak exposure by country



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 creditworthiness. This could materialise in its downgrading by a rating agency at any time until the maturity of the longest-dated transaction outstanding with that counterparty. More precisely, it can be referred to as pre-settlement risk. 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[14]) 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/region

At 31 December 2005, the portfolio's credit exposure covered 20 countries/regions. The United States (with a 45.3 per cent share against 46.9 per cent in 2004), the United Kingdom (with 10.0 per cent against 9.6 per cent in 2004) and France (with 9.0 per cent against 3.2 per cent in 2004) were the largest contributors. No other country exceeded 7 per cent of the Treasury portfolio credit exposure.

Diversification by counterparty type

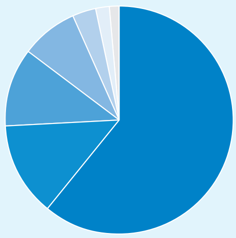
Some 61.1 per cent of the overall exposure was to banks (2004: 57.4 per cent), while the next two largest counterparty types were sovereigns at 13.1 per cent (2004: 15.8 per cent) and ABS at 11.3 per cent (2004: 8.5 per cent).

B. Market risk

Market risk is the potential loss that could result from adverse market movements. The drivers of market risk are usually 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.

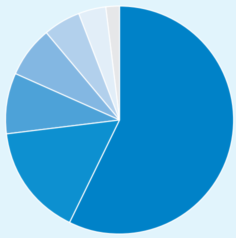
Exposure by counterparty type

31 December 2005



	%
Banks	61.1
Sovereigns	13.1
ABS	11.3
Insurance companies	7.9
Derivative product companies	3.3
Corporates	2.0
Multilateral organisations	1.3

31 December 2004



	%
Banks	57.4
Sovereigns	15.8
ABS	8.5
Insurance companies	7.2
Derivative product companies	5.3
Corporates	4.1
Multilateral organisations	1.7

The EBRD's main market risk exposure arises from the fact that the 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 hedging the interest rate profiles of assets and liabilities, mainly through the use of exchange-traded and OTC derivatives for hedging purposes. Exposures to foreign exchange 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, also known as Expected Shortfall, 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.

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 VaR[15] 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.

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 also produced on a daily 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.

[14] 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.

[15] 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.

C. Currency risk

Net currency position at 31 December 2005	Euro € million	United States dollars € million	Sterling € million	Japanese yen € million	Other currencies € million	Total € million
Assets						
Placements with and advances to credit institutions	1,254.1	2,414.0	13.4	42.9	75.7	**3,800.1**
Collateralised placements	901.2	574.1	–	–	–	**1,475.3**
Debt securities	2,982.9	3,658.1	641.1	234.8	100.5	**7,617.4**
Derivative financial instruments	67.6	(6,910.4)	2,875.5	2,512.4	3,773.1	**2,318.2**
Other assets	196.3	885.0	37.2	4.3	14.5	**1,137.3**
Loan investments	3,373.1	4,078.5	1.0	–	366.7	**7,819.3**
Provisions for impairment of loan investments and guarantees	(122.3)	(180.2)	(0.2)	–	(20.8)	**(323.5)**
Share investments	4,179.3	–	–	–	–	**4,179.3**
Intangible assets	16.2	–	–	–	–	**16.2**
Property, technology and office equipment	12.3	–	–	–	–	**12.3**
Paid-in capital receivable	168.8	125.3	–	32.5	–	**326.6**
Total assets at 31 December 2005	**13,029.5**	**4,644.4**	**3,568.0**	**2,826.9**	**4,309.7**	**28,378.5**
Liabilities and members' equity						
Amounts owed to credit institutions	(843.9)	(61.3)	(4.4)	–	(68.5)	**(978.1)**
Debts evidenced by certificates	(1,772.8)	(4,344.2)	(2,924.4)	(2,773.3)	(4,114.7)	**(15,929.4)**
Derivative financial instruments	(412.8)	698.7	(511.1)	(34.1)	(97.3)	**(356.6)**
Other liabilities	(150.1)	(914.6)	(144.1)	(19.7)	(33.1)	**(1,261.6)**
Members' equity	(9,845.4)	(6.9)	(0.3)	–	(0.2)	**(9,852.8)**
Total liabilities and members' equity at 31 December 2005	**(13,025.0)**	**(4,628.3)**	**(3,584.3)**	**(2,827.1)**	**(4,313.8)**	**(28,378.5)**
Currency position at 31 December 2005	**4.5**	**16.1**	**(16.3)**	**(0.2)**	**(4.1)**	**–**

Restated Net currency position at 31 December 2004	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	995.0	650.0	–	–	0.1	**1,645.1**
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	61.4	456.6	44.1	4.6	30.6	**597.3**
Loans	3,403.5	3,867.0	0.6	–	342.2	**7,613.3**
Provisions for impairment of loans	(204.1)	(284.0)	(0.1)	–	(19.3)	**(507.5)**
Share investments	2,651.8	–	–	–	–	**2,651.8**
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 at 31 December 2004	**9,856.2**	**2,935.0**	**3,141.2**	**3,254.3**	**2,844.9**	**22,031.6**
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	(988.7)	962.7	(299.1)	(198.2)	(46.9)	**(570.2)**
Other liabilities	(84.1)	(440.6)	(121.0)	(24.9)	(29.2)	**(699.8)**
Members' equity	(6,876.6)	(6.1)	–	–	–	**(6,882.7)**
Total liabilities and members' equity at 31 December 2004	**(9,801.9)**	**(2,982.9)**	**(3,137.4)**	**(3,252.7)**	**(2,856.7)**	**(22,031.6)**
Currency position at 31 December 2004	**54.3**	**(47.9)**	**3.8**	**1.6**	**(11.8)**	**–**

In addition to the Bank's reporting currency, the euro, currencies individually disclosed are those in which the Bank primarily raises funds (see note 17) and which expose the Bank to exchange rate risk.

