

Annual report 2003

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 2003

Financial report

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Both volumes are published in English, French, German and Russian.
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Highlights

Financial results

(€ million)	2003	2002	2001	2000	1999
Operating income ¹	557.9	471.8	501.5	519.2	376.4
Expenses and depreciation ¹	(158.0)	(177.1)	(206.7)	(192.1)	(172.8)
Operating profit before provisions	399.9	294.7	294.7	327.1	203.6
Provisions for impairment	(21.7)	(186.6)	(137.6)	(174.3)	(160.9)
Net profit for the year	378.2	108.1	157.2	152.8	42.7
Paid-in capital	5,197	5,197	5,197	5,186	5,163
Capital instalments received (cumulative)	4,626	4,350	4,063	3,769	3,480
Total provisions and reserves	2,159	1,952	1,713	1,278	1,040
Total assets	22,045	20,112	20,947	21,290	19,595

¹ During the year the EBRD deferred €45.2 million (2002: €45.2 million) of direct costs related to loan origination and commitment maintenance on the balance sheet in accordance with the International Financial Reporting Standards. These costs, together with the corresponding front-end and commitment fees, will be recorded in interest income over the period from disbursement to repayment of the related loan. Excluding the effect of these deferrals, operating income was €603.1 million (2002: €517.0 million) for the year and expenses and depreciation amounted to €203.2 million (2002: €222.3 million).

Operational results

	2003	2002	2001	2000	1999	Cumulative 1991-2003
Annual commitments 1999-2003						
Number of projects	119	102	102	95	88	1,017
EBRD financing (€ million)	3,721	3,899	3,656	2,673	2,162	22,668
Resource mobilisation (€ million)	5,307	4,862	6,212	5,188	4,862	45,822

Financial results

The EBRD recorded a net profit after provisions of €378.2 million for 2003, compared with a net profit of €108.1 million for 2002. The principal factors contributing to this increase were strong returns from the equity and Treasury portfolios, lower administrative expenses and sharply reduced provisions for impairment. The results for 2003 include a credit of €10.3 million representing the fair value movement on non-qualifying hedges¹ (2002: charge of €38.3 million) which does not reflect the underlying economic performance of the Bank. Excluding the impact of the fair value movement on non-qualifying hedges, the Bank recorded a profit after provisions of €367.9 million (2002: €146.4 million). The Bank's reserves increased from €661.1 million at the end of 2002 to €989.6 million at the end of 2003, primarily reflecting the net profit for the year.

Operating profit of €389.6 million before provisions and the fair value movement on non-qualifying hedges was 17 per cent above the €333.0 million operating profit of last year. The reduction in the value of impaired loans continued during 2003 with the repayments from several projects. At 31 December 2003, the Bank had 19 impaired loans totalling €125.2 million, compared with 23 such loans totalling €204.5 million at the end of 2002.

Successful work-outs along with a generally improved Banking portfolio performance resulted in a net credit of €34.3 million for specific provisions for the identified impairment of Banking assets during the year (2002: credit of €0.9 million). This was due to the fact that new specific provision charges of €55.4 million (2002: €65.8 million) were offset by releases of existing specific provisions totalling €89.7 million (2002: €66.7 million). Net specific provisions for the identified impairment of Treasury assets for 2003 totalled €5.2 million (2002: €83.6 million).

Banking operations achieved a net profit of €311.9 million (2002: €181.7 million) after full allocation of expenses, provisions and return on net paid-in capital. This reflected a strong performance across all revenue areas, in particular with increased returns on the equity portfolio. Net profit from the sale of share investments totalled €155.9 million in 2003 compared with €140.0 million

in 2002, reflecting several major exits during the year. Excluding the fair value movement on non-qualifying hedges, Treasury, after full allocation of expenses, provisions and return on net paid-in capital, achieved a net profit of €56.0 million (2002: net loss of €35.3 million). After the €10.3 million impact of non-qualifying hedges, Treasury's reported net profit for the year totalled €66.3 million (2002: loss of €73.6 million).

The EBRD's general administrative expenses, before the deferral of direct costs related to loan origination and commitment maintenance, were well within budget, reflecting continuing budgetary discipline and effective cost controls. General administrative expenses amounted to €203.2 million, €19.2 million lower than the 2002 figure of €222.3 million.² The weakening of sterling against the euro during the year accounted for €8.0 million of the decrease compared with 2002. In sterling terms such expenses amounted to £132.8 million compared with £142.0 million in 2002. Part of the difference was due to a £5.4 million credit in 2003 relating to the surrender of a sublease of the Bank's headquarters building at One Exchange Square, London. In addition, rent costs on the headquarters building were £2.5 million lower following the renegotiation of the head lease in June 2003.

¹ See financial statement note 5.

² Deferral of direct costs related to loan origination and commitment maintenance totalled €45.2 million during the year (2002: €45.2 million) and resulted in reported general administrative expenses for the year, including depreciation, of €158.0 million (2002: €177.1 million).

Total provisions for Banking operations amounted to €1.1 billion at the end of 2003, compared with €1.2 billion at the end of 2002. This represented 12.1 per cent of disbursed outstanding loans and share investments³ (2002: 13.3 per cent) and reflects the EBRD's commitment to provide prudently for impairment. Provisions on non-sovereign exposures represented 14.7 per cent of non-sovereign disbursed outstandings (2002: 16.6 per cent). Provisions attributable to operations in Russia accounted for 26.5 per cent of total Banking provisions (2002: 27.6 per cent). Provisions on non-sovereign exposures in Russia represented 18.7 per cent of non-sovereign disbursed outstandings in that country (2002: 20.0 per cent).

Banking operations

Annual business volume and portfolio

Annual business volume amounted to €3.7 billion representing 119 projects in 2003 (2002: €3.9 billion representing 102 projects). Share investments and equity-linked products accounted for 15 per cent of the new business volume. The private sector share of the business volume was 79 per cent. Annual business volume included €151.2 million of restructured operations.

Net cumulative business volume reached €22.7 billion by the end of 2003 (2002: €21.6 billion), representing a total project value (including co-financing) of €68.5 billion (2002: €68.7 billion). The portfolio of the Bank's net outstanding commitments grew from €14.6 billion at the end of 2002 to €14.8 billion at the end of 2003, an increase of 1 per cent.

The number of projects under development increased during 2003 following Board approval of 133 projects. These consisted of loans and share investments by the Bank totalling €4.0 billion, compared with 115 projects totalling €4.2 billion in 2002. At the end of 2003 cumulative Board approvals, net of cancellations, totalled €24.2 billion (2002: €25.4 billion).

Gross disbursements totalled €2.1 billion in 2003. Operating assets reached €9.4 billion at the end of 2003 (2002: €9.4 billion), comprising €6.8 billion of disbursed outstanding loans and €2.6 billion of disbursed outstanding share investments.

There was significant variation in the euro/United States dollar exchange rate during 2003 which moved from €/ \$ 1.05 at the start of 2003 to €/ \$ 1.26 at the end of the year. The resulting impact reduced the reported levels of annual business volume by €240 million, of gross disbursements by €150 million, operating assets by €724 million and the portfolio by €1.1 billion during the year.

Risks

Internal rating procedures

The EBRD conducts regular reviews of individual exposures within its portfolio. Generally projects are formally reviewed by Risk Management twice a year, with more frequent reviews for those that are perceived to be more vulnerable to possible default. Regular reviews continue after project completion for non-sovereign risk exposures. Each review includes a consideration of the project risk rating and, for underperforming projects, the level of impairment and corresponding specific provisions. Control of disbursement is managed by the Operation Administration Unit within Finance, which is responsible for checking compliance with project conditionality prior to disbursement. It also ascertains that correct procedures are followed in line with approved policy. Investments that are in jeopardy are transferred to the Corporate Recovery Unit, which reports jointly to Risk Management and Banking, to manage the restructuring work-out process.

³ Fair value adjustments for loans and share investments are excluded from provisioning percentage calculations.

All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (low risk) to 10 (highest risk). The Bank maintains three types of risk ratings: project, country and overall. The project rating is determined from the financial strength of the client and the risk mitigation built into the project structure. The country rating is assessed internally taking into consideration the ratings assigned by external rating agencies.

For non-sovereign operations, the overall rating is usually the lower 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 designed to approximate losses calculated on the basis of external indicators of loss, EBRD experience, and project, sector and country risks.

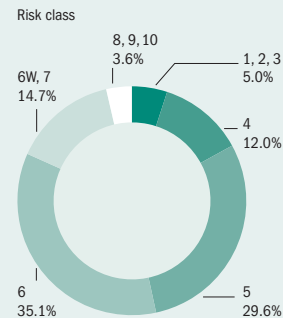
In view of the markets in which it operates and its transition mandate, the EBRD expects the majority of its project ratings in normal circumstances to range from risk categories 4 to 6 (approximately equivalent to Standard & Poor's BBB to B ratings) at the time of approval. At end 2003, 77 per cent of the loan and equity portfolio was in risk ratings 4 to 6, as illustrated in the chart on the right.

The EBRD's portfolio continued to show improvement in 2003, driven by an improving economic performance in Russia in particular, allied with a generally resilient economic performance across the region. This trend led to the upgrading of countries of operations' credit ratings by both the independent rating agencies and the Bank's own internal rating process. The reduction of the classified portfolio (loans and equity investments in the risk rating categories 7 to 10), which grew rapidly after the 1998 Russian crisis continued, and for the third consecutive year there was a significant decline in the level of impaired assets. The value of impaired loans fell from €204.5 million to €125.2 million during the year. There was also a decrease in the level of impaired equity from €414.7 million to €366.2 million.

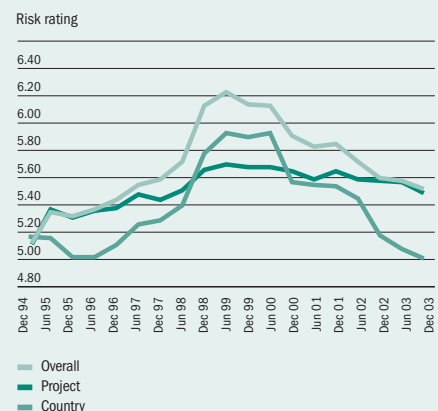
The percentage of the portfolio rated 4, 5 or 6 rose to 77 per cent from 75 per cent a year earlier. The proportion of the portfolio in the weaker performance categories of 6W to 10 fell from 20 per cent to 18 per cent.

Credit quality of the Banking portfolio

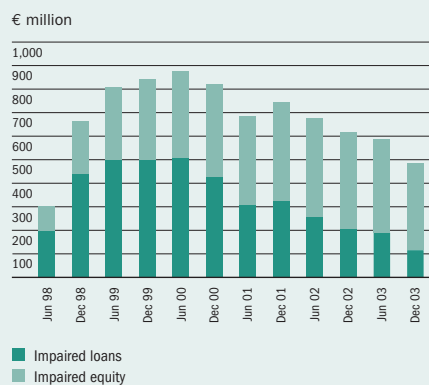
31 December 2003



Facility, overall and country weighted average risk ratings



Impaired assets



Impaired assets

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

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

The Bank's impaired assets peaked in mid-2000, largely reflecting the after-effects of the Russian crisis of 1998. Since then, through the improvements in, or successful restructuring of, some projects and some write-offs, the level of impaired assets has declined to a level of 5.4 per cent of operating assets at 31 December 2003, compared with 6.8 per cent as at 31 December 2002. Net write-offs (after recoveries from previously written-off projects) were €62.6 million for 2003 (2002: €44.6 million), bringing the cumulative total of net write-offs since the Bank's inception to €364.2 million.

Financial performance

Banking operations recorded a net profit (after fully allocated expenses, provisions and the allocation of the return on capital) of €311.9 million for 2003 compared with a net profit of €181.7 million on the same basis for 2002. Excluding the deferral of front-end and commitment fees, operating income of €515.7 million from the Banking business in 2003 was 6 per cent above the €488.8 million achieved in 2002. This increase was mainly attributable to an increased contribution from the equity sector of the portfolio. Dividend income amounted to €52.2 million in 2003 compared with €35.9 million in 2002, while net profit from the sale of share investments totalled €155.9 million in 2003 compared with €140.0 million in 2002. The contribution from this sector of the portfolio 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 equity exits. These are linked to the completion of the Bank's transition role in the specific operation and the opportunity, in the market or otherwise, to achieve a sale of its holding.

Treasury operations

Portfolio

The value of assets under Treasury management was €9.6 billion at 31 December 2003 (2002: €9.1 billion), comprising €6.0 billion of debt securities, €1.4 billion of collateralised placements and €2.2 billion of placements with credit institutions (including repurchase agreements).

At the end of 2003, 4 per cent of Treasury assets were managed by a total of eight external asset managers. The externally managed portfolios comprised a funded and notional amount of €186.6 million of a euro-denominated interest rate trading programme⁴ and €377.7 million of a US dollar-denominated mortgage-backed securities programme. The funds are managed by independent managers in order to obtain specialised services and investment techniques and to establish third-party performance benchmarks. These independent managers are required to comply with the same investment guidelines that the Bank applies to its internally managed funds.

