European Bank
for Reconstruction and Development

The Municipal Finance Facility Special Fund

Annual Financial Report
31 December 2015

The Municipal Finance Facility Special Fund

Contents

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Statement of comprehensive income

For the year ended 31 December 2015	Note	Year to 31 December 2015 € 000	Year to 31 December 2014 € 000
Net interest		**(13)**	4
Incentive fees	3		
Energy efficiency fees to participating banks		**(654)**	(320)
Energy efficiency fees to sub-borrowers		**(6,403)**	(3,279)
Disbursements for technical cooperation	4	**(289)**	(1,009)
Other operating expenses	11	**(75)**	(25)
Net loss and comprehensive expense for the year		**(7,434)**	(4,629)
Attributable to:			
Contributor		**(7,434)**	(4,629)

Balance sheet

At 31 December 2015	Note	31 December 2015 € 000	31 December 2014 € 000
Assets			
Placements with credit institutions		**12,492**	14,141
Contributions receivable	5	**-**	6,293
Bank charges refundable		**5**	-
Total assets		**12,497**	20,434
Liabilities and contributor's resources			
Other financial liabilities	6	**1,139**	1,349
Total liabilities		**1,139**	1,349
Contributions	5	**32,707**	33,000
Reserves and accumulated loss		**(21,349)**	(13,915)
Total contributor's resources		**11,358**	19,085
Total liabilities and contributor's resources		**12,497**	20,434

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Statement of changes in contributor's resources

For the year ended 31 December 2015

	Contributions	Accumulated loss	Total
	€ 000	**€ 000**	**€ 000**
At 31 December 2013	33,000	(9,286)	23,714
Total comprehensive expense for the year	-	(4,629)	(4,629)
At 31 December 2014	33,000	(13,915)	19,085
Reversal of contributions receivable	(293)	-	(293)
Total comprehensive expense for the year	-	(7,434)	(7,434)
At 31 December 2015	**32,707**	**(21,349)**	**11,358**

Statement of cash flows

For the year ended 31 December 2015		Year to 31 December 2015		Year to 31 December 2014
	€ 000	**€ 000**	€ 000	€ 000
Cash flows used in operating activities				
Net loss for the year	**(7,434)**		(4,629)	
Adjustments for:				
Net interest	**13**		(4)	
	(7,421)		(4,633)	
Net interest received	**(11)**		4	
Increase in operating assets				
Other financial assets	**(5)**		-	
(Decrease) / increase in operating liabilities				
Accrued expenses	**(212)**		100	
Net cash used in operating activities		**(7,649)**		(4,529)
Cash flows from financing activities				
Contributions received	**6,000**		2,000	
Net cash from financing activities		**6,000**		2,000
Net decrease in cash and cash equivalents		**(1,649)**		(2,529)
Cash and cash equivalents at the beginning of the year		**14,141**		16,670
Cash and cash equivalents at 31 December		**12,492**		14,141

The Municipal Finance Facility Special Fund

Accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

A. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

Going concern

The final contribution agreements of the Municipal Finance Facility Special Fund ("the Fund") state that all project agreements must be signed by 30 June 2015 and completed by 30 June 2016. The Fund terminated on 31 December 2015, but final payments to contractors will be made up until 30 June 2016.

The financial statements for the Fund are therefore presented on a basis other than that of a going concern as the Fund terminated on 31 December 2015. In such circumstances all assets and liabilities are more appropriately reported at net realisable value rather than historical cost.

New and amended IFRS mandatorily effective for the current reporting period

There are no new or amended standards for the current reporting period.

IFRS not yet mandatorily effective but adopted early

IFRS 9: Financial Instruments is the IASB's replacement project for IAS 39. The Standard has developed in phases and was completed in July 2014 with a mandatory application date for annual reporting periods beginning on or after 1 January 2018. The Fund adopted the first phase 'recognition and measurement of financial assets' (November 2009) in its 2010 financial statements. See the accounting policy for financial assets for more details.