D. 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 "3 months to 1 year" category.

Repricing interval at 31 December 2005	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	Non-interest-bearing funds € million	**Total € million**
Assets						
Placements with and advances to credit institutions	3,768.1	7.2	24.8	–	–	**3,800.1**
Collateralised placements	1,475.3	–	–	–	–	**1,475.3**
Debt securities	2,744.4	3,741.2	1,131.8	–	–	**7,617.4**
Derivative financial instruments	565.8	620.5	1,080.7	1.2	50.0	**2,318.2**
Other assets	108.1	38.4	978.1	–	12.7	**1,137.3**
Loan investments	1,102.0	2,851.4	3,770.0	59.6	36.3	**7,819.3**
Provisions for impairment of loan investments and guarantees	(46.5)	(119.4)	(123.9)	–	(33.7)	**(323.5)**
Share investments	–	–	–	–	4,179.3	**4,179.3**
Non interest earning assets including paid-in capital receivable	–	–	–	–	355.1	**355.1**
Total assets	**9,717.2**	**7,139.3**	**6,861.5**	**60.8**	**4,599.7**	**28,378.5**
Liabilities and members' equity						
Amounts owed to credit institutions	(944.2)	(21.5)	(12.4)	–	–	**(978.1)**
Debts evidenced by certificates	(3,938.0)	(5,884.5)	(6,106.9)	–	–	**(15,929.4)**
Derivative financial instruments	(105.3)	(147.3)	(104.0)	–	–	**(356.6)**
Other liabilities	(4.5)	(127.7)	(1,101.2)	–	(28.2)	**(1,261.6)**
Members' equity	–	–	–	–	(9,852.8)	**(9,852.8)**
Total liabilities and members' equity	**(4,992.0)**	**(6,181.0)**	**(7,324.5)**	**–**	**(9,881.0)**	**(28,378.5)**
Interest rate risk at 31 December 2005	**4,725.2**	**958.3**	**(463.0)**	**60.8**	**(5,281.3)**	**–**
Cumulative interest rate risk at 31 December 2005	**4,725.2**	**5,683.5**	**5,220.5**	**5,281.3**	**–**	**–**

Restated Repricing interval at 31 December 2004	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	Non-interest-bearing funds € million	**Total € million**
Assets						
Placements with and advances to credit institutions	680.5	4.0	–	–	–	**684.5**
Collateralised placements	635.5	1,009.6	–	–	–	**1,645.1**
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	60.0	**597.3**
Loans	1,369.7	2,927.4	3,238.4	20.9	56.9	**7,613.3**
Provisions for impairment of loans	(11.5)	(1.5)	(5.7)	–	(488.8)	**(507.5)**
Share investments	–	–	–	–	2,651.8	**2,651.8**
Non-interest-earning assets including paid-in capital receivable	–	–	–	–	599.4	**599.4**
Total assets	**5,862.6**	**8,871.3**	**4,375.8**	**42.6**	**2,879.3**	**22,031.6**
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	(150.3)	(367.2)	(52.7)	–	–	**(570.2)**
Other liabilities	(374.2)	(120.6)	(60.7)	–	(144.3)	**(699.8)**
Members' equity	–	–	–	–	(6,882.7)	**(6,882.7)**
Total liabilities and members' equity	**(3,916.6)**	**(6,054.2)**	**(5,033.8)**	**–**	**(7,027.0)**	**(22,031.6)**
Interest rate risk at 31 December 2004	**1,946.0**	**2,817.1**	**(658.0)**	**42.6**	**(4,147.7)**	**–**
Cumulative interest rate risk at 31 December 2004	**1,946.0**	**4,763.1**	**4,105.1**	**4,147.7**	**–**	**–**

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 interest rates applying at year end 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.

	2005 EUR %	**2005 US$ %**	**2005 JPY %**	**2005 GBP %**	2004 EUR %	2004 US$ %	2004 JPY %	2004 GBP %
Assets								
Placements with and advances to credit institutions	**2.39**	**4.35**	**–**	**4.75**	2.17	2.44	0.35	–
Collateralised placements	**2.86**	**4.91**	**–**	**–**	2.39	3.04	–	–
Debt securities	**2.69**	**4.87**	**0.23**	**5.67**	2.36	3.02	0.16	5.01
Loans	**4.31**	**7.14**	**–**	**6.54**	3.82	5.23	–	6.88
Liabilities								
Amounts owed to credit institutions	**(2.18)**	**(3.60)**	**–**	**(4.75)**	(2.06)	(1.47)	–	(4.82)
Debts evidenced by certificates	**(2.37)**	**(4.35)**	**0.23**	**(4.19)**	(1.93)	(2.44)	0.31	(4.53)

E. 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 plus one year's debt service. In addition, 30 per cent of the Bank's net Treasury investments must mature within one year. This policy is implemented by maintaining liquidity in an operating target zone of 90 per cent of the next three years' net cash requirements and 100 per cent of committed but undisbursed project financing, plus one year's debt service – 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. Assets held as part of Treasury's dealing portfolio are assigned a maturity of between 3 months and 1 year to reflect the typical holding pattern of assets in that portfolio.

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

Liquidity risk at 31 December 2005	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	3,768.1	–	24.8	7.2	–	–	**3,800.1**
Collateralised placements	1,475.3	–	–	–	–	–	**1,475.3**
Debt securities	16.3	75.6	946.9	2,923.9	3,654.7	–	**7,617.4**
Derivative financial instruments	111.7	155.6	272.3	376.8	1,401.8	–	**2,318.2**
Other assets	104.6	52.9	952.0	0.2	25.1	2.5	**1,137.3**
Loan investments	192.2	406.1	1,247.8	4,153.2	1,739.0	81.0	**7,819.3**
Provisions for impairment of loan investments and guarantees	(11.5)	(14.3)	(38.3)	(183.1)	(47.7)	(28.6)	**(323.5)**
Share investments	–	–	–	–	–	4,179.3	**4,179.3**
Intangible assets	–	–	–	–	–	16.2	**16.2**
Property, technology and office equipment	–	–	–	–	–	12.3	**12.3**
Paid-in capital receivable	–	–	133.2	156.5	–	36.9	**326.6**
Total assets	**5,656.7**	**675.9**	**3,538.7**	**7,434.7**	**6,772.9**	**4,299.6**	**28,378.5**
Liabilities and members' equity							
Amounts owed to credit institutions	(944.2)	(21.5)	(12.4)	–	–	–	**(978.1)**
Debts evidenced by certificates	(912.2)	(770.6)	(2,633.9)	(3,729.4)	(7,883.3)	–	**(15,929.4)**
Derivative financial instruments	(72.5)	(111.3)	(107.0)	(36.0)	(29.8)	–	**(356.6)**
Other liabilities	(9.6)	(6.0)	(1,107.2)	–	–	(138.8)	**(1,261.6)**
Members' equity	–	–	–	–	–	(9,852.8)	**(9,852.8)**
Total liabilities and members' equity	**(1,938.5)**	**(909.4)**	**(3,860.5)**	**(3,765.4)**	**(7,913.1)**	**(9,991.6)**	**(28,378.5)**
Net liquidity position at 31 December 2005	**3,718.2**	**(233.5)**	**(321.8)**	**3,669.3**	**(1,140.2)**	**(5,692.0)**	**–**
Cumulative net liquidity position at 31 December 2005	**3,718.2**	**3,484.7**	**3,162.9**	**6,832.2**	**5,692.0**	**–**	**–**