Risks

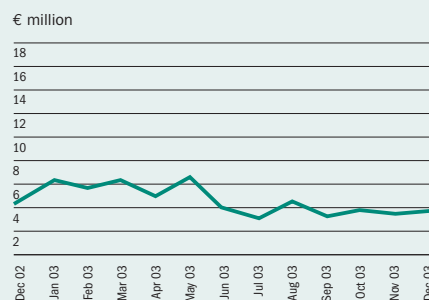
For monitoring purposes, the Bank distinguishes between market, credit and operational risks, together with liquidity and settlement risks.

Market risk

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

Total VaR – overall limit: €18 million

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



⁴ In the euro programme, managers are assigned notional amounts for interest rate positioning without being allocated the actual cash funds.

As at 31 December 2003, the aggregate Value at Risk (VaR) 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 €3.6 million⁵ (2002: €4.2 million). Its highest and lowest values over the year were €7.8 million and €2.2 million respectively.

Both month-end (see chart on page 7) and daily figures in-between denote a modest utilisation of the Board-approved total VaR limit for all Treasury funds, which amounts to €18.0 million when expressed in the same units (99 per cent confidence level, ten-trading-day horizon).

The VaR of the internally managed portfolios stood at €2.5 million at the end of 2003 (2002: €2.3 million). The range during the year was between €0.8 million and €6.4 million, a widening compared with previous years. The size of the internally managed portfolio to which these figures relate was €9.2 billion at 31 December 2003 (2002: €8.7 billion).

In addition, market risks incurred on the externally managed portfolios exhibited a year-end VaR of €0.5 million (2002: €0.8 million) for the euro-denominated programme and €0.7 million (2002: €2.7 million) for the US\$-denominated programme.⁶ The net asset value of these externally managed portfolios was respectively €9.4 million (2002: €28.2 million) and €299.4 million (2002: €352.5 million) at 31 December 2003.

The specific contribution from foreign exchange risk to the overall VaR stood at €0.03 million at year-end (2002: €0.2 million). As in previous years, this contribution was limited at all times in 2003 and never exceeded €1.8 million. Interest rate positioning thus continued to represent the majority of the Bank's market risk exposure.

Interest rate options were used more frequently than in previous years, while a limited number of long foreign exchange options positions were taken. However, options VaR⁷ stood at only €0.3 million at year-end and represented only a fraction of total VaR throughout the year.

Credit risk

Credit risk is the potential loss to a portfolio that could result from the default of a counterparty or the deterioration of its creditworthiness, such as its downgrading by a rating agency, at any time until the maturity of the longest-dated transaction outstanding with that counterparty. More precisely, it can be referred to as pre-settlement risk, as opposed to settlement risk that occurs only at the time, typically at the onset and at the maturity, when an exchange of cash or securities occurs in a transaction. As a special case, potential losses due to downgrading or, more generally, any change in the relative credit quality of securities are also often known as spread risk or credit spread risk. Also monitored is concentration risk, which is the risk arising from too high a proportion of the portfolio being allocated to a specific country, industry sector, obligor, type of instrument or individual transaction.

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

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 exposure amounts at future points in time for each counterparty (i.e. counterparty exposure profiles).

The overall credit exposure incurred by the Bank in its Treasury transactions, defined as the peak amount from the overall credit exposure profile created from the aggregation of all counterparty exposure profiles, is subject to a limit set out in the Treasury Authority. Additionally, overall credit risk limits are applied for selected sectors and product types including asset-backed securities (ABS) and credit derivatives. Large exposure limits and diversification triggers are also in place, together with the specific

⁵ This means that the Bank had a 1 per cent chance of experiencing a loss of at least €3.6 million over a horizon of ten trading days, due to adverse movements in interest rates and foreign exchange rates. The aggregate linear VaR reported here assumes that changes in the value of the Bank's portfolio are proportional to changes in the risk drivers (interest rates, foreign exchange rates). Options VaR, reported on further in the text, examines departures from linearity.

⁶ The VaR of the US\$-denominated programme is computed by an external risk-information provider.

⁷ Options VaR is computed on a portfolio comprising: a) the options (interest rate, foreign exchange) held by the Bank; and b) delta-hedges made of discount bonds and spot foreign exchange positions in relevant currencies. Its computation involves: a) a Monte Carlo simulation to generate the portfolio's P&L profile; b) a full valuation of each option and delta-hedge in the portfolio; and c) the same confidence level and trading horizon at linear VaR. By construction, Options VaR captures the non-linear aspects of the P&L of the options portfolio of the Bank. Although the delta-hedges are notional ones, in the sense that they have not been necessarily traded by Treasury in the market, the mirror images of these delta-hedges are taken into account in the computation of linear VaR, so as to render both risk measures consistent and complementary.

monitoring of the counterparties to which the Bank has its largest exposures. The Bank devotes particular attention to minimising the risks inherent in over-the-counter (OTC) derivatives and foreign exchange transactions. These require appropriate documentation to be in place prior to trading, including master agreements, unwinding upon credit downgrading clauses, unilateral break clauses for long-dated transactions and collateral agreements. Similarly, the Bank emphasises mitigation through master agreement documentation for repurchase and reverse repurchase agreements and related transaction types.

Treasury peak credit exposure at 31 December 2003 was €10.9 billion.

Although the economic and financial environment became gradually more benign, especially towards the end of the year, the quality of the Treasury credit exposure deteriorated marginally in 2003. At year-end 2003, the average credit rating weighted by peak counterparty exposure was 1.74 (on the Bank's internal rating scale, broadly equivalent to an external rating of AA+ by Standard & Poor's or Fitch Ratings and Aa1 by Moody's), compared with the 2002 year-end average rating of 1.69. Some 95.8 per cent of exposure from Treasury transactions was of investment grade quality (96.5 per cent at year-end 2002). Exposure to below investment grade risk resulted from the rating downgrades of a few ABS investments that were originally rated 1.0 (AAA/Aaa equivalent).

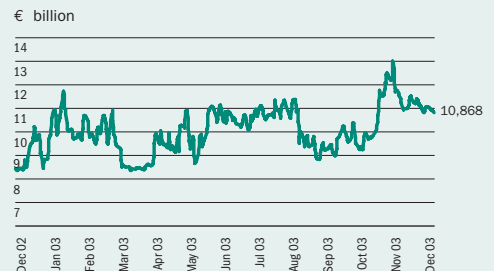
The portfolio's credit exposure covered 21 countries, with concentrations in the United States at 36.7 per cent (2002: 40.3 per cent) and Germany at 14.8 per cent (2002: 7.9 per cent). None of the exposures to other countries exceeded 10 per cent of the portfolio credit exposure.

Operational risk

Operational risk for Treasury transactions is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Liquidity risk and settlement risk also display some operational risk features.⁸

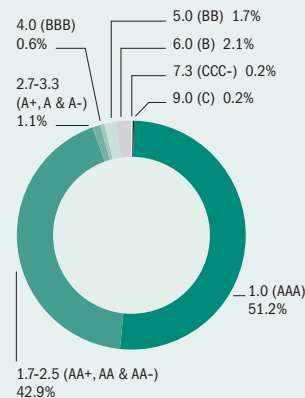
Liquidity risk is risk arising from the inability to meet short-term cash requirements, difficulties in accessing capital markets for long-term funding, or the inability to liquidate positions in a timely fashion and without adversely affecting market price. In theory, it can also materialise if surplus liquidity has to be invested at below-market rates.

Evolution of the overall Treasury credit exposure in 2003



Credit quality profile of the Treasury portfolio

31 December 2003



⁸ Settlement risk materialises upon a credit event affecting the counterparty; however, its mitigation relies heavily upon the ability to stop an outgoing payment or transfer with minimal previous notice. Liquidity risk is mainly experienced in situations of market disruption, which in turn could be caused by a failure in industry-wide payment systems.

Settlement risk is risk incurred on transactions involving payment and/or delivery of cash and/or securities by both parties to a transaction, where no settlement mechanism exists that would ensure that each transfer is conditional upon the other transfer simultaneously occurring. Risk would materialise by the counterparty defaulting precisely when a transaction is being settled, once the outgoing transfer is made and before the incoming transfer is received.

Management of operational risk in the EBRD's Treasury transactions has continued to emphasise risk monitoring and risk mitigation, pending further progress in the quantification techniques for operational risk in the industry at large.

An Operational Risk Management Group, chaired by the Vice-President, Risk Management is responsible for developing an integrated Bank-wide operational risk management framework, including responsibilities for identification, assessment, management and mitigation of the Bank's principal exposures to operational risk. Such mitigation includes segregation of duties at all stages of processing transactions, maintenance and upgrade of systems and a regular review of compliance with the Bank's policies.

Operational risk indicators were reviewed and further enhanced during the year.

Financial performance

Treasury operations, excluding the fair value movement on non-qualifying hedges, recorded an operating profit of €61.2 million for 2003 before provisions but after fully allocated expenses and the allocation of the return on capital. This compared with an operating profit of €48.3 million on the same basis for 2002. During the year net specific provisions of €5.2 million (2002: €83.6 million) were raised, giving a net profit after provisions of €56.0 million (2002: operating loss of €35.3 million). After the €10.3 million fair value movement on non-qualifying hedges, Treasury's reported profit for the year totalled €66.3 million (2002: loss of €73.6 million).

Funding

Capital

Paid-in capital totalled €5.2 billion at 31 December 2003 and at 31 December 2002, with the number of the EBRD's subscribed shares being almost 2 million. The sixth instalment of the capital increase became due in April 2003, and paid-in capital received increased to €4.6 billion, from €4.3 billion at the end of 2002. Paid-in capital receivable has been stated at its present value on the balance sheet to reflect future receipt by instalments.

Overdue capital of cash and promissory notes to be deposited totalled €16.9 million at the end of 2003 (2002: €19.4 million) and a further €4.3 million of encashments of deposited promissory notes is also overdue (2002: €4.8 million). Of the €21.2 million total overdue, €12.2 million relates to the capital increase.

Borrowings

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

Total borrowings at 31 December 2003 stood at €14.2 billion, an increase of €0.9 billion compared with 2002. There were 129 new issues under the EBRD's medium- to long-term borrowing programme at an average after-swap cost of Libor minus 41 basis points. The average remaining life of medium- to long-term debt increased slightly during the year to stand at 8.8 years at 31 December 2003 (2002: 8.7 years).

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

Expenses

Operating expenditure of £123.6 million in 2003 was £5.2 million, or 4.0 per cent, lower than in 2002. However, excluding the £5.4 million credit relating to the surrender of the sublease of the Bank's London headquarters in 2003, operating costs increased by £0.2 million, or 0.2 per cent.

Personnel costs were £2.7 million or 3.4 per cent higher than 2002. Within overhead expenses, rent costs were reduced by £2.5 million following the renegotiation of the headquarters lease in June 2003.

The Bank continues to focus on budgetary discipline, effective cost controls and a proactive cost-recovery programme. When translated into euro, the EBRD's general administrative expenses, including depreciation, were €203.2 million (2002: €222.4 million).

During the year the Bank deferred €45.2 million of direct costs related to loan origination and commitment maintenance on the balance sheet in accordance with IAS 18. These costs, together with the corresponding front-end and commitment fees, which will be recorded in interest income, will be amortised over the period from disbursement to repayment of the related loan. Therefore, the reported figure for general administration expenses and depreciation for the year was €158.0 million.

Provisions

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

The application of the EBRD's provisioning policy resulted in a charge for the year of €21.7 million compared with the 2002 charge of €186.6 million. The 2003 charge for Banking provisions of €16.5 million was split between portfolio provisions for the unidentified impairment of assets, which totalled €50.8 million compared with €103.9 million in 2002, and specific provisions for the identified impairment of assets, which were a net credit of €34.3 million in 2003 compared with a credit of €0.9 million in 2002. Lower net disbursements were the principal influence on the portfolio provisions charge. Substantial asset recoveries following the restructuring of projects, and the consequent reversal of specific provisions totalling €89.7 million, offset new specific provision charges of €55.4 million during the year. The charge in 2003 included Treasury net specific provisions of €5.2 million (2002: €83.6 million).

As a result, total provisions for Banking operations stood at €1.1 billion at the end of 2003, which amounted to 12.1 per cent of the outstanding disbursed portfolio of loans and equity investments (2002: €1.2 billion and 13.3 per cent).

Outlook for 2004

The EBRD has budgeted for a lower but solid profit in 2004. However the Bank's results remain vulnerable to continued uncertainty in the economic environment and in financial markets.

Additional reporting and disclosures

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

A separate section relating to financial risk management disclosures can be found as an integral part of the financial statements.

Operational risk

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

- *transaction risk*, which considers all types of errors in the processing of transactions, whether in the areas of execution, booking and settlement, or due to inadequate legal documentation;
- *control risk*, or breakdown in the controls surrounding trading activities, such as unidentified limit excesses, unauthorised trading or trading outside policies, or insufficient controls on the processing of transactions;
- *people risk*, or dependency on a limited number of key personnel, inadequate or insufficient staffing in trading, risk management, operations processing and reporting activities, or inadequate skill levels or training; and
- *systems risk*, defined as errors or failures in transaction support systems, ranging from errors in the mathematical formulae of pricing or hedging models or in the computation of the fair value of transactions (model risk), to inadequate disaster recovery planning.