IFRS not yet mandatorily effective and not adopted early

The following standards are not yet effective and have not been adopted early.

Pronouncement	Nature of change	Potential Impact
IFRS 9 Financial Instruments	Classification and measurement of financial liabilities (October 2010). Hedge accounting (November 2013). Impairment methodology and introduction of 'fair value through other comprehensive income' measurement category for financial assets represented by simple debt instruments (July 2014). IFRS 9 to be adopted in its entirety for annual reporting periods beginning on or after 1 January 2018.	The Fund is yet to assess the potential impact of adopting this standard.
Amendments to: IFRS 10: Consolidation Financial Statements and IAS 28: Investments in Associates and Joint Ventures	Provides guidance for the accounting for the loss of control of a subsidiary as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method. Effective for annual reporting periods beginning on or after a date to be determined by the IASB.	The Fund is yet to assess the potential impact of adopting this standard.

Amendments to: IFRS 11: Joint Arrangements	Provides guidance on the accounting for acquisitions of interests in joint operations in which the activity constitutes a business. Effective for accounting periods beginning on or after 1 January 2016.	The Fund considers that this amendment has no applicability to its existing operations.
IFRS 15: Revenue from Contracts with Customers	Establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Effective for annual reporting periods beginning on or after 1 January 2018.	The Fund is yet to assess the potential impact of adopting this standard.
IFRS 16: Leases	Sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, ie the customer ('lessee') and the supplier ('lessor'). Effective for annual reporting periods beginning on or after 1 January 2019.	The Fund considers that this amendment has no applicability to its existing operations.
Amendments to: IAS 1: Presentation of Financial Statements	Various amendments to improve presentation and disclosure under IAS 1. Effective for annual reporting periods beginning on or after 1 January 2016.	The Fund considers that this standard will have minimal impact on the presentation of its financial statements and the disclosures therein.
Amendments to: IAS 7: Statement of Cash Flows	An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Effective for annual reporting periods beginning on or after 1 January 2017.	This is a disclosure requirement only which the Fund will comply with in 2017.
Amendments to: IAS 16: Property, Plant and Equipment and IAS 38: Intangible Assets	Clarification of acceptable methods of depreciation and amortisation. Effective for annual reporting periods beginning on or after 1 January 2016.	The Fund considers that this amendment has no applicability to its existing operations.

B. Significant accounting policies

Financial assets and financial liabilities

As the Fund is in the process of being wound up, assets and liabilities are measured at fair value. In the case of cash placements, the principal equates to fair value given the short-term nature of such placements. The value of the financial liabilities equates to their fair value as these are expected to be settled for the values disclosed on the balance sheet in the short-term.

Derecognition of financial assets

The Fund derecognises a financial asset, or a portion of a financial asset, where the contractual rights to that asset have expired or where the rights to further cash flows from the asset have been transferred to a third party and, with them, either:

(i) substantially all the risks and rewards of the asset; or
(ii) significant risks and rewards, along with the unconditional ability to sell or pledge the asset..

Contributions

Outstanding contributions are recognised as receivables on the balance sheet on the date of signature of a contribution agreement by the European Bank for Reconstruction and Development ("the Bank") and a contributor. Contributions receivable are not discounted on a present value basis as there is no indication as to their precise payment date at the date of signature. Contributions receivable at 31 December 2014 were either received or derocognised during the year ended 31 December 2015.

Contributor's resources

The Fund recognises contributions received from the contributor as equity on the basis that the termination of the contribution agreement would lead to the winding up of the Fund and the distribution of the residual assets to the contributor.

Statement of cash flows

The statement of cash flows is prepared using the indirect method. Cash and cash equivalents comprise balances with less than three months maturity from the date of the transaction, which are available for use at short notice and that are subject to insignificant risk of changes in value.