Restated Liquidity risk at 31 December 2004	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	635.5	1,009.6	–	–	–	–	**1,645.1**
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	32.8	17.7	68.9	–	**597.3**
Loans	158.8	371.4	1,155.2	4,114.4	1,742.9	70.6	**7,613.3**
Provisions for impairment of loans	(11.9)	(24.9)	(83.1)	(246.8)	(112.9)	(27.9)	**(507.5)**
Share investments	–	–	–	–	–	2,651.8	**2,651.8**
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	**2,071.4**	**1,632.6**	**2,070.2**	**7,673.5**	**5,798.3**	**2,785.6**	**22,031.6**
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	–	(160.4)	(161.2)	(167.7)	(80.9)	–	**(570.2)**
Other liabilities	(322.7)	(27.8)	(245.8)	(26.5)	(43.8)	(33.2)	**(699.8)**
Members' equity	–	–	–	–	–	(6,882.7)	**(6,882.7)**
Total liabilities and members' equity	**(1,332.0)**	**(667.3)**	**(2,062.6)**	**(3,723.5)**	**(7,330.3)**	**(6,915.9)**	**(22,031.6)**
Net liquidity position at 31 December 2004	**739.4**	**965.3**	**7.6**	**3,950.0**	**(1,532.0)**	**(4,130.3)**	**–**
Cumulative net liquidity position at 31 December 2004	**739.4**	**1,704.7**	**1,712.3**	**5,662.3**	**4,130.3**	**–**	**–**

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 2005, the fair value of these loans was €25.6 million above the current balance sheet value (2004: €29.8 million).

Notes to the financial statements

1. Establishment of the Bank

i Agreement Establishing the Bank

The European Bank for Reconstruction and Development ("the Bank"), whose principal office is located in London, is an international organisation formed under the Agreement Establishing the Bank dated 29 May 1990 ("the Agreement"). At 31 December 2005, 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 2005 € million	Treasury 2005 € million	Aggregated 2005 € million	Restated Banking 2004 € million	Restated Treasury 2004 € million	Restated Aggregated 2004 € million
Interest income	**416.9**	**352.7**	**769.6**	310.3	215.6	525.9
Other income	**1,158.3**	**9.3**	**1,167.6**	305.5	24.0	329.5
Fair value movement on paid-in capital receivable and associated hedges [1]	**9.5**	**1.1**	**10.6**	19.2	2.1	21.3
Total segment revenue	**1,584.7**	**363.1**	**1,947.8**	635.0	241.7	876.7
Less interest expenses and similar charges [2]	**(258.7)**	**(303.7)**	**(562.4)**	(172.4)	(162.1)	(334.5)
Allocation of the return on capital [1, 2]	**137.2**	**15.2**	**152.4**	100.4	11.2	111.6
Fair value movement on non-qualifying hedges	**–**	**6.1**	**6.1**	–	4.8	4.8
Less general administrative expenses	**(184.5)**	**(17.3)**	**(201.8)**	(158.4)	(15.0)	(173.4)
Less depreciation and amortisation	**(16.2)**	**(0.9)**	**(17.1)**	(15.5)	(0.9)	(16.4)
Segment result before provisions	**1,262.5**	**62.5**	**1,325.0**	389.1	79.7	468.8
Provisions for impairment of loan investments and guarantees	**200.6**	**–**	**200.6**	(67.2)	–	(67.2)
Net profit for the year	**1,463.1**	**62.5**	**1,525.6**	321.9	79.7	401.6
Segment assets	**11,878.5**	**16,173.4**	**28,051.9**	9,905.0	11,558.9	21,463.9
Paid-in capital receivable			**326.6**			567.7
Total assets			**28,378.5**			22,031.6
Segment liabilities						
Total liabilities	**146.0**	**18,379.7**	**18,525.7**	136.0	15,012.9	15,148.9
Capital expenditure	**13.2**	**0.8**	**14.0**	10.0	0.6	10.6

1 Unwinding of interest income from the present value adjustment of paid-in capital receivable and the allocation of the return on capital total €163.0 million (2004: €132.9 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 €410.0 million (2004: €222.9 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 2005 € million	Restated Segment revenue 2004 € million	Segment assets 2005 € million	Restated Segment assets 2004 € million
Advanced countries [1]	**923.0**	312.8	**4,548.4**	4,144.4
Early/Intermediate countries [2]	**333.3**	171.9	**4,749.4**	3,693.3
Russian Federation	**328.4**	150.3	**2,580.7**	2,067.3
OECD (Treasury operations)	**363.1**	241.7	**16,173.4**	11,558.9
Total	**1,947.8**	876.7	**28,051.9**	21,463.9

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:

	2005 € million	2004 € million
Cancellation fees	**5.6**	3.2
Trade finance fees	**5.2**	4.3
Appraisal fees	**3.4**	3.7
Guarantee fees	**3.1**	4.0
Other	**5.3**	9.2
Equity fund fee expenses	(**3.2**)	(6.8)
Net fee and commission income	**19.4**	17.6

Front-end and commitment fees of €38.2 million (2004: €48.0 million) received in 2005, together with related direct costs of €5.7 million (2004 restated: €5.2 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. In 2005, €12.6 million (2004 restated: €8.2 million) of previously deferred fees and direct costs were recognised in interest income.

4. Net gains from share investments at fair value through profit or loss

	2005 € million	Restated 2004 € million
Net unrealised gains from associate share investments and high-risk equity funds	**366.2**	126.0
Net realised gains from associate share investments and high-risk equity funds	**113.8**	–
Net unrealised gains from equity-related derivatives	**8.6**	–
Net gains from share investments at fair value through profit or loss	**488.6**	126.0

5. Net gains from available-for-sale share investments

	2005 € million	Restated 2004 € million
Net realised gains from available-for-sale share investments	**526.1**	122.4
Recoveries of previously recognised impairment losses [1]	**35.0**	49.6
Impairment losses from available-for-sale share investments [1]	(**8.6**)	(63.3)
Net gains from available-for-sale share investments	**552.5**	108.7

[1] The 2004 comparative recoveries of previously recognised impairment losses of €49.6 million and impairment losses from available-for-sale share investments of €63.3 million were together recorded within provisions for impairment in the 2004 income statement.

6. Net gains/(losses) from available-for-sale Treasury assets

	2005 € million	Restated 2004 € million
Realised gains from available-for-sale Treasury assets	**3.3**	2.3
Recoveries of previously recognised impairment losses	**6.7**	–
Impairment losses from available-for-sale Treasury assets [1]	**–**	(4.0)
Net gains/(losses) from available-for-sale Treasury assets	**10.0**	(1.7)

[1] The 2004 comparative impairment losses from available-for-sale Treasury assets of €4.0 million were recorded within provisions for impairment in the 2004 income statement.