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

These are supplemented with:

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

The Bank's Chief Compliance Officer also acts as the Bank's Anti-Money-Laundering Officer and is responsible for maintaining the Bank's policies of sound business standards and corporate practices. Anti-money-laundering reviews are conducted internally and the Bank seeks to ensure that anti-money-laundering policies and procedures are maintained by its customers, especially financial institution clients. The Bank develops, keeps under regular review and takes measures to ensure that it is not inadvertently dealing with terrorists or terrorist activities. Financial and integrity due diligence is integrated into the Bank's normal approval of new business and the review of its existing transactions. Even though the Bank is not a deposit-taking institution, it has extensive "know your customer" policies which include identification of specific integrity concerns and independent review of these risks. The Bank provides regular

corporate integrity and anti-money-laundering seminars to its staff and to external bodies to raise skill levels and to increase awareness of these concerns.

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

Corporate governance

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

The EBRD's governing constitution is the Agreement Establishing the Bank, which 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 representing the Bank's 62 shareholders. With the exception of certain reserved powers, the Board of Governors has delegated the exercise of its powers to the Board of Directors while retaining overall authority.

Board of Directors and Board Committees

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

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

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

The composition of these committees during 2003 is detailed in the separate Review section of the Annual Report.

During the year the Audit Committee further developed its activities and had regular bilateral meetings with the Bank's external auditor as well as with management, together with the external auditor as appropriate, to review financial, accounting, risk management, project evaluation, compliance, internal control and audit matters. The Committee also continued to review the Bank's quarterly and annual financial statements prior to their issue. In light of current internal and external governance developments, a Working Group was established to review and update the Audit Committee's terms of reference to ensure these continue to reflect best practice. Also, following the 2003 year-end, the Bank decided to proceed with the creation and implementation of a framework for the certification of internal controls.

The President

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

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

Reporting

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

External auditor

During 2003 the Bank completed the re-tender of its external audit mandate and PricewaterhouseCoopers LLP was appointed for the period 2003-06, succeeding Deloitte and Touche. As part of this development, the Board of Directors updated the Bank's policy regarding the independence of the external auditor. The key provisions are outlined below.

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

The external auditor is prohibited to provide non-audit related services, except pursuant to specific exemptions if judged to be in the interest of the Bank and approved by the Audit Committee, or in respect of technical cooperation consultancy services relating to client projects. However, the following categories are not permitted as exceptions: outsourced internal audit work; the implementation of major financial systems;

contracted-out accounting work; management of IT systems; provision of valuation, actuarial or legal services; or provision of management or human resources functions.

All audit and any consultancy fees (including Technical Cooperation Fund contracts) paid to the external auditor are disclosed in the notes to the Annual Financial Statements of the Bank.

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

Compensation policy

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

- to be competitive in order to attract and retain high-calibre employees;
- to take account of differing levels of responsibility;
- to be sufficiently flexible to respond rapidly to the market; and
- to motivate and encourage excellent performance.

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

The bonus programme allocations are structured to recognise individual and team contributions to the EBRD's overall performance. Bonus payments, although an important element of the total staff compensation package, are limited as a 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, whereas the Vice Presidents' remuneration is established by the Board of Directors.

Financial statements

Income statement

For the year ended 31 December 2003	Note	Year to 31 December 2003 € million	Year to 31 December 2002 € million
Interest and similar income			
From loans		297.4	356.0
From fixed-income debt securities and other interest		219.6	259.5
Interest expenses and similar charges		(199.5)	(303.1)
Net interest income		317.5	312.4
Dividend income from share investments		52.2	35.9
Net fee and commission income	3	8.9	11.2
Financial operations			
Net profit on sale of share investments		155.9	140.0
Net profit on dealing activities and foreign exchange	4	13.1	10.6
Fair value movement on non-qualifying hedges	5	10.3	(38.3)
Operating income		557.9	471.8
General administrative expenses	6	(141.8)	(158.5)
Depreciation	11	(16.2)	(18.6)
Operating profit before provisions		399.9	294.7
Provisions for impairment	7	(21.7)	(186.6)
Net profit for the year		378.2	108.1

Balance sheet

At 31 December 2003	Note	€ million	31 December 2003 € million	€ million	31 December 2002 € million
Assets					
Placements with and advances to credit institutions		2,164.8		990.2	
Collateralised placements		1,464.6		2,932.5	
Debt securities	8	5,971.1		5,197.1	
			9,600.5		9,119.8
Other assets	9		3,203.6		1,431.6
Loans and share investments					
Loans	10	6,803.4		6,823.9	
Share investments	10	2,611.2		2,619.6	
Less: Provisions for impairment	7	(1,058.4)		(1,174.0)	
			8,356.2		8,269.5
Property, technology and office equipment	11		37.5		43.6
Paid-in capital receivable	14		847.5		1,247.7
Total assets			22,045.3		20,112.2
Liabilities					
Borrowings					
Amounts owed to credit institutions		1,111.9		599.9	
Debts evidenced by certificates	12	13,111.2		12,761.8	
			14,223.1		13,361.7
Other liabilities	13		1,635.9		892.7
Total liabilities			15,859.0		14,254.4
Members' equity					
Subscribed capital	14	19,789.5		19,789.5	
Callable capital	14	(14,592.8)		(14,592.8)	
Paid-in capital	14		5,196.7		5,196.7
Reserves and profit for the year	15		989.6		661.1
Total members' equity			6,186.3		5,857.8
Total liabilities and members' equity			22,045.3		20,112.2
Memorandum items					
Undrawn commitments	16		5,664.9		5,474.0

These financial statements have been approved for issue by the Board of Directors on 2 March 2004.

Statement of changes in members' equity

For the year ended 31 December 2003	Subscribed capital Note 14 € million	Callable capital Note 14 € million	General reserve Note 15 € million	Special reserve Note 15 € million	Accumulated profit and loss reserve € million	Net profit for the year € million	Total reserves and profit for the year € million	Total members' equity € million
At 31 December 2001	19,789.5	(14,592.8)	356.2	136.6	(161.3)	157.2	488.7	5,685.4
Internal tax for the year	-	-	4.9	-	-	-	4.9	4.9
Qualifying fees and commissions from the prior year	-	-	-	21.0	(21.0)	-	-	-
Net fair value movement of available-for-sale investments for the year	-	-	62.0	-	-	-	62.0	62.0
Net fair value movement of cash flow hedges for the year	-	-	(2.6)	-	-	-	(2.6)	(2.6)
Profit from the prior year	-	-	-	-	157.2	(157.2)	-	-
Net profit for the year	-	-	-	-	-	108.1	108.1	108.1
At 31 December 2002	19,789.5	(14,592.8)	420.5	157.6	(25.1)	108.1	661.1	5,857.8
Internal tax for the year	-	-	4.4	-	-	-	4.4	4.4
Qualifying fees and commissions from the prior year	-	-	-	5.3	(5.3)	-	-	-
Net fair value movement of available-for-sale investments for the year	-	-	20.5	-	-	-	20.5	20.5
Net fair value movement of cash flow hedges for the year	-	-	(7.1)	-	-	-	(7.1)	(7.1)
Present value adjustment for paid-in capital receivable	-	-	(67.5)	-	-	-	(67.5)	(67.5)
Reserves transfer	-	-	30.2	-	(30.2)	-	-	-
Profit from the prior year	-	-	-	-	108.1	(108.1)	-	-
Net profit for the year	-	-	-	-	-	378.2	378.2	378.2
At 31 December 2003	19,789.5	(14,592.8)	401.0	162.9	47.5	378.2	989.6	6,186.3

Statement of cash flows

For the year ended 31 December 2003	€ million	Year to 31 December 2003 € million	€ million	Year to 31 December 2002 € million
Cash flows from operating activities				
Operating profit for the year	378.2		108.1	
Adjustments for:				
Unwinding of the discount relating to impaired identified assets	(2.4)		(2.2)	
Internal taxation	4.4		4.9	
Realised gains on share investments	(155.9)		(140.0)	
Unrealised (gains)/losses on dealing securities	(2.8)		1.2	
Realised losses on available-for-sale securities	0.7		4.9	
Foreign exchange losses/(gains)	1.4		(1.7)	
Profit on disposal of property, technology and office equipment	(0.1)		–	
Depreciation	16.2		18.5	
Gross provisions for losses before recoveries from assets previously written off	24.8		209.0	
Operating profit before changes in operating assets	264.5		202.7	
Increase in operating assets:				
Interest receivable and prepaid expenses	(153.5)		(64.2)	
Fair value movement	(465.9)		(243.9)	
Increase in operating liabilities:				
Interest payable and accrued expenses	431.3		2.7	
Net cash from/(used in) operating activities		76.4		(102.7)
Cash flows from investing activities				
Proceeds from sale of available-for-sale securities	2,387.8		2,647.6	
Purchases of available-for-sale securities	(3,810.6)		(1,684.2)	
Proceeds from repayments of loans	2,166.6		2,284.9	
Proceeds from prepayments of loans	185.7		198.6	
Funds advanced for loans	(3,074.9)		(3,350.2)	
Proceeds from sale of share investments	490.7		336.5	
Funds advanced for share investments	(398.0)		(383.6)	
Proceeds from sale of property, technology and office equipment	0.1		0.1	
Purchase of property, technology and office equipment	(10.1)		(17.4)	
Net placements with credit institutions	(19.3)		(171.8)	
Net cash used in investing activities		(2,082.0)		(139.5)
Cash flows from financing activities				
Capital received	333.0		254.0	
Issue of debts evidenced by certificates	6,770.5		8,751.6	
Redemption of debts evidenced by certificates	(5,951.0)		(8,510.6)	
Net cash from financing activities		1,152.5		495.0
Net (decrease)/increase in cash and cash equivalents		(853.1)		252.8
Cash and cash equivalents at beginning of year		3,298.6		3,045.8
Cash and cash equivalents at 31 December¹		2,445.5		3,298.6

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

	2003 € million	2002 € million
Placements with and advances to credit institutions	2,142.5	966.1
Collateralised placements	1,401.4	2,932.4
Amounts owed to credit institutions	(1,098.4)	(599.9)
Cash and cash equivalents at 31 December	2,445.5	3,298.6

Note: Operating profit includes dividends received of €52.2 million for the year to 31 December 2003 (31 December 2002: €35.9 million).

Accounting policies

A. Accounting convention

The financial statements have been prepared in accordance with the Bank's Accounting Policies, which comply 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 by the revaluation of available-for-sale investment securities, financial assets and financial liabilities held for trading and all derivative contracts.

B. Financial instruments

IAS 39, Financial Instruments: Recognition and Measurement became a requirement for financial reporting periods beginning on or after 1 January 2001. The standard provides guidance on the accounting treatment for financial instruments. Financial instruments are categorised into financial assets, financial liabilities and derivatives, with the latter required to be recognised on the balance sheet at fair value.

Financial assets

Dealing

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

Loans and receivables

Loans and receivables originated by the Bank are measured at amortised cost using the effective yield method less any provision for impairment or uncollectibility, unless they form part of a qualifying hedging relationship with a derivative position (see "Hedge accounting" under "Derivatives" on page 18). This occurs in cases of fixed rate loans that, through association with individual swaps, are transformed from a fixed rate basis to a floating rate basis. In such cases, the loan is re-measured to fair value in respect of interest rate risk with the change in value reported in the income statement as an offset to the change in value of the related swap. Loans are recognised at settlement date.

Available-for-sale

This category comprises assets that do not specifically belong to one of the other categories. For the Bank this comprises its share investments and the majority of its Treasury portfolio. Such assets are measured at fair value on the balance sheet. The Bank records changes in fair value through reserves, as disclosed in the

"Statement of changes in members' equity", until the financial asset is sold or until the financial asset is determined to be impaired. At this time the cumulative profit or loss previously recognised in reserves is included in the income statement.

Where an available-for-sale asset is the hedged item in a qualifying fair value hedge (see "Hedge accounting" on page 18), the fair value gain or loss attributable to the risk being hedged is reported in the income statement rather than reserves. This is to ensure there is consistency of reporting as the fair value changes on the derivative acting as the hedge must be reported in the income statement. Hedge accounting features in Treasury positions where asset swaps are used to transform the returns on fixed interest-rate securities to a floating rate basis.

Share investments

The basis of fair value for listed share investments is the quoted bid market price on the balance sheet date. The Bank's unlisted share investments are held at historic cost less any provisions for impairment at the balance sheet date, as there are no quoted market prices available in an active market and their fair value cannot currently be reliably measured. Purchases and sales of share investments are recorded at trade date. Note 10 analyses listed and unlisted share investments indicating purchases and sales.

Treasury portfolio

The fair value of available-for-sale assets in the Bank's Treasury portfolio is determined by bid quotes from third-party sources or, where there is no active market, by the use of discounted cash flow models populated with observable market data. Included in Treasury available-for-sale assets are collateralised placements, which are structures wherein the risks and rewards associated with the ownership of a reference asset are transferred to another party through the use of a swap contract and economically are a form of collateralised lending. Purchases and sales of Treasury's available-for-sale assets are recorded at trade date.

Financial liabilities

Liabilities held for dealing

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

All other financial liabilities

With the exception of liabilities held for dealing, all other financial liabilities are measured at amortised cost, unless they form part of a qualifying hedge relationship with a derivative position (see "Hedge accounting" on page 18).