Incentive fees

Incentive fees represent amounts incurred for the period by partner banks and end-borrowers to encourage particular lending and investment behaviours. Fees are recognised as a liability when the participating bank or end-borrower satisfies various performance targets.

Disbursements for technical cooperation

Disbursements for technical cooperation, which represent payments for consultancy services provided to the Fund over a period of time, are recorded as expenditure over the period during which the services are received.

Interest

Interest is recorded on an accruals basis using the effective interest method. All interest, positive and negative earned on placements with credit institutions, is recognised within 'net interest' in the income statement.

Taxation

In accordance with Article 53 of the Agreement Establishing the Bank ("the AEB"), 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. As described in note 1, this exemption is extended to the Fund.

The Municipal Finance Facility Special Fund

Risk management

The purpose of the Fund is to alleviate the financing problems of small and medium-sized municipalities within Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia ("the Accession countries"). To achieve this, the resources of the Fund may be used to provide technical assistance and financial incentives to partner banks and end-borrowers participating in the Municipal Finance Facility which provides financing to small and medium sized municipalities, municipally owned companies and private companies providing municipal services. In 2008 modifications have been introduced with the aim to stimulate implementation of energy efficient rehabilitation of municipal buildings and infrastructure.

As the purpose of the Fund is to assist small and medium-sized municipalities rather than to generate a return on its assets, financial risks, with the exception of credit risk, are not actively managed by the Fund.

Risk governance

The Fund follows the Bank's risk governance procedures as below:

The Bank's overall framework for identification and management of risks is underpinned by: (i) the Banking Vice-Presidency being the "first line of defence" in identifying and managing risks related to debt and equity operations, (ii) independent "second line of defence" control functions, including Risk Management, Office of the Chief Compliance Officer, Environmental and Social Department, Procurement Department, Office of the General Counsel, Evaluations Department and other relevant units, and (iii) Internal Audit Department, which acts as "third line of defence" and independently assesses the effectiveness of the processes within the first and second lines of defence. The Vice President Risk and Chief Risk Officer (VP & CRO) is responsible for ensuring independent risk management of the Banking and Treasury exposures, including adequate processes and governance structure for independent identification, measurement, monitoring and mitigation of risks incurred by the Bank. The challenge of the control functions, review of their status and assessment of their ability to perform duties independently fall within the remit of the Audit Committee of the Board.

Matters related to Bank-wide risk and associated policies and procedures are considered by the Risk Committee. The Risk Committee is accountable to the President. It oversees all aspects of the Banking portfolio across all sectors and countries, and provides advice on Risk Management policies, measures and controls. It also approves proposals for new products submitted by Banking. The membership comprises senior managers across the Bank including representatives from Risk Management, Finance, Banking and the Office of the General Counsel.

The Risk Committee is chaired by the VP & CRO.

The Managing Director Risk Management reports directly to the VP & CRO and leads the overall management of the department. Risk Management (i) provides an independent assessment of risks associated with individual investments undertaken by the Bank, (ii) performs an ongoing review of the portfolio to monitor the risk presented by investments from inception to repayment or exit, (iii) assesses and proposes ways to manage risks arising from correlations and concentrations within the portfolio, and (iv) ensures that adequate systems and controls are put in place for identification and management of operational risks across the Bank. It develops and maintains the Risk Management policies to facilitate Banking and Treasury operations and promotes risk awareness across the Bank.

In exercising its responsibilities, Risk Management is guided by its mission to:

• Provide assurance to stakeholders that risk decision-making in the Bank is balanced and within agreed appetite, and that control processes are rigorously designed and applied; and

• Support the Bank's business strategy including the maximisation of transition impact through provision of efficient and effective delivery of risk management advice, challenge and decision making.

A. 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.

The Fund's exposure to credit risk is currently limited to the financial institutions with which it may place its cash resources. For banks with which the Fund places its cash, internal credit ratings are determined by Risk Management and are the same as those used for Banking exposures. These ratings are based on internal analysis of approved counterparties' creditworthiness through synthesis of externally provided credit research and market data, including approved external agency ratings. All individual counterparty credit lines for banks are measured, monitored and reviewed by Risk Management annually.