Realised gains arose from the disposal of available-for-sale debt securities.

7. Net (losses)/gains from dealing activities and foreign exchange

	2005 € million	2004 € million
Debt buy-backs	**1.3**	24.9
Foreign exchange	**(0.9)**	1.0
Dealing portfolio	**(1.1)**	(0.2)
Net (losses)/gains from dealing activities and foreign exchange	**(0.7)**	25.7

Net losses on the dealing portfolio includes both realised and unrealised gains or losses, together with associated interest income and expense.

8. 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, which does not qualify for hedge accounting, 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 2005, both euro and US dollar rates rose, resulting in a net gain of €5.3 million for the year (2004: loss of €1.7 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 2005, this figure amounted to a gain of €0.8 million (2004: €6.5 million).

During the year, the fair value movement of €1.7 million (2004: €7.0 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.

9. General administrative expenses

	2005 € million	Restated 2004 € million
Personnel costs	**145.4**	118.9
Overhead expenses net of government grants	**62.1**	59.7
General administrative expenses	**207.5**	178.6
Deferral of direct costs related to loan origination and commitment maintenance	**(5.7)**	(5.2)
Net general administrative expenses	**201.8**	173.4

The increase in personnel costs in 2005 compared with 2004 largely reflects €22.9 million (£15.3 million) of one-off expenditure relating to a restructuring of the Bank's retirement plans. This included adjustments to enhance the Bank's retirement plans, reflecting the past service of personnel, and a change to the actuarial estimate of the defined benefit scheme's liabilities.

The average numbers of staff included in personnel costs during the year were: 968 headquarters staff (2004: 964), 235 locally hired staff in Resident Offices (2004: 233), 105 contract staff (comprising special contract staff, interns/short-term staff and locally hired general service contract staff), and 77 Board of Directors personnel. Some 89 staff members were externally funded.

Staff numbers at 31 December 2005 consisted of: 971 headquarters staff (comprising regular and analyst staff in Bank Departments and Board support staff) (2004: 965), 232 locally hired staff in Resident Offices (2004: 237), 111 contract staff (comprising 31 special contract staff, 58 interns/short-term staff and 22 locally hired general service contract staff), and 76 Board of Directors personnel. Some 86 staff members were externally funded. In addition, 90 Project Bureau staff (2004: 89) were engaged by the Russia Small Business Fund on projects in the Russian Federation.

During the year, government grants of €2.1 million (2004: €2.1 million) were taken to the income statement.

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

Audit and assurance services	2005 € 000	2004 € 000
Services as auditors of the bank	**275**	236
Retirement plan audit	**21**	21
Internal controls framework	**127**	158
Tax recovery audit	**7**	7
	430	422

Sterling general administrative expenses totalled £148.3 million (2004: £126.2 million).

Direct costs of €5.7 million (2004 restated: €5.2 million) relating to loan origination and commitment maintenance in 2005, together with received front-end and commitment fees of €38.2 million (2004: €48.0 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.

10. Provisions for impairment of loan investments and guarantees

(Release)/charge for the year	2005 € million	Restated 2004 € million
Portfolio provisions for the unidentified impairment of loan investments		
Non-sovereign loan investments	**(134.7)**	99.6
Sovereign loan investments	**(48.6)**	(0.7)
Guarantees	**(3.9)**	(8.3)
Specific provisions for the identified impairment of loan investments [1]	**(13.4)**	(23.4)
Provision for impairment of loan investments and guarantees [2, 3]	**(200.6)**	67.2

1 During the year new specific provisions for the identified impairment of loan investments of €22.3 million (2004: €14.7 million) were made and €35.7 million (2004: €38.1 million) were released. This resulted in a net release to the income statement of €13.4 million (2004: release of €23.4 million).

2 The 2004 comparative provision for impairment of loan investments and guarantees of €67.2 million was recorded within provisions for impairment in the 2004 income statement.

3 €186.0 million of the overall release of the provision for impairment of loan investments and guarantees in 2005 is the result of the change in provision estimate as described in the "changes in critical accounting estimates and judgements" section of the accounting policies.

Movement in provisions	2005 Loans € million	2005 Guarantees € million	2005 Total € million	2004 Loans € million	2004 Guarantees € million	2004 Total € million
At 1 January	**507.5**	**32.0**	**539.5**	465.1	40.3	505.4
(Release)/charge for the year	**(196.7)**	**(3.9)**	**(200.6)**	75.5	(8.3)	67.2
Unwinding of the discount relating to the impairment of identified assets [1]	**(0.5)**	**–**	**(0.5)**	(0.6)	–	(0.6)
Foreign exchange adjustments	**41.7**	**–**	**41.7**	(18.8)	–	(18.8)
Release against amounts written off	**(28.5)**	**–**	**(28.5)**	(13.7)	–	(13.7)
At 31 December	**323.5**	**28.1**	**351.6**	507.5	32.0	539.5

Analysed between

Portfolio provisions for the unidentified impairment of loan investments						
Non-sovereign loan investments	**275.3**	**–**	**275.3**	377.8	–	377.8
Sovereign loan investments	**14.5**	**–**	**14.5**	57.7	–	57.7
Specific provisions for the identified impairment of loan investments	**33.7**	**–**	**33.7**	72.0	–	72.0
Deducted from assets	**323.5**	**–**	**323.5**	507.5	–	507.5
Included in other liabilities	**–**	**28.1**	**28.1**	–	32.0	32.0
At 31 December	**323.5**	**28.1**	**351.6**	507.5	32.0	539.5

1 Included in interest income is €0.5 million (2004: €0.6 million) relating to the unwinding of the net present value discount.

11. Debt securities

	2005 € million	2004 € million
Available-for-sale portfolio	**6,908.0**	5,293.4
Dealing portfolio		
Internally managed funds	**144.5**	473.0
Externally managed funds	**564.9**	359.3
	709.4	832.3
At 31 December	**7,617.4**	6,125.7

12. Other assets

	2005 € million	Restated 2004 € million
Fair value of derivatives	**2,318.2**	2,622.0
Deals pending settlement	**926.7**	415.0
Interest receivable	**151.5**	117.8
Other	**59.1**	64.5
At 31 December	**3,455.5**	3,219.3