Derivatives

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

Hedge accounting

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

Fair value hedges

The Bank's hedging activities are primarily designed to mitigate interest rate risk by using swaps to convert fixed interest rate risk, on both assets and liabilities, into floating rate risk. Such hedges are known as "fair value" hedges. IAS 39 requires that hedge relationships must be identified to an individual asset or liability, or similar groups thereof. Hedges of net risks between assets and liabilities ("macro" hedging) do not currently qualify for hedge accounting. The Bank, in common with most financial institutions, engages in such macro hedging on grounds of cost, prudence and efficiency. However, because this type of hedging does not qualify for hedge accounting under IAS 39, the fair value changes of the hedging derivatives are immediately reflected in the income statement, while no such adjustment is made in respect of the movements in fair value of the hedged item. The fair value changes arising on the net positions hedged, which would otherwise largely offset the change in fair values of the derivatives, cannot be reported in the income statement and therefore increase volatility. However, provided the macro hedges are economically effective, the short-term gains and losses that have an impact on the income statement are reversed over time as the net income or expense on the underlying positions accrues into the income statement.

Cash flow hedges

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

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

C. Foreign currencies

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

Monetary assets and liabilities denominated in foreign currencies are translated into euro at spot rates as at 31 December 2003. Non-monetary items are expressed in euro at the exchange rates ruling at the time of the transaction. Revenue and expense items are translated into euro at the rate on the date on which they occurred.

D. Capital subscriptions

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

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

E. Associates

The Bank has considered both IAS 28 and the European Community's Council Directive on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions in relation to its share investments and avails of the provision in IAS 28 which, as the Bank does not produce consolidated financial statements, allows for investments in associates to be held at cost. In cases where the Bank holds 20 per cent or more of an investee company, the Bank does not normally seek to exert significant influence. Since the Bank does not prepare consolidated financial statements, all such equity investments are carried at cost, with disclosure in note 10 of their book value and of the income statement impact were equity accounting principles to have been applied.

F. Provisions for impairment

Where the collectability of identified loans and advances and future cash flows from identified unlisted share investments is in doubt, specific provisions for impairment are recognised in the income statement. Impairment is defined as the difference between the carrying value of the asset and the net present value of expected future cash flows determined using the instrument's original effective interest rate where applicable. If a specific provision for impairment is made for a share investment or Treasury asset, any change in fair value that had previously been recognised in reserves is taken to the income statement. The Bank's Risk Management Vice Presidency reviews assets for impairment normally every six months. Resulting adjustments include the unwinding of the discount in the income statement over the life of the asset, and any adjustments required in respect of a reassessment of the initial impairment.

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

Impairment, as determined above, is deducted from the loans, share investments and Treasury asset categories on the balance sheet. Impairment of guarantees is applied when the guarantees are effective and for trade finance is based on utilisation. The methodology is consistent to that on non-sovereign risk assets (as above) and is included in "Other liabilities".

Impairment, less any amounts reversed during the year, is charged to the income statement under the caption "Provisions for impairment", as summarised in note 7. When a loan is deemed uncollectable, or there is no possibility of recovery of a share investment, the principal is written off against the related estimated impairment. Subsequent recoveries are credited to the income statement if previously written off.

G. 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:	3 years.

H. Accounting for leases

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

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

I. 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, and are recognised as an adjustment to the effective yield, being recorded in the income statement 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 taken to income when received. Issuance fees and redemption premiums or discounts are amortised over the period to maturity of the related borrowings.

Dividends relating to share investments are recognised when received.

J. Staff retirement plan

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

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

K. 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.

L. 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".

M. Borrowing costs

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

N. Comparatives

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

Financial risk management

A. Principles of financial management and risk management

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

The EBRD's financial management aims to:

- pursue financial viability;
- build up reserves and ensure sustainable profitability;
- follow market and performance orientation in all its activities;
- work within a comprehensive risk management framework; and
- ensure transparency and accountability at all levels and support effective corporate governance.

The EBRD's financial policies define the financial and risk parameters that apply to Banking and Treasury operations. These policies include provisioning, pricing and liquidity policies as well as the Treasury Authority. The provisioning policy 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.

Pricing policies determine the considerations and parameters used to price loans, guarantees and equity investments. The liquidity policy determines the amount of liquid assets required by the Bank. The annual review in 2003 confirmed the liquidity policy adopted in 2001 and reaffirmed liquidity as central to the Bank's financial strength. Furthermore, the financial policies define capital utilisation and provide portfolio risk parameters for Banking operations, hedging policies, equity valuation, exit procedures and strategies, underwriting, risk management and corporate governance policies. These policies are reviewed regularly in light of experience and external developments.

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

A re-organisation of the Bank was approved by the Board of Directors in July 2003 and implemented in September 2003. In order to enhance corporate governance at the Bank and to comply with evolving practice in the banking industry, a clearer segregation of duties between risk takers and risk managers was implemented. A newly created Risk Management Vice Presidency now has overall responsibility for the independent identification, measurement, monitoring and mitigation of all risks incurred by the Bank in both its Banking and Treasury operations. The Vice President, Risk Management, is a member of the Bank's Executive Committee, as are the First Vice President, Banking, and the Vice President, Finance, to whom Treasury reports. The Vice President, Risk Management, has overall responsibility for the formulation of the Bank's risk management strategy regarding both Banking and Treasury functions. Risk Management seeks to ensure that any risks are correctly identified and appropriately managed and mitigated through comprehensive and rigorous processes, which reflect best industry practice.

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

Treasury risks are reviewed by the Treasury Exposure Committee, which was established as part of the internal reorganisation of the Bank during 2003 and meets monthly. The membership of the committee is: the Vice President, Finance; the Vice President, Risk Management; the Chief Economist; the General Counsel; the Business Group Director, Financial Institutions; and senior members of the Treasury and Risk Management departments. The Treasury Exposure Committee is responsible for reviewing risk management of Treasury activities. It makes assessments of Treasury and Treasury Risk Management policy proposals for approval by the Board, and reviews whether adequate procedures are in place for identifying, measuring and monitoring market and credit risks in Treasury activities. Provisions for Treasury exposures are recommended by Risk Management, assessed by the Treasury Exposure Committee and approved by the Vice Presidents of Finance and Risk Management.

B. Capital adequacy

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

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

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

In accordance with the requirements of Article 5.3 of the Agreement, the Bank completed a review of its capital stock during 2001. This second Capital Resources Review included a review of the transition impact and operational activity of the Bank, an assessment of the economic outlook and transition challenges in the region, the formulation of the medium-term portfolio development strategy and objectives, and a detailed analysis of the Bank's projected future financial performance and capital adequacy. The traditional headroom measure of capital adequacy was reviewed and further supplemented with a risk-based analysis applying the Bank's risk capital model.

Capital utilisation is reviewed annually as part of the Bank's medium-term strategy update. The 2003 update highlighted the impact of exchange rate variations on capital utilisation and confirmed that the Bank should have sufficient capital to fulfil its medium-term portfolio development objectives within the stated risk and financial assumptions. The analysis of future financial performance confirmed that the Bank was on course to implement its manageable growth strategy, with portfolio turnover and profit generating further headroom and risk-bearing capacity for the Bank, enabling it to continue to enhance its transition impact and operational activity.

C. Credit risk

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

Banking credit risk

Internal rating procedures

The EBRD conducts regular reviews of individual exposures within its portfolio. Generally projects are formally reviewed by Risk Management twice a year, with more frequent reviews for those that are perceived to be more vulnerable to possible default. Regular reviews continue after project completion for non-sovereign exposures. Each review includes a consideration of the project risk rating and, for underperforming projects, the level of impairment and corresponding specific provisions. Control of disbursement is managed by the Operation Administration Unit within Finance, which is responsible for checking compliance with project conditionality prior to disbursement. It also ascertains that correct procedures are followed in line with approved policy. Investments that are in jeopardy are transferred to the Corporate Recovery Unit, which reports jointly to Risk Management and Banking, to manage the restructuring work-out process.

All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (low risk) to 10 (highest risk). The Bank maintains three types of risk ratings: project, country and overall. The project rating is determined from the financial strength of the client 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 lower of the project and country rating. The exception to this is where the Bank has recourse to unconditional sponsor support from outside the country of operations, in which case the overall rating is the same as the project rating. For sovereign risk projects, the overall rating is the same as the country rating. For the performing portfolio, general portfolio provisions are established according to a matrix designed to approximate losses calculated on the basis of external indicators of loss, EBRD experience, and project, sector and country risks.

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

Geographic concentration of Banking operating assets

<i>Analysis by country</i>	Outstanding disbursements 2003 € million	Outstanding disbursements 2002 € million	Undrawn commitments 2003 € million	Undrawn commitments 2002 € million
Albania	38.9	32.9	93.1	88.8
Armenia	44.1	57.6	3.8	24.2
Azerbaijan	134.0	164.3	25.7	101.6
Belarus	46.8	54.8	12.0	7.6
Bosnia and Herzegovina	81.5	76.4	146.5	135.0
Bulgaria	250.4	273.7	257.6	165.3
Croatia	559.8	525.1	284.4	373.1
Czech Republic	410.8	359.3	86.7	113.8
Estonia	199.2	230.7	6.2	23.9
FYR Macedonia	71.5	73.7	121.8	71.6
Georgia	59.6	95.8	36.4	49.7
Hungary	560.0	507.4	171.4	106.1
Kazakhstan	364.5	342.8	281.8	319.6
Kyrgyz Republic	54.3	72.4	2.1	1.6
Latvia	81.7	89.1	33.1	19.7
Lithuania	179.4	186.8	52.8	67.0
Moldova	78.4	92.3	20.1	22.6
Poland	1,263.3	1,411.2	547.9	535.9
Romania	920.9	950.0	558.6	423.9
Russian Federation	1,792.0	1,898.1	1,414.9	1,107.2
Serbia and Montenegro	120.2	48.9	367.2	312.0
Slovak Republic	518.2	390.3	123.5	141.8
Slovenia	235.1	252.3	23.0	118.8
Tajikistan	10.6	9.3	12.8	19.0
Turkmenistan	71.4	82.5	26.8	54.9
Ukraine	492.9	467.7	307.9	388.8
Uzbekistan	183.6	235.5	154.7	196.4
Regional	591.5	462.6	492.1	484.1
At 31 December	9,414.6	9,443.5	5,664.9	5,474.0

Analysis by instrument

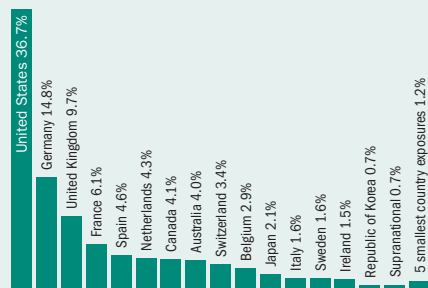
Loans	6,750.5	6,771.2	4,562.0	4,278.9
Share investments	2,611.2	2,619.6	515.3	669.4
Debt securities	52.9	52.7	–	–
Guarantees	–	–	587.6	525.7
At 31 December	9,414.6	9,443.5	5,664.9	5,474.0

Analysis by sector

Commerce and tourism	303.1	344.4	278.7	104.5
Community and social services	273.1	227.9	88.1	132.6
Energy/power generation	1,026.6	1,060.1	1,274.8	1,236.4
Extractive industries	420.3	522.8	151.7	282.7
Finance	3,549.9	3,302.3	1,488.4	1,581.5
Manufacturing	1,730.4	1,918.5	630.4	513.1
Primary industries	172.2	193.3	291.2	154.1
Telecommunications	779.5	834.3	206.6	192.9
Transport and construction	1,159.5	1,039.9	1,255.0	1,276.2
At 31 December	9,414.6	9,443.5	5,664.9	5,474.0

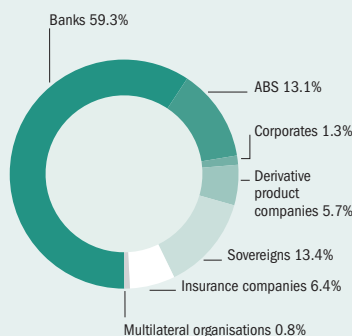
Diversification of Treasury peak exposure by country

31 December 2003



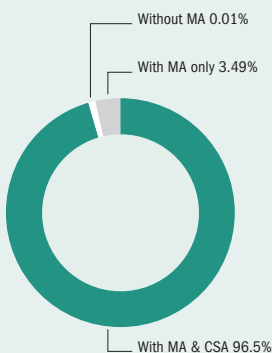
Exposure by counterparty type

31 December 2003



OTC derivatives and foreign exchange exposure

31 December 2003



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, such as its downgrading by a rating agency, at any time until the maturity of the longest-dated transaction outstanding with that counterparty. More precisely, it can be referred to as pre-settlement risk, as opposed to settlement risk that occurs only at the time, typically at the onset and at the maturity, when an exchange of cash or securities occurs in a transaction. As a special case, potential losses due to downgrading or, more generally, any change in the relative credit quality of securities are also often known as spread risk or credit spread risk. Also monitored is concentration risk, which is the risk arising from too high a proportion of the portfolio being allocated to a specific country, industry sector, obligor, type of instrument or individual transaction.

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

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 exposure amounts at future points in time for each counterparty (i.e. counterparty exposure profiles).

More than half of the overall exposure was to banks at 59.3 per cent (2002: 41.2 per cent), while exposure to ABS reduced noticeably (13.1 per cent at year-end 2003, down from 31.9 per cent at year-end 2002).