At year end the Fund's cash was placed with financial institutions which ranked in the second highest internal credit rating risk category assigned by the Bank's Risk Management department. This rating approximated to an external equivalent rating in the range of AA+ to AA-.

The carrying amount of placements and contributions presented on the balance sheet represents the Fund's maximum exposure to credit risk at 31 December 2015 and 31 December 2014.

B. Market risk

Market risk is the potential loss that could result from adverse market movements. The driver of market risk for the Fund is interest rate risk.

Market risk management and measurement

As discussed at the beginning of the Risk Management section, the Fund does not actively monitor or hedge against market risk.

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 Fund's placements are repriced to market interest rates within one month, therefore the exposure to interest rate risk is considered to be minimal.

Foreign exchange risk
Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund does not hold any assets or liabilities of non-euro denomination, nor does it have any non-euro commitments, hence it is not exposed to any foreign exchange risk.

C. Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Fund's Rules and Regulations require that technical assistance, performance fees, financial incentives and loan guarantees are financed from the resources of the Fund, which comprise contributions received and investment income. Accordingly, the Fund cannot commit more than the available resources and cannot borrow funds to finance operations. The Fund recognises contributions received as equity, which will only be returned to the contributor as part of the residual assets upon termination of the Fund. As a result, the Fund's exposure to liquidity risk is considered to be minimal.

The Municipal Finance Facility Special Fund

Notes to the financial statements

1. Creation of the Special Fund

The creation of the Fund was approved by the Board of Directors ("the Board") of the Bank at its meeting of 29 April 2003 and is administered, *inter alia*, in accordance with the AEB and under the terms of the Rules and Regulations of such Fund approved by the Board on that date, as may be amended from time to time. On 12 December 2003, the Bank entered into a contribution agreement ("the Agreement") in respect of the Fund with the European Union ("EU").

The Fund's principal office is located in London at One Exchange Square, EC2A 2JN.

The Fund was established in accordance with Article 18 of the AEB. The Fund is not part of the ordinary capital resources of the Bank, but any privileges and immunities available to the Bank are extended to the Fund. The objective of the Fund is to alleviate the financing problems of municipalities and their utility companies for small infrastructure investments in the Accession countries.

2. President's responsibilities

The President is responsible for preparing the financial statements in accordance with IFRS issued by the IASB.

3. Incentive fees

Maturity enhancement fees, municipality financial incentives and performance fees are paid from the Fund to partner banks participating in the Municipal Finance Facility, to encourage longer-term lending to small and medium sized municipalities, municipally owned companies and private companies providing municipal services.

Maturity enhancement fees and municipality financial incentives are calculated for each sub-loan on a sliding scale based on maturity and paid to the partner bank. Partner banks retain maturity enhancement fees which are paid annually or semi-annually. Municipality financial incentives are paid to the partner bank on account for the sub-borrower and are payable following final disbursement of the sub-loan.

Performance fees are calculated as a percentage of the total commitment of each eligible sub-loan and are directly paid to the partner banks following signature of the sub-loan.

Energy efficiency fees are paid from the Fund to partner banks and sub-borrowers to encourage the financing of an investment in energy efficiency projects. Fees paid to partner banks are calculated as a percentage of the sub-loan whereas fees paid to the sub-borrowers are a fixed percentage of the estimated energy savings of the project which are paid upon verification.