13. Loan investments

Operating assets	2005 Sovereign loans € million	2005 Non-sovereign loans € million	2005 Total loans € million	Restated 2004 Sovereign loans € million	Restated 2004 Non-sovereign loans € million	Restated 2004 Total loans € million
At 1 January	**1,891.2**	**5,722.1**	**7,613.3**	2,028.6	4,696.9	6,725.5
Movement in fair value revaluation	**(0.8)**	**(5.8)**	**(6.6)**	(1.5)	(2.4)	(3.9)
Disbursements	**379.4**	**2,629.0**	**3,008.4**	500.3	4,335.3	4,835.6
Repayments and prepayments	**(414.6)**	**(2,939.2)**	**(3,353.8)**	(526.9)	(3,122.1)	(3,649.0)
Foreign exchange movements	**186.9**	**423.7**	**610.6**	(98.9)	(147.9)	(246.8)
Movement in net deferral of front-end fees and related direct costs	**(4.9)**	**(15.0)**	**(19.9)**	(10.4)	(24.2)	(34.6)
Written off	**–**	**(32.7)**	**(32.7)**	–	(13.5)	(13.5)
At 31 December	**2,037.2**	**5,782.1**	**7,819.3**	1,891.2	5,722.1	7,613.3
Impairment at 31 December	**(14.5)**	**(309.0)**	**(323.5)**	(57.7)	(449.8)	(507.5)
Total operating assets net of impairment at 31 December	**2,022.7**	**5,473.1**	**7,495.8**	1,833.5	5,272.3	7,105.8

At 31 December 2005, the Bank categorised 11 loans as impaired, with operating assets totalling €35.0 million (2004: 17 loans totalling €85.8 million). Specific provisions on these assets amounted to €33.7 million (2004: €72.0 million). The unwinding of the net present value discount relating to provisions for the impairment of identified loans has added €0.5 million (2004: €0.6 million) of income to the income statement in the form of interest income from loans.

14. Share investments

	Fair value through profit or loss unlisted share investments € million	Fair value through profit or loss listed share investments € million	**Fair value through profit or loss total share investments € million**	Available-for-sale unlisted share investments € million	Available-for-sale listed share investments € million	**Available-for-sale total share investments € million**	**Total share investments € million**
Outstanding disbursements							
At 31 December 2003	–	–	**–**	1,747.2	566.3	**2,313.5**	**2,313.5**
Designated as fair value through profit or loss	–	114.3	**114.3**	–	(114.3)	**(114.3)**	**–**
At 1 January 2004 as restated	–	114.3	**114.3**	1,747.2	452.0	**2,199.2**	**2,313.5**
Disbursements	–	–	**–**	484.5	87.7	**572.2**	**572.2**
Disposals	–	–	**–**	(287.7)	(103.2)	**(390.9)**	**(390.9)**
Written off	–	–	**–**	(56.6)	(6.2)	**(62.8)**	**(62.8)**
At 31 December 2004 as restated	–	114.3	**114.3**	1,887.4	430.3	**2,317.7**	**2,432.0**
Designated as fair value through profit or loss	1,096.1	–	**1,096.1**	(1,096.1)	–	**(1,096.1)**	**–**
At 1 January 2005 as restated	1,096.1	114.3	**1,210.4**	791.3	430.3	**1,221.6**	**2,432.0**
Transfer between classes [1]	(9.9)	9.9	**–**	(110.1)	110.1	**–**	**–**
Disbursements	239.5	1.6	**241.1**	84.7	52.5	**137.2**	**378.3**
Disposals	(283.1)	–	**(283.1)**	(171.0)	(159.7)	**(330.7)**	**(613.8)**
Written off	(12.3)	–	**(12.3)**	(1.6)	(9.9)	**(11.5)**	**(23.8)**
At 31 December 2005	**1,030.3**	**125.8**	**1,156.1**	**593.3**	**423.3**	**1,016.6**	**2,172.7**
Fair value adjustment							
At 31 December 2003	–	–	**–**	(544.7)	249.1	**(295.6)**	**(295.6)**
Designated as fair value through profit or loss	–	(13.5)	**(13.5)**	–	13.5	**13.5**	**–**
At 1 January 2004 as restated	–	(13.5)	**(13.5)**	(544.7)	262.6	**(282.1)**	**(295.6)**
Movement in fair value	–	126.0	**126.0**	–	340.4	**340.4**	**466.4**
Movement in impairment provisions	–	–	**–**	34.3	14.7	**49.0**	**49.0**
At 31 December 2004 as restated	–	112.5	**112.5**	(510.4)	617.7	**107.3**	**219.8**
Transitional restatement of opening balance to fair value	(84.8)	–	**(84.8)**	–	–	**–**	**(84.8)**
At 1 January 2005 as restated	(84.8)	112.5	**27.7**	(510.4)	617.7	**107.3**	**135.0**
Transitional revaluation of opening balance to fair value	–	–	**–**	329.8	–	**329.8**	**329.8**
At 1 January 2005 as revalued	(84.8)	112.5	**27.7**	(180.6)	617.7	**437.1**	**464.8**
Movement in fair value revaluation	326.4	39.8	**366.2**	883.9	265.3	**1,149.2**	**1,515.4**
Impairment of available-for-sale share investments	–	–	**–**	0.5	25.9	**26.4**	**26.4**
At 31 December 2005	**241.6**	**152.3**	**393.9**	**703.8**	**908.9**	**1,612.7**	**2,006.6**
Fair value at 31 December 2005	**1,271.9**	**278.1**	**1,550.0**	**1,297.1**	**1,332.2**	**2,629.3**	**4,179.3**
Fair value at 31 December 2004	–	226.8	**226.8**	1,377.0	1,048.0	**2,425.0**	**2,651.8**

[1] This reflects unlisted share investments that became listed during 2005.

At 31 December 2005, the Bank categorised 18 available-for-sale share investments as impaired, with operating assets totalling €55.4 million (2004: 17 available-for-sale share investments totalling €126.4 million).

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 2005 and where the fair value of the Bank's total investment exceeded €40 million.

	Percentage ownership
MPF Lafarge: Romcim	38
Winterthur MPF	35
Connex	35
Dalkia Lodz Cogeneration Privatisation	35
Baring Vostok Private Equity Fund	32
Danone MPF – Danone Industria LLC	30
Polish Enterprise Fund IV	23
Privredna Banka Zagreb	21

15. Intangible assets

	2005 Computer software development costs € million	2004 Computer software development costs € million
Cost		
At 1 January	**54.9**	73.3
Additions	**8.2**	8.3
Disposals	**–**	(26.7)
At 31 December	**63.1**	54.9
Amortisation		
At 1 January	**36.8**	54.2
Charge	**10.1**	9.3
Disposals	**–**	(26.7)
At 31 December	**46.9**	36.8
Net book value at 31 December	**16.2**	18.1