At the end of 2003, 96.5 per cent (2002: 72.1 per cent) of the Bank's credit exposure to over-the-counter (OTC) derivative and foreign exchange transactions was with counterparties with which both a Master Agreement (MA) and a Credit Support Annex (CSA) had been completed. Consequently, at year-end 2003, 97.9 per cent of overall OTC derivatives and foreign exchange exposure was via transactions with counterparties either subject to a collateral agreement or 1.0-rated (AAA/Aaa equivalent) in their own right, or, in many cases, both collateralised and 1.0-rated. This figure was 96.7 per cent at year-end 2002.

Use of derivatives

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

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

For the purpose of controlling credit risk in OTC derivative transactions, the EBRD's policy is to pre-approve each counterparty individually and to review its eligibility regularly. Individual counterparty limits are allocated in compliance with guidelines that set a maximum size and duration of exposure, based on the counterparty's internal credit rating. For those counterparties that are deemed eligible for foreign exchange and OTC derivatives, a maximum portion of the individual counterparty limit is allocated to these instruments. Utilisation of limits, whether individual counterparty limits or foreign exchange and OTC derivatives limits, is independently calculated and monitored daily for all counterparties.

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

The EBRD has continued to expand its use of collateral agreements in relation to its activity in OTC derivatives. By the end of 2003, 96.5 per cent of the Bank's gross exposure to derivatives counterparties was with counterparties with whom a collateral agreement had been completed. As a result, 97.9 per cent of the Bank's exposure to foreign exchange and OTC derivatives was either with counterparties rated triple-A in their own right, or with counterparties with whom a collateral agreement had been completed, allowing for receipt of collateral in the form of cash or triple-A rated government securities.

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

Derivative transactions

	Nominal 2003 € million	Fair value 2003 € million	Nominal 2002 € million	Fair value 2002 € million
Foreign currency products				
<i>OTC</i>				
Currency swaps	9,874.2	2,106.5	15,559.8	480.5
Forward currency transactions	1,224.7	(44.8)	1,349.8	35.5
Total	11,098.9	2,061.7	16,909.6	516.0
Interest rate products				
<i>OTC</i>				
Interest rate swaps	9,837.0	(239.5)	10,798.9	(56.3)
Forward rate agreements	3,555.4	2.1	5,450.2	2.2
Caps/floors	319.6	–	299.8	0.1
<i>Exchange traded</i>				
Interest-rate futures	5,611.6	–	4,132.5	–
Interest-rate options	151.3	–	0.6	–
Total	19,474.9	(237.4)	20,682.0	(54.0)
Other				
<i>OTC</i>				
Credit derivatives	1,977.2	(14.2)	3,824.3	53.4
Total OTC products	26,788.1	1,810.1	37,282.8	515.4
Total exchange-traded products	5,762.9	–	4,133.1	–

Credit exposure arises when the Bank has an overall positive fair value with individual counterparties. At year-end 2003, this amounted to €2,205.9 million (2002: €1,511.7 million). Against this, the Bank held collateral of €1,505.7 million (2002: €944.7 million), thereby reducing its exposure to €700.2 million (2002: €567.0 million).

D. Market risk

The EBRD's main market risk exposure arises from the fact that movement of interest rates and foreign exchange rates may adversely affect positions taken by the Bank in its Treasury portfolio. The EBRD aims to limit and manage market risks as far as possible through active asset and liability management. Interest rate risks are managed by synthetically matching the interest rate profiles of assets and liabilities, mainly through the use of exchange-traded and OTC derivatives for hedging purposes. Exposures to foreign currency and interest rate risks are measured and monitored 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 primarily on VaR, and a variety of additional risk measures. Risk Management computes VaR on a daily basis. The Bank's overall VaR limit is laid down in the Board-approved Treasury Authority. Foreign exchange transactions are further constrained by a VaR sub-limit dedicated to foreign exchange exposures. For internal monitoring purposes, VaR is defined as the potential loss that could be incurred, due to adverse fluctuations in interest rates and foreign exchange rates, over a one-day horizon and computed with a 95 per cent confidence level. For enhanced comparability across institutions, however,

VaR numbers displayed in the Annual Report are scaled up to a 99 per cent confidence level over a ten-trading-day horizon. Additional VaR measures are communicated to senior management, in particular for drilling down from aggregate VaR measures to individual market factors (marginal VaR and VaR sensitivities). Monte-Carlo simulation-based VaR numbers are also produced on a daily basis. For the entire portfolio, eVaR (expected loss beyond VaR, also known as expected shortfall) aims at quantifying the impact of large changes in market drivers. For the options portfolio, dedicated options VaR computations are performed in order to verify whether the standard assumptions that underlie VaR calculations hold true.

A number of other risk measures are employed to complement VaR data with numbers produced using a different set of assumptions, so that material risks are not ignored by focusing on one particular set of risk measures. Foreign exchange risk and the various types of interest rate risks, whether for outright exposures or for options, are monitored with sensitivity-based measures, independently for each currency and type of option. A series of stress tests is produced on an ongoing basis. These primarily encompass:

- (i) stress-testing the options portfolio for joint large changes in the level of the price of the underlying security and that of volatility;
- (ii) analysing, for each currency separately, the profit and loss impact of large deformations in the level and shape of the yield

curve; (iii) the production of stress tests based on historical scenarios; (iv) specific stress tests aimed at quantifying the impact of a breakdown in correlation patterns.

Treasury market risk

Market risk is the potential loss that could result from adverse market movements. The drivers of market risk are currently divided into: (i) interest rate risk; (ii) foreign exchange risk; (iii) equity risk; and (iv) commodity price risk. The latter two are not relevant to the Bank's Treasury operations. Interest rate risks are further broken down into yield curve risk, which measures the impact of changes in the shape of the yield curve for a given currency, and volatility risk, which deals with risks specific to interest rate option transactions. Yield curve risk can in turn be divided into changes

in the overall level of interest rates (a parallel shift of an entire yield curve) and changes in the slope or the shape of the yield curve. Similarly, foreign exchange rate risks are split into risk emanating from changes in the level of foreign exchange rates and volatility risk, which is inherent to foreign exchange options. These risks have so far been limited.

As at 31 December 2003, the aggregate VaR of the Bank's Treasury portfolio, calculated with reference to a 99 per cent confidence level and over a ten-trading-day horizon, stood at €3.6 million⁹ (2002: €4.2 million), a significant year-on-year decrease. Its highest and lowest values over the year were €7.8 million and €2.2 million respectively.

E. Currency risk

Net currency position	Euro € million	United States dollars € million	Sterling € million	Japanese Yen € million	Other currencies € million	Total € million
Assets						
Placements with and advances to credit institutions	303.5	1,744.1	68.3	27.3	21.6	2,164.8
Collateralised placements	1,040.5	217.0	–	–	207.1	1,464.6
Debt securities	2,023.9	3,250.1	416.1	251.5	29.5	5,971.1
Other assets (including fair value of derivatives)	698.3	(6,211.9)	2,696.9	2,316.5	3,703.8	3,203.6
Loans	2,947.3	3,599.7	–	3.8	252.6	6,803.4
Share investments	2,611.2	–	–	–	–	2,611.2
Provisions for impairment	(748.2)	(299.8)	–	(0.3)	(10.1)	(1,058.4)
Property, technology and office equipment	37.5	–	–	–	–	37.5
Paid-in capital receivable	465.6	292.0	–	89.9	–	847.5
Total assets	9,379.6	2,591.2	3,181.3	2,688.7	4,204.5	22,045.3
Liabilities						
Amounts owed to credit institutions	(680.6)	(130.7)	(262.9)	(0.6)	(37.1)	(1,111.9)
Debts evidenced by certificates	(1,063.2)	(2,751.8)	(2,726.3)	(2,740.1)	(3,829.8)	(13,111.2)
Other liabilities (including fair value of derivatives)	(1,554.7)	292.6	(107.3)	46.1	(312.6)	(1,635.9)
Members' equity	(6,173.4)	1.1	(13.9)	(0.1)	–	(6,186.3)
Total liabilities	(9,471.9)	(2,588.8)	(3,110.4)	(2,694.7)	(4,179.5)	(22,045.3)
Currency position at 31 December 2003	(92.3)	2.4	70.9	(6.0)	25.0	–
Currency position at 31 December 2002	(83.3)	102.9	1.8	2.2	(23.6)	–

In addition to the Bank's reporting currency, euro, currencies individually disclosed are those in which the Bank primarily raises funds (see note 12) and which expose the Bank to exchange rate risk. Amounts aggregated under "Other currencies" and which, after allowing for derivative instruments, expose the Bank to exchange rate risk, are primarily derived from the currency risks undertaken through the Bank's share investments in countries of operations where currency hedges are not readily available.

⁹ This means that the Bank had a 1 per cent chance of experiencing a loss of at least €3.6 million over a horizon of ten trading days, due to adverse movements in interest rates and foreign exchange rates. The aggregate linear VaR reported here assumes that changes in the value of the Bank's portfolio are proportional to changes in the risk drivers (interest rates, foreign exchange rates). Options VaR, reported on further in the text, examines departures from linearity.

F. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk.

The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next repricing date. Securities that comprise the Bank's dealing portfolio are assumed to reprice within the "Up to and including 1 month" category.

Repricing interval	Up to and including 1 month € million	Over 1 month and up to and including 3 months € million	Over 3 months and up to and including 1 year € million	Over 1 year and up to and including 5 years € million	Over 5 years € million	Non-interest-bearing funds € million	Total € million
Assets							
Placements with and advances to credit institutions	2,142.6	7.4	14.8	–	–	–	2,164.8
Collateralised placements	533.9	895.3	35.4	–	–	–	1,464.6
Debt securities	1,611.0	3,416.2	943.9	–	–	–	5,971.1
Other assets (including derivative positions)	561.4	383.8	2,095.0	26.0	1.8	135.6	3,203.6
Loans	1,631.0	2,246.9	2,909.5	16.0	–	–	6,803.4
Share investments	–	–	–	–	–	2,611.2	2,611.2
Provisions for impairment	–	–	–	–	–	(1,058.4)	(1,058.4)
Non-interest-earning assets including paid-in capital receivable	–	–	–	–	–	885.0	885.0
Total assets	6,479.9	6,949.6	5,998.6	42.0	1.8	2,573.4	22,045.3
Liabilities							
Amounts owed to credit institutions	(1,093.3)	(5.1)	(13.5)	–	–	–	(1,111.9)
Debts evidenced by certificates	(2,607.6)	(4,879.5)	(5,618.3)	(5.8)	–	–	(13,111.2)
Other liabilities (including derivative positions)	(469.7)	(192.3)	(695.0)	(26.9)	(6.6)	(245.4)	(1,635.9)
Members' equity	–	–	–	–	–	(6,186.3)	(6,186.3)
Total liabilities and members' equity	(4,170.6)	(5,076.9)	(6,326.8)	(32.7)	(6.6)	(6,431.7)	(22,045.3)
Interest rate risk at 31 December 2003	2,309.3	1,872.7	(328.2)	9.3	(4.8)	(3,858.3)	–
Cumulative interest rate risk at 31 December 2003	2,309.3	4,182.0	3,853.8	3,863.1	3,858.3	–	–
Cumulative interest rate risk at 31 December 2002	2,396.1	4,020.8	2,296.0	2,700.6	3,602.4	–	–

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

Effective interest rates

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

	EUR %	US\$ %	JPY %	GBP %
Assets				
Placements with and advances to credit institutions	2.10	1.10	0.42	3.84
Collateralised placements	2.48	1.43	–	–
Debt securities	2.31	1.57	0.30	4.30
Loans	4.45	2.62	2.99	–
Liabilities				
Amounts owed to credit institutions	(2.00)	(0.94)	–	(3.69)
Debts evidenced by certificates	(1.87)	(0.86)	0.33	(3.77)

G. Liquidity risk

Liquidity is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank's commitment to maintaining a strong liquidity position is embodied in policies which require a minimum target liquidity ratio, based on a multi-year context, of 45 per cent of its next three years' net cash requirements, with full coverage of all committed but undisbursed project financing, together with a requirement that 25 per cent of the Bank's net Treasury investments mature within one year. This policy is implemented by maintaining liquidity in a target zone of 90 per cent of the next three years' net requirements – above the required minimum level.

The table below provides an analysis of assets, liabilities and members' equity placed into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment patterns allow for early repayment possibilities. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date.

