European Bank
for Reconstruction and Development

The SME Finance Facility Special Fund

Annual Financial Report
31 December 2014

The SME Finance Facility Special Fund

Contents

The SME Finance Facility Special Fund

Statement of comprehensive income

For the year ended 31 December 2014	Note	Year to 31 December 2014 € 000	Year to 31 December 2013 € 000
Interest income		**12**	8
Disbursements for technical cooperation	3	**(4,690)**	(4,479)
Incentive fees		**(4,593)**	(9,339)
Performance fees		**(234)**	(478)
Management Fees		**-**	(23)
Net loss and comprehensive expense for the year		**(9,505)**	(14,311)
Attributable to:			
Contributor		**(9,505)**	(14,311)

Balance sheet

At 31 December 2014	Note	31 December 2014 € 000	31 December 2013 € 000
Assets			
Placements with credit institutions		**28,863**	39,670
Interest receivable		**-**	1
Total assets		**28,863**	39,671
Liabilities and contributor's resources			
Other financial liabilities	5	**5,366**	6,669
Total liabilities		**5,366**	6,669
Contributions		**191,390**	191,390
Reserves and accumulated loss		**(167,893)**	(158,388)
Total contributor's resources		**23,497**	33,002
Total liabilities and contributor's resources		**28,863**	39,671

The SME Finance Facility Special Fund

Statement of changes in contributor's resources

For the year ended 31 December 2014

	Contributions	Accumulated loss	Total
	€ 000	**€ 000**	**€ 000**
At 31 December 2012	191,390	(144,077)	47,313
Total comprehensive expense for the year	-	(14,311)	(14,311)
At 31 December 2013	191,390	(158,388)	33,002
Total comprehensive expense for the year	-	(9,505)	(9,505)
At 31 December 2014	**191,390**	**(167,893)**	**23,497**

Statement of cash flows

For the year ended 31 December 2014

		Year to 31 December 2014		Year to 31 December 2013
	€ 000	**€ 000**	€ 000	€ 000
Cash flows used in operating activities				
Net loss for the year	**(9,505)**		(14,311)	
Adjustments for:				
Interest income	**(12)**		(8)	
Bank charges reimbursed	**-**		(2)	
	(9,517)		(14,321)	
Interest income received	**13**		9	
Decrease in operating assets				
Bank charges recoverable	**-**		2	
Increase/(decrease) in operating liabilities				
Accrued expenses	**(1,303)**		2,484	
Net cash used in operating activities		**(10,807)**		(11,826)
Cash flows from financing activities				
Contributions received	**-**		1,832	
Net cash from financing activities		**-**		1,832
Net decrease in cash and cash equivalents		**(10,807)**		(9,994)
Cash and cash equivalents at the beginning of the year		**39,670**		49,664
Cash and cash equivalents at 31 December		**28,863**		39,670

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

The financial statements for the Fund are therefore presented on a basis other than that of a going concern as the Fund is expected to terminate within the next year. In such circumstances all assets and liabilities are more appropriately reported at net realisable value rather than historical cost. No material adjustments arose from ceasing to apply the going concern basis.

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

New and amended IFRS mandatorily effective for the current reporting period

The following new and amended standards are effective for the current reporting period:

Pronouncement	Nature of change	Impact
Investment entities – amendments to IFRS 10, IFRS 12 and IAS 27	Introduces an exception to consolidating particular subsidiaries for "investment entities", requiring instead such subsidiaries to be measured at fair value through profit or loss in accordance with IFRS 9 Financial Instruments. New disclosure requirements are also introduced.	Not applicable as the Fund is not an investment entity.
IAS 32 (Amendment) Financial Instruments: Presentation – Offsetting of Financial Assets and Financial Liabilities	Updates the application guidance and basis of conclusions in relation to the offsetting of financial assets and financial liabilities.	Applicable but no changes of presentation required.

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 January 1, 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 January 1, 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 1 January 2016.	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 July 2016.	The Fund is yet to assess the potential impact of adopting this standard
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 2017.	The Fund is yet to assess the potential impact of adopting this standard
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 is yet to assess the potential impact of adopting this standard
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 is yet to assess the potential impact of adopting this standard

A number of existing standards were reviewed by the IASB in December 2014 as part of the IFRS annual improvements cycle. It is the Fund's opinion that none of these amendments, effective for accounting periods beginning on or after 1 January 2016, will have a material impact on the Fund's financial statements.

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 basis of fair value for share investments that are unlisted is determined using valuation techniques appropriate to the market and industry of each investment. The primary valuation technique used is net asset value.

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.

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.