16. Property, technology and office equipment

	2005 Property € million	**2005 Technology and office equipment € million**	**2005 Total € million**	2004 Property € million	2004 Technology and office equipment € million	2004 Total € million
Cost						
At 1 January	**64.7**	**32.6**	**97.3**	67.0	48.9	115.9
Additions	**3.6**	**2.1**	**5.7**	0.4	1.9	2.3
Disposals	**–**	**(0.3)**	**(0.3)**	(2.7)	(18.2)	(20.9)
At 31 December	**68.3**	**34.4**	**102.7**	64.7	32.6	97.3
Depreciation						
At 1 January	**54.2**	**29.5**	**83.7**	52.1	45.4	97.5
Charge	**4.6**	**2.4**	**7.0**	4.8	2.3	7.1
Disposals	**–**	**(0.3)**	**(0.3)**	(2.7)	(18.2)	(20.9)
At 31 December	**58.8**	**31.6**	**90.4**	54.2	29.5	83.7
Net book value at 31 December	**9.5**	**2.8**	**12.3**	10.5	3.1	13.6

17. 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 2005 € million**	Net currency obligations 2004 € million
Australian dollars	939.7	230.8	1,170.5	(1,170.5)	**–**	–
Canadian dollars	36.8	7.8	44.6	(44.6)	**–**	–
Czech koruna	138.0	(42.9)	95.1	(95.1)	**–**	–
Euro	1,615.1	181.2	1,796.3	347.1	**2,143.4**	1,420.3
Gold bullion	138.7	0.9	139.6	(139.6)	**–**	–
Hungarian forints	81.1	7.7	88.8	(85.5)	**3.3**	4.6
Japanese yen	2,691.0	(40.8)	2,650.2	(2,364.7)	**285.5**	392.5
Mexican peso	67.4	2.7	70.1	(70.1)	**–**	–
New Taiwan dollars	453.1	(0.8)	452.3	(452.3)	**–**	–
New Turkish lira	31.4	(1.6)	29.8	(29.8)	**–**	–
New Zealand dollars	576.1	8.9	585.0	(585.0)	**–**	–
Polish zloty	14.0	(0.2)	13.8	(13.8)	**–**	45.9
Slovak koruna	16.1	7.2	23.3	(23.3)	**–**	–
South African rands	1,529.6	(201.1)	1,328.5	(1,328.5)	**–**	–
Sterling	2,607.5	693.8	3,301.3	(1,467.0)	**1,834.3**	1,712.1
Russian rouble	121.9	–	121.9	–	**121.9**	–
United States dollars	3,827.8	190.5	4,018.3	7,522.7	**11,541.0**	9,390.2
At 31 December	**14,885.3**	**1,044.1**	**15,929.4**	**–**	**15,929.4**	12,965.6

During the year the Bank redeemed €54.8 million of bonds and medium-term notes prior to maturity (2004: €358.0 million), generating a net gain of €1.3 million (2004: €24.9 million).

18. Other liabilities

	2005 € million	Restated 2004 € million
Fair value of derivatives	**356.6**	570.2
Treasury deals pending settlement	**858.2**	314.7
Interest payable	**144.2**	131.8
Other	**259.2**	253.3
At 31 December	**1,618.2**	1,270.0

19. Subscribed capital

	2005 Number of shares	**2005 Total € million**	2004 Number of shares	2004 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.

The Agreement allows for a member to withdraw from the Bank, in which case the Bank is required to repurchase the former member's shares. No member has ever withdrawn its membership, nor has any indicated to the Bank that it is intending to do so. The stability in the membership reflects the fact that the members are 60 states and two inter-governmental organisations, and that the purpose of the Bank is to foster the transition process in politically qualifying countries in central and eastern Europe. Moreover, there is a financial disincentive to withdrawing membership. The upper limit of the amount of the repurchase price of the former member's shares is the amount of its paid-in capital, yet a former member remains liable for its direct obligations and its contingent liabilities to the Bank for as long as any part of the loans, equity investments or guarantees contracted before it ceased to be a member are outstanding.

Were a member to withdraw from the Bank, the Bank would be able to impose conditions and set dates in respect of payments for shares repurchased. If, for example, paying a former member would have adverse consequences for the Bank's financial position, the Bank could defer payment until the risk had passed, and indefinitely if appropriate. If a payment was then made to a former member, the member would be required to repay, on demand, the amount by which the repurchase price would have been reduced if the losses for which the former member remained liable had been taken into account at the time of payment.

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	**2005 € million**	2004 € million
Paid-in subscribed capital		
Cash and promissory note encashments not yet due	**289.7**	546.4
Cash and promissory notes due but not yet received	**24.4**	18.1
Promissory note encashments due but not yet received	**12.5**	3.2
Paid-in capital receivable at 31 December	**326.6**	567.7

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

19. Subscribed capital (continued)

Statement of capital subscriptions At 31 December 2005	Total shares (number)	Resulting votes[1] (number)	Total capital € million	Callable capital € million	Paid-in capital € million
Members					
Albania	2,000	1,539	20.0	14.8	5.2
Armenia	1,000	743	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	1,141	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	367	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	15,207	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	667	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	3,850	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	951	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	9,600	96.0	70.8	25.2
Russian Federation	80,000	77,000	800.0	590.0	210.0
Serbia and Montenegro	9,350	8,999	93.5	68.9	24.6
Slovak Republic	8,534	8,534	85.3	62.9	22.4
Slovenia	4,196	4,039	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	261	20.0	14.8	5.2
Turkey	23,000	23,000	230.0	169.6	60.4
Turkmenistan	200	139	2.0	1.5	0.5
Ukraine	16,000	13,520	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	199,645	2,000.0	1,475.0	525.0
Uzbekistan	4,200	4,147	42.0	30.9	11.1
Capital subscribed by members	**1,978,950**	**1,964,169**	**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 (2004: 1,978,950).