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

	Up to and including 1 month € 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	2,142.5	7.4	–	14.9	–	–	2,164.8
Collateralised placements	535.8	893.3	35.5	–	–	–	1,464.6
Debt securities	3,222.6	71.4	813.7	204.3	1,642.5	16.6	5,971.1
Other assets (including derivative positions)	203.3	47.7	747.1	929.2	1,273.9	2.4	3,203.6
Loans	230.2	302.9	875.3	3,726.1	1,501.9	167.0	6,803.4
Share investments	–	–	–	–	–	2,611.2	2,611.2
Provisions for impairment	(20.3)	(22.1)	(57.2)	(207.2)	(78.0)	(673.6)	(1,058.4)
Property, technology and office equipment	–	–	–	–	–	37.5	37.5
Paid-in capital subscribed, cash and promissory note encashments	–	–	252.7	541.5	32.1	–	826.3
Overdue capital	–	–	–	–	–	21.2	21.2
Total assets	6,314.1	1,300.6	2,667.1	5,208.8	4,372.4	2,182.3	22,045.3
Liabilities							
Amounts owed to credit institutions	(1,093.3)	(5.1)	(13.5)	–	–	–	(1,111.9)
Debts evidenced by certificates	(343.1)	(371.8)	(2,198.5)	(3,929.7)	(6,268.1)	–	(13,111.2)
Other liabilities (including derivative positions)	(142.6)	(26.2)	(607.3)	(426.9)	(289.7)	(143.2)	(1,635.9)
Members' equity	–	–	–	–	–	(6,186.3)	(6,186.3)
Total liabilities and members' equity	(1,579.0)	(403.1)	(2,819.3)	(4,356.6)	(6,557.8)	(6,329.5)	(22,045.3)
Net liquidity position at 31 December 2003	4,735.1	897.5	(152.2)	852.2	(2,185.4)	(4,147.2)	–
Cumulative net liquidity position at 31 December 2003	4,735.1	5,632.6	5,480.4	6,332.6	4,147.2	–	–
Cumulative net liquidity position at 31 December 2002	3,910.4	4,353.5	4,973.4	6,568.7	4,254.5	–	–

H. Fair values of financial assets and liabilities

The Bank's balance sheet approximates to fair value in all financial asset and liability categories, with the exception of Banking fixed rate loans where interest rate risk has been hedged on a portfolio basis. Such loans do not qualify for special hedge accounting treatment under IAS 39 which allows underlying changes to the fair value of assets to be recognised on the balance sheet. At 31 December 2003 the fair value of these loans was €34.1 million above the current balance sheet value (2002: €43.1 million).

Notes to the financial statements

1. Establishment of the Bank

i Agreement Establishing the Bank

The European Bank for Reconstruction and Development ("the Bank"), whose principal office is located in London, is an international organisation formed under the Agreement Establishing the Bank dated 29 May 1990 ("the Agreement"). At 31 December 2003 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 2003 € million	Treasury 2003 € million	Aggregated 2003 € million	Banking 2002 € million	Treasury 2002 € million	Aggregated 2002 € million
Interest income	297.4	193.2	490.6	356.0	259.5	615.5
Other income	217.0	13.1	230.1	187.1	10.6	197.7
Unwinding of interest income from the present value adjustment of paid-in capital receivable ¹	23.8	2.6	26.4	–	–	–
Total segment revenue	538.2	208.9	747.1	543.1	270.1	813.2
Less interest expenses and similar charges ²	(167.9)	(143.0)	(310.9)	(229.1)	(217.9)	(447.0)
Allocation of capital benefit ^{1,2}	100.2	11.2	111.4	129.5	14.4	143.9
Fair value movement on non-qualifying hedges	–	10.3	10.3	–	(38.3)	(38.3)
Less general administrative expenses	(126.8)	(15.0)	(141.8)	(141.2)	(17.3)	(158.5)
Less depreciation	(15.3)	(0.9)	(16.2)	(17.6)	(1.0)	(18.6)
Segment result before provisions	328.4	71.5	399.9	284.7	10.0	294.7
Provisions for impairment	(16.5)	(5.2)	(21.7)	(103.0)	(83.6)	(186.6)
Net profit/(loss) for the year	311.9	66.3	378.2	181.7	(73.6)	108.1
Segment assets	8,573.5	12,624.3	21,197.8	8,500.9	10,363.6	18,864.5
Paid-in capital receivable			847.5			1,247.7
Total assets			22,045.3			20,112.2
Segment liabilities						
Total liabilities	232.3	15,626.7	15,859.0	198.7	14,055.7	14,254.4
Capital expenditure	9.5	0.6	10.1	16.5	0.9	17.4

¹ Unwinding of interest income from the present value adjustment of paid-in capital receivable and allocation of capital benefit total €137.8 million (2002: €143.9 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 capital benefit total €199.5 million (2002: €303.1 million) which 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 2003 € million	Segment revenue 2002 € million	Segment assets 2003 € million	Segment assets 2002 € million
Advanced countries ¹	301.4	286.1	4,000.8	4,006.1
Early/Intermediate countries ²	222.9	166.6	2,749.6	2,881.6
Russian Federation	13.9	90.4	1,823.1	1,613.2
OECD	208.9	270.1	12,624.3	10,363.6
Total	747.1	813.2	21,197.8	18,864.5

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:

	2003 € million	2002 € million
Guarantee fees	6.5	4.0
Trade finance fees	4.2	2.8
Administration fees	2.4	1.5
Equity fund fee expenses	(7.0)	(1.4)
Other	2.8	4.3
Net fee and commission income	8.9	11.2

Front-end and commitment fees received in 2003 of €45.2 million (2002: €45.2 million), together with an equal amount of related direct costs, have been deferred on the balance sheet and will be recorded in interest income over the period from disbursement to repayment of the related loan in accordance with IAS 18.

4. Net profit on dealing activities and foreign exchange

	2003 € million	2002 € million
Available-for-sale portfolio	(0.7)	(4.8)
Dealing portfolio	15.2	13.7
Foreign exchange	(1.4)	1.7
Net profit on dealing activities and foreign exchange	13.1	10.6

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

5. Fair value movement on non-qualifying hedges

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

First, derivatives macro-hedging the Bank's fixed-rate loan book, in which the Bank exchanges the fixed rate flows on the loan assets in return for floating interest payments using swap contracts, are subject to fair value accounting while the fixed rate loan assets

being hedged are not. As the Bank is paying fixed rates of interest in these contracts, increases in the relevant interest rates, essentially US dollar and the euro, will result in fair value gains on these contracts, while the converse will happen if rates fall. While euro interest rates remained relatively unchanged from last year, US dollar interest rates rose by 0.43 per cent based on the average life of these fixed rate exposures. This generated a fair value gain of €9.0 million for the year (2002: loss of €20.8 million).

Second, the derivatives hedging the Bank's capital to be received in US dollar or Japanese yen are subject to fair value accounting while the underlying capital sums receivable are not. This difference in measurement will cause interim volatility in the income statement until the transactions settle, which in 2003 resulted in a fair value gain of €4.1 million (2002: loss of €17.5 million).

While hedge accounting treatment can be applied to the majority of the Bank's derivative positions, 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 2003 this figure amounted to a loss of €2.8 million (2002: nil).

6. General administrative expenses

	2003 € million	2002 € million
Personnel costs ¹	126.8	128.0
Overhead expenses net of government grants ^{2, 3}	60.2	75.7
General administrative expenses ⁴	187.0	203.7
Deferral of direct costs related to loan origination and commitment maintenance ⁵	(45.2)	(45.2)
Net general administrative expenses	141.8	158.5

¹ The average numbers of staff included in personnel costs during the year were: regular staff of 903 (2002: 903), contract staff of 114 (comprising analyst programme staff of 26, special contract staff of 38 and interns/short-term staff of 50), locally hired staff in Resident Offices of 229, and Board of Directors personnel of 75. Of these, 56 were externally funded.

Staff numbers at 31 December 2003 were: regular staff of 911 (2002: 893), contract staff of 105 (comprising analyst programme staff of 22, special contract staff of 38 and interns/short-term staff of 45), locally hired staff in Resident Offices of 228, and Board of Directors personnel of 75. Of these, 58 were externally funded.

In addition, 64 Project Bureau staff (2002: 137) were engaged by the Regional Venture Funds and Russia Small Business Fund on projects in the Russian Federation.

² During the year, government grants of €2.1 million (2002: €2.1 million) were taken to the income statement.

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

	2003 € 000	2002 € 000
Services as auditors	231	122
Further assurance services		
Pension audit	20	11
Tax compliance	7	3
	27	14
Other non-audit services		
Consultancy services	-	1,332
Consultancy services – countries of operations	7	30
	7	1,362

At its meeting of 29 January 2003 the Board approved the appointment of PricewaterhouseCoopers LLP as the Bank's external auditor for the period 2003-06. Prior year fees for other non-audit services reflected payments to Arthur Andersen for the period from 1 January 2002 to 31 July 2002 and to Deloitte & Touche for the period from 1 August 2002 to 31 December 2002. The Bank had appointed Deloitte & Touche as auditors in succession to Arthur Andersen with effect from 1 August 2002.

⁴ Sterling general administrative expenses totalled £123.6 million (2002: £128.8 million).

⁵ Direct costs related to loan origination and commitment maintenance in 2003, together with front-end and commitment fees received, have been deferred on the balance sheet in accordance with IAS 18 and will be recorded in interest income over the period from disbursement to repayment of the related loan.

7. Provisions for impairment

Charge/(release) for the year	Loans € million	Share investments € million	Total loans and share investments € million	Guarantees € million	Treasury provisions € million	Total 2003 € million	Total 2002 € million
Portfolio provision for the unidentified impairment of assets:							
Non-sovereign risk assets	34.4	7.4	41.8	–	–	41.8	86.0
Sovereign risk assets	4.5	–	4.5	–	–	4.5	(1.4)
Guarantees	–	–	–	4.5	–	4.5	19.3
Specific provisions for the identified impairment of assets ¹	(32.1)	(2.2)	(34.3)	–	5.2	(29.1)	82.7
For the year ended 31 December 2003	6.8	5.2	12.0	4.5	5.2	21.7	
For the year ended 31 December 2002	27.5	57.5	85.0	18.0	83.6		186.6

¹ During the year new specific provisions for the identified impairment of assets of €90.1 million (2002: €149.3 million) were made and €119.2 million (2002: €66.6 million) were released, resulting in a net release to the income statement of €29.1 million (2002: net charge of €82.7 million).

Movement in provisions	Loans € million	Share investments € million	Total loans and share investments € million	Guarantees € million	Treasury impairment € million	Total 2003 € million	Total 2002 € million
At 1 January 2003	534.5	639.5	1,174.0	35.8	81.2	1,291.0	1,224.2
Charge for the year	6.8	5.2	12.0	4.5	5.2	21.7	186.6
Unwinding of the discount relating to the identified impairment of assets ¹	(1.5)	–	(1.5)	–	(0.9)	(2.4)	(2.2)
Foreign exchange adjustments	(63.3)	–	(63.3)	–	(14.6)	(77.9)	(73.0)
Release against amounts written off ²	(11.4)	(51.4)	(62.8)	–	–	(62.8)	(44.6)
At 31 December 2003	465.1	593.3	1,058.4	40.3	70.9	1,169.6	1,291.0

Analysed between

Portfolio provisions for the unidentified impairment of assets:							
Non-sovereign risk assets	291.6	327.4	619.0	–	–	619.0	609.9
Sovereign risk assets	61.5	–	61.5	–	–	61.5	64.7
Specific provisions for the identified impairment of assets	112.0	265.9	377.9	–	70.9	448.8	580.6
Deducted from assets	465.1	593.3	1,058.4	–	70.9	1,129.3	1,255.2
Included in other liabilities	–	–	–	40.3	–	40.3	35.8
At 31 December 2003	465.1	593.3	1,058.4	40.3	70.9	1,169.6	1,291.0

¹ Included in interest income is €2.4 million (2002: €2.2 million) relating to the unwinding of the net present value discount.

² Release against amounts written off is reduced by €1.3 million (2002: €22.4 million) relating to receipts from previously written-off investments which have been deducted from the charge for the year.

8. Debt securities

Analysis by issuer	Book value 2003 € million	Book value 2002 € million
Governments	229.1	296.8
Public bodies	201.5	400.1
Other borrowers	5,540.5	4,500.2
At 31 December	5,971.1	5,197.1

Analysis by portfolio

Available-for-sale portfolio	5,263.8	4,403.4
Dealing portfolio		
Internally managed funds	323.0	241.2
Externally managed funds	384.3	552.5
	707.3	793.7
At 31 December	5,971.1	5,197.1

9. Other assets

	2003 € million	2002 € million
Fair value of derivatives	2,736.1	651.8
Interest receivable	138.4	167.2
Treasury deals pending settlement	181.1	449.9
Other	148.0	162.7
At 31 December	3,203.6	1,431.6

10. Loans and share investments

Outstanding disbursements	Sovereign loans € million	Non-sovereign loans € million	Total loans € million	Unlisted share investments € million	Listed share investments € million	Total share investments € million	Total loans and share investments € million
At 1 January 2003	2,191.3	4,632.6	6,823.9	1,650.3	969.3	2,619.6	9,443.5
Movement in fair value revaluation	(3.1)	(3.4)	(6.5)	–	(20.3)	(20.3)	(26.8)
Disbursements	462.5	2,612.4	3,074.9	333.9	64.1	398.0	3,472.9
Repayments, prepayments and disposals	(345.5)	(2,006.8)	(2,352.3)	(188.0)	(146.8)	(334.8)	(2,687.1)
Foreign exchange movements	(253.1)	(470.7)	(723.8)	–	–	–	(723.8)
Written off	–	(12.8)	(12.8)	(49.0)	(2.3)	(51.3)	(64.1)
At 31 December 2003	2,052.1	4,751.3	6,803.4	1,747.2	864.0	2,611.2	9,414.6
Provisions for impairment at 31 December 2003	(61.5)	(403.6)	(465.1)	(544.7)	(48.6)	(593.3)	(1,058.4)
Total outstanding disbursements net of impairment at 31 December 2003	1,990.6	4,347.7	6,338.3	1,202.5	815.4	2,017.9	8,356.2
Total outstanding disbursements net of impairment at 31 December 2002	2,126.6	4,162.8	6,289.4	1,125.1	855.0	1,980.1	8,269.5

At 31 December 2003 the Bank categorised 19 loans as impaired, totalling €125.2 million (2002: 23 loans totalling €204.5 million). Specific provisions on these assets amounted to €112.0 million (2002: €180.0 million). The unwinding of the net present value discount relating to provisions for the impairment of identified assets has added €1.5 million of income to the income statement in interest income from loans.