4. Disbursements for technical cooperation

	Commitments approved € 000	Disbursements € 000	Undrawn commitments € 000
Total projects			
At 31 December 2013	5,271	(3,503)	1,768
Movement in the year	-	(1,009)	(1,009)
At 31 December 2014	5,271	(4,512)	759
Movement in the year	(270)	(289)	(559)
At 31 December 2015	**5,001**	**(4,801)**	**200**

5. Contributions

Contributions received and receivable from the EU are set out below:

	2015	2014
	€ 000	€ 000
Cumulative contributions received	**32,707**	26,707
Contributions receivable	**-**	6,293
At 31 December	**32,707**	33,000

As the Fund is in the process of being wound up, the remaining €293,000 in contributions receivable is not expected to be called from the EU.

6. Other financial liabilities

	2015	2014
	€ 000	€ 000
Energy efficiency fees to participating banks payable	**344**	147
Energy efficiency fees to sub-borrowers payable	**546**	124
Disbursements for technical cooperation payable	**197**	1,078
Management fee payable	**50**	-
Interest payable	**2**	-
At 31 December	**1,139**	1,349

7. Undrawn commitments

	2015	2014
	€ 000	€ 000
Energy efficiency incentives	**8,030**	15,087
Municipality financial incentives	**-**	183
Performance fees	**-**	58
Disbursements for technical cooperation	**200**	759
At 31 December	**8,230**	16,087

This represents amounts for which the Fund has contracted but for which the transaction or service was not undertaken during the year.

8. Fair value of financial assets and liabilities

The carrying amounts of financial assets and liabilities presented on the balance sheet approximate to their fair value.

9. Analysis of current and non-current assets and liabilities

All assets and liabilities are classified as current for both 2014 and 2015.

10. Events after the reporting period

There have been no material events since the reporting date that would require disclosure or adjustment to these financial statements.

11. Related parties

The Fund’s related parties are the Bank and the contributor.

The Bank is entitled to charge the Fund a management fee of an amount equal to 1.25 per cent of contributions received. Management fees of €75,000 were charged during the year (2014: €25,000). There was an accrued management fee payable of €50,000 by the Fund to the Bank at 31 December 2015 (2014: nil). External auditor's remuneration of €7,700 (2014: €7,200) is payable by the Bank from management fees. In 2014 the Bank approved an extension of the term of appointment from four years to five with a maximum of two consecutive terms. Deloitte LLP (UK) completed its first four-year term in 2014 and has been re-appointed for the five year period 2015 - 2019.

During 2015 the Bank reimbursed the Fund €5,100 of bank charges (2014: €2,800), which are receivable as at 31 December 2015 (2014: €300).

Contributions received and receivable from the contributor are outlined in note 5.

INDEPENDENT AUDITOR'S REPORT TO THE GOVERNORS OF THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT ("THE BANK")

Report on the financial statements

We have audited the financial statements of the Municipal Finance Facility Special Fund ("the Fund") for the year ended 31 December 2015 which comprise the statement of comprehensive income, the balance sheet, the statement of changes in contributor's resources, the statement of cash flows, the accounting policies, the risk management statement and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is the International Financial Reporting Standards as issued by the International Accounting Standards Board.

President's responsibility for the financial statements

The President is responsible for the preparation and fair presentation of the Financial Statements in accordance with International the Financial Reporting Standards issued by the International Accounting Standards Board, and for such internal control as the President determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the Financial Statements present fairly, in all material respects, the financial position of the Municipal Finance Facility Special Fund as at 31 December 2015 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board.

Emphasis of matter - Financial statements prepared other than on a going concern basis

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in the Basis of preparation to the financial statements, which explains that the financial statements have been prepared on a basis other than that of a going concern.

Other reporting responsibilities

We also report to you if, in our opinion, the Financial Statements are not in agreement with the accounting records, if the proper accounting records have not been kept, or if we have not received all the information and explanations we require for our audit. We have nothing to report in connection with these matters.

Other matters

This report, including the opinion, has been prepared for, and only for, the Bank in accordance with Article 24 of the Agreement Establishing the Bank dated 29 May 1990, and for the use of the contributor 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.

Deloitte LLP

Deloitte LLP
Chartered Accountants
London, United Kingdom
6 April 2016