20. Reserves and retained earnings

	2005 € million	Restated 2004 € million
Revaluation reserve – available-for-sale assets		
At 1 January	**663.9**	291.6
Transitional restatement of opening balance for fair value of financial assets at fair value through profit or loss	**(84.8)**	13.5
At 1 January as restated	**579.1**	305.1
Transitional revaluation of opening balance for fair value of available-for-sale share investments	**329.8**	–
Transitional revaluation of opening balance for fair value of equity derivatives	**42.7**	–
At 1 January as revalued	**951.6**	305.1
Net gains from changes in fair value	**1,323.9**	523.4
Transfer to the income statement	**–**	(126.0)
Net gains transferred to net profit on disposal	**(171.8)**	(38.6)
At 31 December	**2,103.7**	663.9
Hedging reserve – cash flow hedges		
At 1 January	**(0.4)**	(9.7)
Gains from changes in fair value	**0.4**	9.3
At 31 December	**–**	(0.4)
Other		
At 1 January	**138.6**	119.1
Internal tax for the year	**4.3**	4.6
Transferred from retained earnings	**7.7**	14.9
At 31 December	**150.6**	138.6
Retained earnings		
At 1 January	**710.2**	425.7
Prior year restatement for changes in accounting policies	**–**	(77.9)
Reserve transfer for fair value movement of listed financial assets at fair value through profit or loss	**–**	(13.5)
At 1 January as restated	**710.2**	334.3
Qualifying fees and commissions from the prior year	**(13.9)**	(10.8)
Transferred to general reserve	**(7.7)**	(14.9)
Transferred to loan loss reserve	**(292.0)**	–
Net profit for the year	**1,525.6**	401.6
At 31 December	**1,922.2**	710.2
Total general reserve	**4,176.5**	1,512.3
Loan loss reserve		
At 1 January	**–**	–
Transferred from retained earnings	**292.0**	–
At 31 December	**292.0**	–
Special reserve		
At 1 January	**173.7**	162.9
Qualifying fees and commissions from the prior year	**13.9**	10.8
At 31 December	**187.6**	173.7
Total reserves and retained earnings	**4,656.1**	1,686.0

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 €57.0 million (2004: €52.7 million). The general reserve includes the effect of restating 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, €13.6 million (2004: €13.9 million) of qualifying fees and commissions recognised in the income statement will be appropriated in 2006 from the profit for 2005 and set aside to the special reserve.

In response to developments in the best practice application of incurred loss provision models on a portfolio basis, the Bank has revised its provisioning estimate for the 2005 financial year. The impact on the Bank's financial statements has been to reduce portfolio provisions for the impairment of loan investments by €186.0 million as at 31 December 2005. The Bank also created a **loan loss reserve** of €292.0 million, within members' equity, to set aside an amount of retained earnings equal to the difference between the impairment losses expected over the life of the loan portfolio and the amount recognised through the Bank's income statement.

Reserves and retained earnings	2005 € million	2004 € million
Special reserve	**187.6**	173.7
Loan loss reserve	**292.0**	–
Unrealised gains	**2,474.6**	776.0
Total restricted reserves	**2,954.2**	949.7
Unrestricted general reserves	**1,701.9**	736.3
At 31 December	**4,656.1**	1,686.0

The Bank's reserves are used in a number of prudential ratio calculations as well as in determining, in accordance with the Agreement Establishing the Bank, when distributions shall be made to its members. For the purposes of these calculations, the Bank uses unrestricted general reserves to reflect the conservative and prudent financial management practices of the Bank.

21. Operating lease commitments

The Bank leases its headquarters building in London and certain of its Resident Office buildings in countries of operations. These are standard operating leases and include renewal options, periodic escalation clauses and are mostly non-cancellable in the normal course of business without the Bank incurring substantial penalties. The most significant lease is that for the 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.

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

Payable	2005 € million	2004 € million
Not later than one year	**8.8**	1.7
Later than one year and not later than five years	**113.1**	85.1
Later than five years	**327.4**	348.9
At 31 December	**449.3**	435.7
Expenditure	**25.4**	25.5

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	2005 € million	2004 € million
Not later than one year	**0.8**	3.1
Later than one year and not later than five years	**–**	0.8
At 31 December	**0.8**	3.9
Income	**2.7**	4.4

22. 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 2005. 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:

	2005 € million	2004 € million
Fair value of plan assets	**128.2**	101.4
Present value of the defined benefit obligation	**(122.1)**	(89.6)
	6.1	11.8
Unrecognised actuarial losses [1]	**19.0**	25.3
Prepayment at 31 December	**25.1**	37.1
Movement in the prepayment (included in "other assets"):		
At 1 January	**37.1**	36.2
Exchange differences	**1.4**	–
Contributions paid	**13.4**	12.8
Total expense as below	**(26.8)**	(11.9)
At 31 December	**25.1**	37.1

[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 are a lower than expected investment return on plan assets, and a decline in the discount rate used to value the plan's liabilities.

The amounts recognised in the income statement are as follows:

	2005 € million	2004 € million
Current service cost	**(13.7)**	(12.5)
Interest cost	**(5.7)**	(4.8)
Prior service cost	**(13.6)**	–
Expected return on assets [1]	**7.6**	6.7
Amortisation of actuarial loss	**(1.4)**	(1.3)
Total included in staff costs	**(26.8)**	(11.9)

[1] The actual return on assets during the year was €21.6 million (2004: €10.3 million).

Principal actuarial assumptions used:

Discount rate	**4.75%**	5.30%
Expected return on plan assets	**6.50%**	7.00%
Future salary increases	**4.25%**	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 €13.2 million (2004: €6.1 million) and is included in "general administrative expenses".

23. Related parties

The Bank has no related parties other than key management personnel. Salaries and other short-term benefits paid to key management personnel in 2005 amounted to £5.6 million (2004: £5.2 million). Key management personnel do not receive post- employment benefits, other long-term benefits, termination benefits or share-based payments.

Key management personnel comprise the President and Vice Presidents, members of the Bank's Executive Committee, as well as Business Group Directors, Corporate Directors, the Treasurer, the Director of Risk Management, the Controller, the Director of Human Resources, the Head of Internal Audit and the Chief Compliance Officer.

24. Other fund agreements

In addition to the Bank's ordinary operations and the Special Funds programme, the Bank administers numerous bilateral and multilateral grant agreements to provide technical assistance and investment support in its 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 2005, the Bank administered 116 technical cooperation fund agreements (2004: 105) amounting to an aggregate of €862.5 million (2004: €811.5 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 2005 totalled €817.6 million. The total uncommitted balance of the funds at 31 December 2005 was €96.0 million. In addition, the Bank administered 82 project-specific technical cooperation agreements totalling €53.1 million.

For the specific purpose of co-financing EBRD projects, the Bank also administered 17 investment cooperation fund agreements totalling €116.0 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 2005, 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 2005, 24 contributors had made pledges totalling €618.1 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 2005, 16 contributors had made pledges to the Ignalina IDSF totalling €422.5 million; 11 contributors had made pledges to the Kozloduy IDSF totalling €254.9 million; and nine contributors had made pledges to the Bohunice IDSF totalling €167.4 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 2005, 11 contributors had made pledges totalling €225.3 million.

Audit fees payable to the Bank's auditors for the 2005 audits of the technical cooperation and nuclear safety funds totalled €313,000 (2004: €245,000). In addition, during 2005 the Bank's auditors, on a global basis, earned €0.2 million (2004: €0.6 million) in respect of due diligence and general business consultancy services funded by the technical cooperation funds. This represents 0.4 per cent of the total spend in 2005 (2004: 0.8 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.

25. Post-balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements. On 7 March 2006, 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 21 May 2006.