Of the net profit on sale of share investments of €155.9 million (2002: €140.0 million), €77.6 million (2002: €56.4 million) relates to profit on the sale of unlisted share investments, which were held at cost of €126.8 million (2002: €121.8 million) at the time of sale, because their fair value could not previously be measured reliably.

Since the Bank has no subsidiaries it does not prepare consolidated financial statements. It accounts for all unlisted share investments at cost less provision for impairment. If the Bank were to have equity accounted for all investments in which it owns 20 per cent or more of the investee share capital – the book value of which, included in share investments in the balance sheet at 31 December 2003, was €762.9 million – the net incremental impact on the income statement would be a profit of €23.1 million (2002: €694.4 million and €46.8 million respectively). This represents the Bank's share of net profits or losses from the most recent available audited financial statements of its investee

companies. The Bank's share of retained earnings in respect of these investee companies since acquisition would be a profit of €320.5 million (2002: €371.0 million). Due to the time delay in obtaining audited financial statements that have been prepared in accordance with IFRS from all investee companies, these figures are based on profits or losses from the most recent 12-month period for which such information is available.

Listed below are all share investments where the Bank owned greater than or equal to 20 per cent of the investee share capital at 31 December 2003 and where the Bank's total investment, less specific provisions on the impairment of identified assets, exceeded €20.0 million. Significant shareholdings are normally only taken in anticipation of, wherever possible, subsequent external participation.

	% Ownership
Lafarge: Romania	38
Danone MPF – Danone Industria LLC	30
Advent Central & Eastern Europe II – Regional Fund	27
European Property Group	25
Polish Enterprise Fund IV	23
Privredna Banka	21

11. Property, technology and office equipment

	Property € million	Technology and office equipment € million	Total € million
<i>Cost</i>			
At 1 January 2003	67.5	113.0	180.5
Additions	0.1	10.0	10.1
Disposals	(0.6)	(0.8)	(1.4)
At 31 December 2003	67.0	122.2	189.2
<i>Depreciation</i>			
At 1 January 2003	45.0	91.9	136.9
Charge	7.7	8.5	16.2
Disposals	(0.6)	(0.8)	(1.4)
At 31 December 2003	52.1	99.6	151.7
<i>Net book value</i>			
At 31 December 2003	14.9	22.6	37.5
At 31 December 2002	22.5	21.1	43.6

There were no additions during the year for assets purchased under finance leases. The related minimum payments under finance leases amount to €0.2 million due within 12 months of the balance sheet date. These future payments are included in "Other liabilities".

12. 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 2003 € million	Net currency obligations 2002 € million
Australian dollars	1,354.8	(53.6)	1,301.2	(1,301.2)	-	-
Canadian dollars	36.0	0.3	36.3	(36.3)	-	-
Czech koruna	153.9	(54.6)	99.3	(99.3)	-	-
Euro	1,282.8	(226.3)	1,056.5	499.8	1,556.3	2,234.2
Gold bullion	339.0	27.0	366.0	(366.0)	-	-
Hong Kong dollars	61.4	-	61.4	(61.4)	-	-
Hungarian forints	5.4	-	5.4	-	5.4	7.1
Japanese yen	2,569.1	171.0	2,740.1	(2,168.1)	572.0	330.9
New Taiwan dollars	596.6	16.2	612.8	(612.8)	-	-
New Zealand dollars	62.1	(0.7)	61.4	(61.4)	-	-
Polish zloty	81.5	10.8	92.3	(39.1)	53.2	27.8
Russian roubles	-	-	-	-	-	5.3
Singapore dollars	70.1	0.6	70.7	(70.7)	-	-
Slovak koruna	14.8	0.9	15.7	(15.7)	-	-
South African rands	462.0	650.2	1,112.2	(1,112.2)	-	-
Sterling	2,540.7	187.3	2,728.0	(982.8)	1,745.2	1,725.1
United States dollars	2,533.6	218.3	2,751.9	6,427.2	9,179.1	8,431.4
At 31 December	12,163.8	947.4	13,111.2	-	13,111.2	12,761.8

During the year the Bank redeemed €463.0 million of bonds (2002: €247.1 million) and medium-term notes prior to maturity generating a net gain of €13.4 million (2002: €4.3 million).

13. Other liabilities

	2003 € million	2002 € million
Fair value of derivatives	926.0	136.4
Interest payable	179.3	158.4
Treasury deals pending settlement	118.7	218.5
Other	411.9	379.4
At 31 December	1,635.9	892.7

14. Subscribed capital

	2003 Number of shares	2003 Total € million	2002 Number of shares	2002 Total € million
Authorised share capital	2,000,000	20,000.0	2,000,000	20,000.0
<i>of which</i>				
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
Sub total – 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 provides that payment of the amount subscribed to the callable capital shall be 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 provides that in the event of termination of the operations of the Bank, the liability of all members for all uncalled subscriptions to the capital stock shall continue until all claims of creditors, including all contingent claims, shall have been discharged.

Under the Agreement, payment for the paid-in shares of the original capital stock subscribed to by members was made in five equal annual instalments. Of each instalment, up to 50 per cent was payable in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the subscribing member and payable

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

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

Summary of paid-in capital receivable:

	2003 € million	2002 € million
Paid-in subscribed capital:		
Cash and promissory note encashments not yet due	826.3	1,223.5
Cash and promissory notes due but not yet received	16.9	19.4
Promissory note encashments due but not yet received	4.3	4.8
Paid-in capital receivable at 31 December	847.5	1,247.7

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

14. Subscribed capital (continued)

Statement of capital subscriptions At 31 December 2003

Members	Total shares (number)	Resulting votes ¹ (number)	Total capital € million	Callable capital € million	Paid-in capital ² € million
Members of the European Union					
Austria	45,600	45,600	456.0	336.3	119.7
Belgium	45,600	45,600	456.0	336.3	119.7
Denmark	24,000	24,000	240.0	177.0	63.0
Finland	25,000	25,000	250.0	184.4	65.6
France	170,350	170,350	1,703.5	1,256.3	447.2
Germany	170,350	170,350	1,703.5	1,256.3	447.2
Greece	13,000	13,000	130.0	95.8	34.2
Ireland	6,000	6,000	60.0	44.2	15.8
Italy	170,350	170,350	1,703.5	1,256.3	447.2
Luxembourg	4,000	4,000	40.0	29.5	10.5
Netherlands	49,600	49,600	496.0	365.8	130.2
Portugal	8,400	8,400	84.0	61.9	22.1
Spain	68,000	68,000	680.0	501.5	178.5
Sweden	45,600	45,600	456.0	336.3	119.7
United Kingdom	170,350	170,350	1,703.5	1,256.3	447.2
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
Other European countries					
Cyprus	2,000	2,000	20.0	14.8	5.2
Iceland	2,000	2,000	20.0	14.8	5.2
Israel	13,000	13,000	130.0	95.8	34.2
Liechtenstein	400	400	4.0	2.9	1.1
Malta	200	200	2.0	1.5	0.5
Norway	25,000	25,000	250.0	184.4	65.6
Switzerland	45,600	45,600	456.0	336.3	119.7
Turkey	23,000	23,000	230.0	169.6	60.4
Countries of operations					
Albania	2,000	1,592	20.0	14.8	5.2
Armenia	1,000	713	10.0	7.4	2.6
Azerbaijan	2,000	1,216	20.0	14.8	5.2
Belarus	4,000	4,000	40.0	29.5	10.5
Bosnia and Herzegovina	3,380	3,380	33.8	24.9	8.9
Bulgaria	15,800	15,800	158.0	116.5	41.5
Croatia	7,292	7,292	72.9	53.8	19.1
Czech Republic	17,066	17,066	170.7	125.8	44.9
Estonia	2,000	2,000	20.0	14.8	5.2
Former Yugoslav Republic of Macedonia	1,382	1,361	13.8	10.2	3.6
Georgia	2,000	617	20.0	14.8	5.2
Hungary	15,800	15,800	158.0	116.5	41.5
Kazakhstan	4,600	4,600	46.0	33.9	12.1
Kyrgyz Republic	2,000	917	20.0	14.8	5.2
Latvia	2,000	2,000	20.0	14.8	5.2
Lithuania	2,000	2,000	20.0	14.8	5.2
Moldova	2,000	1,201	20.0	14.8	5.2
Poland	25,600	25,600	256.0	188.8	67.2
Romania	9,600	9,600	96.0	70.8	25.2
Russian Federation	80,000	80,000	800.0	590.0	210.0
Serbia and Montenegro	9,350	9,350	93.5	68.9	24.6
Slovak Republic	8,534	8,534	85.3	62.9	22.4
Slovenia	4,196	4,196	42.0	30.9	11.1
Tajikistan	2,000	511	20.0	14.8	5.2
Turkmenistan	200	165	2.0	1.5	0.5
Ukraine	16,000	13,760	160.0	118.0	42.0
Uzbekistan	4,200	4,200	42.0	30.9	11.1
Non-European countries					
Australia	20,000	20,000	200.0	147.5	52.5
Canada	68,000	68,000	680.0	501.5	178.5
Egypt	2,000	1,750	20.0	14.8	5.2
Japan	170,350	170,350	1,703.5	1,256.3	447.2
Korea, Republic of	20,000	20,000	200.0	147.5	52.5
Mexico	3,000	3,000	30.0	21.0	9.0
Mongolia	200	200	2.0	1.5	0.5
Morocco	1,000	1,000	10.0	7.0	3.0
New Zealand	1,000	1,000	10.0	7.0	3.0
United States of America	200,000	200,000	2,000.0	1,475.0	525.0
Capital subscribed by members	1,978,950	1,970,171	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 (2002: 1,978,950).

² Of paid-in capital, €4.6 billion has been received (2002: €4.3 billion). Some €0.6 billion is not yet due (2002: €0.9 billion), which relates primarily to the capital increase and is payable on or before 15 April 2005.

15. Reserves and retained earnings

	2003 € million	2002 € million
General reserve		
At 1 January	152.0	147.1
Internal tax for the year	4.4	4.9
Present value adjustment for paid-in capital receivable	(67.5)	–
Transferred from retained earnings	30.2	–
At 31 December	119.1	152.0
Revaluation reserve – available-for-sale investments		
At 1 January	271.1	209.1
Net gains from changes in fair value	93.4	74.5
Net losses transferred to net profit due to impairment	13.0	14.8
Net gains transferred to net profit on disposal	(85.9)	(27.3)
At 31 December	291.6	271.1
Hedging reserve – cash flow hedges		
At 1 January	(2.6)	–
Net losses from changes in fair value	(7.1)	(2.6)
At 31 December	(9.7)	(2.6)
Special reserve		
At 1 January	157.6	136.6
Qualifying fees and commissions from the prior year	5.3	21.0
At 31 December	162.9	157.6
Total reserves	563.9	578.1
Retained earnings		
At 1 January	83.0	(4.1)
Qualifying fees and commissions from the prior year	(5.3)	(21.0)
Transferred to general reserve	(30.2)	–
Net profit for the year	378.2	108.1
At 31 December	425.7	83.0
Total reserves and retained earnings	989.6	661.1

The **general reserve** includes the retention of internal tax paid in accordance with Article 53 of the Agreement Establishing the Bank, which requires that all Directors, Alternate Directors, officers and employees of the Bank are subject to an internal tax imposed by the Bank on salaries and emoluments paid by the Bank and which is retained for its benefit. The balance at the end of the year relating to internal tax is €48.1 million (2002: €43.7 million). Included in the general reserve is an adjustment to restate the Bank's paid-in capital receivable to a present value basis. Capital receivable and reserves will be accreted back to their future value by 2009 when the final capital instalment is due. The unwinding of the balance sheet reduction will be recognised in the income statement during this period and a transfer from retained earnings to general reserves processed to reflect this.

The **special reserve** is maintained, in accordance with the Agreement, for meeting certain defined losses of the Bank.

The special reserve has been established, in accordance with the Bank's financial policies, by setting aside 100 per cent of qualifying fees and commissions received by the Bank associated with loans, guarantees and underwriting the sale of securities, until such time as the Board of Directors determines that the size of the special reserve is adequate. In accordance with the Agreement, it is intended that an amount of €10.8 million (2002: €5.3 million), being qualifying fees and commissions recognised in the income statement in the year to 31 December 2003, will be appropriated in 2004 from the profit for the year to 31 December 2003 and set aside to the special reserve.

16. Undrawn commitments

Analysis by instrument	2003 € million	2003 € million	2002 € million	2002 € million
Loans		4,562.0		4,279.0
Share investments		515.3		669.4
Guarantees				
Trade finance guarantees ¹	175.4		160.6	
Other guarantees ²	412.2		365.0	
		587.6		525.6
At 31 December		5,664.9		5,474.0

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

² Other guarantees include unfunded full or partial risk participations.