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 2005, 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 2005 audit of the Special Funds totalled €74,000 (2004: €70,000).

The objectives of the Special Funds are as follows:

- **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.
- **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.
- **Financial Intermediary Investment Special Fund**
  To support financial intermediaries in the countries of operations of the Bank.
- **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.
- **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.
- **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.
- **EBRD Technical Cooperation Special Fund**
  To serve as a facility for financing technical cooperation projects in countries of operations of the Bank.
- **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.
- **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.
- **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, as modified for the revaluation of share investments.
- **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 2005	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000
Operating profit/(loss) before provisions	1,839	16,628
Release/(charge) for provisions for impairment of loans and guarantees	12	(1,955)
Profit/(loss) for the year	**1,851**	**14,673**

Extract from the balance sheet at 31 December 2005		
Loans	–	31,443
Provisions for impairment	–	(4,450)
	–	26,993
Share investments at fair value through profit or loss	371	–
Available-for-sale share investments	5,415	767
	5,786	767
Placements and other assets	37,382	28,482
Contributions receivable	–	–
Total assets	**43,168**	**56,242**
Other liabilities and provisions for impairment and payments under guarantees	7	16,013
Contributions	41,500	59,351
Reserves and retained earnings	1,661	(19,122)
Total liabilities and contributors' resources	**43,168**	**56,242**
Undrawn commitments and guarantees	4,158	47,986

Technical Cooperation Special Funds

Extract from the statement of movement in fund balance and balance sheet for the year ended 31 December 2005	Baltic Technical Assistance Special Fund € 000
Balance of fund brought forward	1,598
Interest and other income	23
Disbursements	(252)
Other operating expenses	(4)
Balance of fund available	**1,365**
Cumulative commitments approved	23,564
Cumulative disbursements	(22,958)
Allocated fund balance	606
Unallocated fund balance	759
Balance of fund available	**1,365**

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
Austria	–	–	–	–	–
Canada	–	2,707	–	–	–
Denmark	8,940	–	–	–	–
European Community	–	–	–	–	173,000
Finland	8,629	–	–	–	–
France	–	7,686	–	–	–
Germany	–	9,843	–	–	–
Iceland	427	–	–	–	–
Italy	–	8,401	–	21,915	–
Japan	–	21,162	–	–	–
Netherlands	–	–	9,500	–	–
Norway	7,732	–	–	–	–
Sweden	15,772	–	–	–	–
Switzerland	–	2,360	–	–	–
Taipei China	–	–	20,059	–	–
United Kingdom	–	–	–	–	–
United States of America	–	7,192	1,716	–	–
Total at 31 December 2005	**41,500**	**59,351**	**31,275**	**21,915**	**173,000**

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
1,670	2,257	(18,550)	(388)	(1,226)	821	(230)	2,821
(705)	158	–	–	311	(2,550)	–	(4,729)
965	**2,415**	**(18,550)**	**(388)**	**(915)**	**(1,729)**	**(230)**	**(1,908)**
8,645	4,510	–	–	7,137	–	–	51,735
(1,573)	(1,372)	–	–	(619)	–	–	(8,014)
7,072	3,138	–	–	6,518	–	–	43,721
–	733	1,392	–	–	–	–	2,496
540	–	2,253	–	–	–	–	8,975
540	733	3,645	–	–	–	–	11,471
17,894	19,562	29,462	8,730	3,788	9,866	14,045	169,211
–	–	67,000	–	2,059	–	16,000	85,059
25,506	**23,433**	**100,107**	**8,730**	**12,365**	**9,866**	**30,045**	**309,462**
340	1,801	3,531	295	3,219	3,505	242	28,953
26,203	21,915	173,000	10,997	37,490	9,443	30,000	409,899
(1,037)	(283)	(76,424)	(2,562)	(28,344)	(3,082)	(197)	(129,390)
25,506	**23,433**	**100,107**	**8,730**	**12,365**	**9,866**	**30,045**	**309,462**
7,388	1,615	35,074	6,751	5,248	3,259	7,783	119,262

Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	Aggregated Technical Cooperation Special Funds € 000
8,357	80	10,035
1,678	1	1,702
(2,274)	(45)	(2,571)
(4)	(1)	(9)
7,757	**35**	**9,157**
72,038	1,076	96,678
(67,518)	(1,052)	(91,528)
4,520	24	5,150
3,237	11	4,007
7,757	**35**	**9,157**

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
276	–	–	–	–	–	–	276
1,472	–	–	–	–	4,309	–	8,488
750	–	–	–	1,450	–	–	11,140
–	–	–	30,000	–	–	–	203,000
–	–	–	–	1,411	–	–	10,040
–	–	–	–	–	4,980	–	12,666
58	–	2,389	–	–	3,025	–	15,315
–	–	–	–	69	–	–	496
–	–	–	–	–	1,360	–	31,676
–	–	–	–	–	3,295	–	24,457
1,160	–	–	–	–	–	–	10,660
1,568	–	–	–	1,256	–	–	10,556
–	–	–	–	2,564	–	–	18,336
4,218	–	7,054	–	–	1,244	–	14,876
1,495	–	–	–	–	–	–	21,554
–	–	–	–	–	12,824	247	13,071
–	37,490	–	–	–	29,695	–	76,093
10,997	**37,490**	**9,443**	**30,000**	**6,750**	**60,732**	**247**	**482,700**

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 the 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 has assessed its internal controls over external financial reporting for 2005. Management's assessment includes the Special Funds and other fund agreements referred to in pages 53–55 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 2005, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Report for 2005.

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 57.

Jean Lemierre
President

Steven Kaempfer
Vice President, Finance

European Bank for Reconstruction and Development
London

7 March 2006

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 2005, 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 the 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 2005, 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 Standards on Auditing, the financial statements of the Bank and, in our report dated 7 March 2006, we have expressed an unqualified opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
London

7 March 2006

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 2005 which comprise the income statement, the balance sheet, the statement of changes in members' equity, the statement of cash flows, the accounting policies, the risk management policies and the notes to the financial statements ("financial statements"). These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of the President and auditors

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

Our responsibility is to audit the financial statements in accordance with the International Standards 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 whether it is consistent with the financial statements. The other information comprises only the highlights, financial results and Summary of Special Funds. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of opinion

We conducted our audit in accordance with the International Standards on Auditing issued by the International Auditing and Assurance Standards Board. 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 2005 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

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

7 March 2006

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Arnhel de Serra	Niki Furniture, Bulgaria (top left)
Simon Crofts	Gostomel Glass, Ukraine (top right)
Mike Ellis	Good Food, Russia (middle)
Simon Crofts	M5 motorway, Hungary (middle right)
Vladimir Pirogov	K-Mobile, Kazakhstan (bottom left)

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