17. Average balance sheet

	2003 € million	2003 € million	2002 € million	2002 € million
Assets				
Placements with and advances to credit institutions	3,222.7		2,172.8	
Collateralised placements	2,248.5		3,044.3	
Debt securities	5,210.1		5,724.8	
		10,681.3		10,941.9
Other assets		1,367.5		614.7
Loans and share investments				
Loans	6,682.3		6,677.5	
Share investments	2,605.6		2,442.8	
Less: Impairment losses	(1,126.0)		(1,197.1)	
		8,161.9		7,923.2
Property, technology and office equipment		36.1		47.1
Paid-in capital receivable		1,036.2		1,331.3
Total assets		21,283.0		20,858.2
Liabilities				
Borrowings				
Amounts owed to credit institutions	1,106.2		1,177.6	
Debts evidenced by certificates	13,229.1		12,977.0	
		14,335.3		14,154.6
Other liabilities		1,000.8		863.3
Total liabilities		15,336.1		15,017.9
Members' equity				
Subscribed capital	19,789.5		19,789.5	
Callable capital	(14,592.8)		(14,592.8)	
Paid-in capital		5,196.7		5,196.7
Reserves and profit for the year		750.2		643.6
Total members' equity		5,946.9		5,840.3
Total liabilities and members' equity		21,283.0		20,858.2
Memorandum items				
Undrawn commitments		5,415.6		5,225.5

The average balance sheet is based on daily averaging.

18. Operating lease commitments

The Bank leases its headquarters building in London and certain of its Resident Office buildings in countries of operations. These are standard operating leases and include renewal options, periodic escalation clauses and are mostly non-cancellable in the normal course of business without the Bank incurring substantial penalties. The most significant lease is that for the Bank's headquarters building. Rent payable under the terms of this lease is reviewed every five years and is based on market rates. Such a review was concluded in March 2002 and was effective from 25 December 2001. Following the 2001 rent review,

the Bank re-examined its facilities requirements and entered into negotiations with the current landlord that culminated in 2003 in an agreement which included:

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

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

Payable:	2003 € million	2002 € million
Not later than one year	2.2	31.7
Later than one year and not later than five years	58.7	84.2
Later than five years	375.4	–
At 31 December	436.3	115.9
Expenditure	29.7	36.4

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:	2003 € million	2002 € million
Not later than one year	3.1	5.2
Later than one year and not later than five years	3.8	12.8
At 31 December	6.9	18.0
Income	12.7	5.2

19. Staff retirement schemes

Defined benefit scheme

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

Amounts recognised in the balance sheet are as follows:

	2003 € million	2002 € million
Fair value of plan assets	84.2	69.8
Present value of the defined benefit obligation	(75.3)	(73.2)
	8.9	(3.4)
Unrecognised actuarial losses ¹	27.3	42.8
Prepayment at 31 December	36.2	39.4
Movement in the prepayment (included in "Other assets"):		
At 1 January	39.4	29.5
Exchange differences	(3.2)	(1.7)
Contributions paid	12.3	22.8
Total expense as below	(12.3)	(11.2)
At 31 December	36.2	39.4

Amounts recognised in the income statement are as follows:

Current service cost	(11.0)	(11.8)
Interest cost	(4.2)	(4.4)
Expected return on assets ²	5.1	6.2
Amortisation of actuarial loss	(2.2)	(1.2)
Total included in staff costs	(12.3)	(11.2)

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

² The actual return on assets during the year was €15.7 million (2002: loss of €14.0 million).

Principal actuarial assumptions used:

Discount rate	5.50%	5.50%
Expected return on plan assets	7.50%	7.50%
Future salary increases	4.00%	4.00%
Average remaining working life of employees	15 years	15 years

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

Defined contribution scheme

The pension charge recognised under the defined contribution scheme was €5.8 million (2002: €6.1 million) and is included in "General administrative expenses".

20. Other fund agreements

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

At 31 December 2003 the Bank administered 90 technical cooperation fund agreements (2002: 81) for an aggregate of €776.4 million (2002: €785.1 million). This includes €298.9 million for the Tacis and Phare programmes of the European Commission under the Bangkok and Investment Preparation Facilities. Of this pledged amount, funds received at 31 December 2003 totalled €707.2 million. The total uncommitted balance of the funds at 31 December 2003 was €104.8 million. In addition, the Bank administered 76 project-specific technical cooperation agreements for an aggregate amount of €49.2 million.

The Bank also administered 17 investment cooperation fund agreements for an aggregate amount of €113.1 million and two EU Pre-accession Preparation Funds for an aggregate amount of €34.8 million for the specific purpose of co-financing EBRD projects.

Following a proposal by the G-7 countries for a multilateral programme of action to improve safety in nuclear power plants in the countries of operations, the Nuclear Safety Account (NSA) was established by the Bank in March 1993. The NSA funds are in the form of grants and are used for funding immediate safety improvement measures. At 31 December 2003, 15 contributors had made pledges up to a total amount of €260.6 million, using the fixed exchange rates defined in the Rules of the NSA.

At their Denver Summit in June 1997, the G-7 countries and the European Union endorsed the setting up of the Chernobyl Shelter Fund (CSF). The CSF was established on 7 November 1997, when the Rules of the CSF were approved by the Board, and became operational on 8 December 1997, when the required eight contributors had entered into contribution agreements with the Bank. The objective of the CSF is to assist Ukraine in transforming the existing Chernobyl sarcophagus into a safe and environmentally stable system. At 31 December 2003, 23 contributors had made pledges up to a total amount of €569.6 million using the fixed exchange rates defined in the Rules of the CSF.

In 1999, in pursuit of their policy to accede to the European Union, three central European countries, namely Lithuania, Bulgaria and the Slovak Republic, undertook firm commitments to close and decommission their nuclear power plant units with RBMK and VVER 440/230 type of reactors by certain dates. In response to this, the European Commission announced its intention to support the decommissioning of these reactors with substantial grants over a period of eight to ten years, and invited the Bank to administer three International Decommissioning Support Funds (IDSFs). On 12 June 2000 the Bank's Board of Directors approved the Rules of the Ignalina, Kozloduy and Bohunice IDSFs and the role of the Bank as their Administrator. The Funds will finance selective projects which will support the first phase of decommissioning of the designated reactors as well as finance measures for facilitating the necessary restructuring, upgrading and modernisation of the energy production, transmission and distribution sectors and improvements in energy efficiency which are a consequence of the closure decisions. At 31 December 2003, 16 contributors had made pledges to the Ignalina IDSF up to a total amount of €210.6 million; 11 contributors had made pledges to the Kozloduy IDSF up to a total amount of €109.6 million; and nine contributors had made pledges to the Bohunice IDSF up to a total amount of €121.1 million, using the fixed exchange rates defined in the Rules of Funds.

In 2001 the Nordic Investment Bank hosted a meeting with participants from Belgium, Finland, Sweden, the European Commission and international financial institutions with activities in the Northern Dimension Area (NDA). At this meeting participants agreed to establish the Northern Dimension Environmental Partnership to strengthen and co-ordinate financing of important environmental projects with cross-border effects in the NDA. On 11 December 2001 the Bank's Board of Directors approved the Rules of the Northern Dimension Environmental Partnership Support Fund and the role of the Bank as Fund Manager. At 31 December 2003 ten contributors had made pledges up to a total of €186.2 million.

Audit fees payable to the Bank's auditors in respect of the 2003 audits of the technical cooperation and nuclear safety funds totalled €191,000 (2002: €191,000). In addition, during 2003 the Bank's auditors, on a global basis, earned €0.9 million (2002: €0.7 million) in respect of due diligence and general business consultancy services funded by the technical cooperation funds. This represents 1.2 per cent of the 2003 total spend (2002: 1.0 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 in 2003. In 2002 payments were made to Arthur Andersen for the period 1 January 2002 to 31 July 2002 and to Deloitte & Touche for the period from 1 August 2002 to 31 December 2002.

21. Post-balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements. On 2 March 2004 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 19 April 2004.

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 Board of Directors of the Bank. At 31 December 2003 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 relating to the 2003 audit of the Special Funds totalled €67,800 (2002: €74,500). The Bank appointed PricewaterhouseCoopers LLP as auditors for 2003 in succession to Deloitte & Touche.

The objectives of the Special Funds are as follows:

Baltic Investment Special Fund and 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 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.

Investment Special Funds

Extract from the profit and loss account for the year ended 31 December 2003

	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Aggregated Investment Special Funds € 000
Operating profit/(loss) before provisions	547	(5,577)	(939)	(904)	(16,863)	(810)	(8,041)	(216)	-	(32,803)
Release/(charge) for provisions for impairment	112	(10,893)	(816)	73	(387)	-	(1,959)	-	-	(13,870)
Profit/(loss) for the year	659	(16,470)	(1,755)	(831)	(17,250)	(810)	(10,000)	(216)	-	(46,673)

Extract from the balance sheet at 31 December 2003

Loans	4,572	24,388	3,673	2,124	-	-	5,317	-	-	40,074
Provisions for impairment	(64)	(3,728)	(930)	(275)	-	-	(632)	-	-	(5,629)
Share investments	7,435	3,020	1,894	2,811	2,494	-	-	-	-	17,654
Provisions for impairment	(2,955)	(1,701)	(906)	(900)	(720)	-	-	-	-	(7,182)
Placements and other assets	4,480	1,319	988	1,911	1,774	-	-	-	-	10,472
Contributions not yet received	31,345	16,757	4,579	19,052	17,831	11,330	8,125	9,009	-	118,028
	-	-	3,175	-	75,000	-	1,897	-	15,000	95,072
Total assets	40,333	38,736	11,485	22,812	94,605	11,330	14,707	9,009	15,000	258,017
Other liabilities and provisions for impairment	8	14,249	13	134	3,983	502	4,110	49	-	23,048
Contributions	41,500	59,351	13,352	21,935	130,000	12,779	33,924	9,443	15,000	337,284
Reserves and (loss)/profit for the year	(1,175)	(34,864)	(1,880)	743	(39,378)	(1,951)	(23,327)	(483)	-	(102,315)
Total liabilities and contributors' resources	40,333	38,736	11,485	22,812	94,605	11,330	14,707	9,009	15,000	258,017
Undrawn commitments and guarantees	8,037	49,622	840	328	44,846	9,360	10,236	4,714	-	127,983

Technical Cooperation Special Funds

Extract from the statement of movement in fund balance and balance sheet for the year ended 31 December 2003

	Technical Assistance Special Fund € 000	Baltic Business Cooperation Special Fund € 000	Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	Aggregated Technical Cooperation Special Funds € 000
Balance of fund brought forward	3,978	12,010	190	190	16,178
Contributions received	-	-	24	24	24
Interest and other income	53	140	3	3	196
Disbursements	(1,353)	(1,705)	(106)	(106)	(3,164)
Other operating expenses	(6)	(1,409)	(3)	(3)	(1,418)
Balance of fund available	2,672	9,036	108	108	11,816
Cumulative commitments approved	23,403	65,899	1,069	1,069	90,371
Cumulative disbursements	(21,616)	(62,770)	(979)	(979)	(85,365)
Allocated fund balance	1,787	3,129	90	90	5,006
Unallocated fund balance	885	5,907	18	18	6,810
Balance of fund available	2,672	9,036	108	108	11,816

Special Fund contributions pledged by donor country

	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Baltic Technical Assistance Special Fund € 000	Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	Aggregated Special Funds € 000
Austria	-	-	-	-	-	276	-	-	-	-	-	-	276
Canada	-	2,707	-	-	-	1,472	-	-	-	-	4,309	-	8,488
Denmark	8,940	-	-	-	-	750	-	-	-	1,450	-	-	11,140
European Community	-	-	-	-	130,000	-	-	-	15,000	-	-	-	145,000
Finland	8,629	-	-	-	-	-	-	-	-	1,411	-	-	10,040
France	-	7,686	-	-	-	-	-	-	-	-	4,980	-	12,666
Germany	-	9,843	-	-	-	2,250	-	2,389	-	-	3,025	-	17,507
Iceland	427	-	-	-	-	-	-	-	-	69	-	-	496
Italy	-	8,401	-	21,935	-	-	-	-	-	-	1,360	-	31,696
Japan	-	21,162	-	-	-	-	-	-	-	-	3,295	-	24,457
Netherlands	-	-	-	-	-	1,173	-	-	-	-	-	-	1,173
Norway	7,732	-	-	-	-	1,145	-	-	-	1,256	-	-	10,133
Sweden	15,772	-	-	-	-	-	-	-	-	2,564	-	-	18,336
Switzerland	-	2,360	-	-	-	4,218	-	7,054	-	-	1,244	-	14,876
Taipei China	-	-	-	-	-	1,495	-	-	-	-	-	-	13,131
United Kingdom	-	-	11,636	-	-	-	-	-	-	-	12,824	247	13,071
United States of America	-	7,192	1,716	-	-	-	33,924	-	-	-	27,657	-	70,489
Total at 31 December 2003	41,500	59,351	13,352	21,935	130,000	12,779	33,924	9,443	15,000	6,750	58,694	247	402,975

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

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

Respective responsibilities of the President and auditors

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

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

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

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the Bank at 31 December 2003 and its profit for the year then ended and have been properly prepared in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.



PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

2 March 2004

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

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Cover: Road construction, Russia.
Photographer: Mike Ellis.

The largest EBRD project signed in 2003 was a €230 million loan to support road construction in Russia.

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