Performance fees

Performance fees, which represent payments to banks and leasing companies for lending to small and medium-sized enterprises (SMEs), are recorded as expenditure over a five year period during which the incentive can be earned by the banks and leasing companies if performance criteria with respect to sub-loan portfolio quality are met.

Incentive fees

Incentive fees represent amounts incurred for the period by banks, for on-payment to sub-borrowers, to encourage higher energy efficiency investment behaviours. Fees are recognised as a liability once the sub-project has been verified by the verification consultant.

Interest

Interest is recorded on an accruals basis. All interest income is recognised within ‘interest income’ in the income statement.

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.

Taxation

In accordance with Article 53 of the Agreement Establishing the European Bank for Reconstruction and Development (“the AEB”) (“the Bank”), 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.

C. Critical accounting estimates and judgements

Preparing financial statements in conformity with IFRS requires the Fund to make estimates and judgements that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts included in the income statement during the reporting period. The Fund's outstanding share investments are considered immaterial at 31 December 2014 and 31 December 2013.

The SME Finance Facility Special Fund

Risk management

The Fund was established to alleviate the financing problems of SMEs in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Turkey ("the Accession countries"). To achieve this, the Fund's resources may be used to:

- finance technical cooperation, which includes procuring consultancy services to assist participating banks and leasing companies which on lend or extend leases to SMEs;
- provide performance fees or other approved incentive fees to PFIs and to sub-borrowers under the General SME and SME Energy Efficiency Sub-Window;
- invest in equity funds which will invest in individual SMEs; and
- finance technical cooperation involving technical assistance related to preparation of sustainable energy projects, project preparation, marketing, training for PBs staff, feasibility and/or energy audits of Sub-projects and verification.

As the primary purpose of the Fund is to assist the financing of SMEs in the Accession countries rather than generate profits, not all financial risks are actively managed by the Fund. As the Fund participates in investments jointly with the Bank, credit risk is jointly managed; however the Fund does not hedge against market risk and is hence exposed to interest rate and equity price risk.

Risk governance

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

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 Vice President Risk and Chief Risk Officer (VP & CRO) who is ultimately responsible for the independent identification, measurement, monitoring and mitigation of all risks incurred by the Bank. The VP & CRO has the overall responsibility for formulating the risk management strategy.

The Managing Director Risk Management reports directly to the VP & CRO and leads the overall management of the Risk Department. The Risk Department provides an independent assessment of risks associated with individual projects investments and loans undertaken by the Bank and performs an ongoing review of the portfolio to monitor the risk presented by projects investments and loans from inception to exit. It develops and maintains the Risk Management policies to facilitate Banking 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 may also be exposed to concentration risk, which is the risk arising from too high a proportion of the portfolio being allocated to a specific country, industry sector or obligor, or to a particular type of instrument or individual transaction.

The Fund is exposed to credit risk as borrowers and counterparties could default on their contractual obligations, or the value of the Fund's investments could be impaired.

The carrying amounts of financial assets presented on the balance sheet, best represents the Fund's maximum exposure to credit risk at 31 December 2014 and 31 December 2013, without taking account of any collateral held or other credit enhancements.

Credit risk management and measurement

As previously stated, the Fund participates jointly with the Bank in the financing of investments in the Bank's countries of operations. It therefore benefits from the same governance process employed by the Bank in the measurement and management of credit exposures, which is described below.

Underlying principles and procedures
The Board of Directors ("the Board") approves a credit process document that defines the procedures for the approval, management and review of Banking exposures. The Audit Committee periodically reviews the credit process and its review is submitted to the Board for approval.

Individual projects
The Operations Committee, which is chaired by the First Vice President Banking and whose membership comprises senior managers of the Bank, including the VP & CRO and Managing Director Risk Management, reviews all Banking projects prior to their submission for Board approval. A number of frameworks for smaller projects are considered by the Small Business Investment Committee or by senior management under a delegated authority framework supervised by the Operations Committee. The project approval process is designed to ensure compliance with the Bank's criteria for sound banking, transition impact and additionality. It operates within the authority delegated by the Board, via the Executive Committee, to approve projects within Board-approved framework operations. The Operations Committee is also responsible for approving significant changes to existing operations.

The Equity Committee acts as the governance committee for the equity portfolio and reports to the Operations Committee.

Risk Management conducts reviews of all exposures within the Banking portfolio. At each review, Risk Management assesses whether there has been any change in the risk profile of the exposure, recommends actions to mitigate risk and reconfirms or adjusts the risk rating. It also reviews the fair value of equity investments.

Portfolio level review
Risk Management reports on the development of the portfolio as a whole on a quarterly basis to the Audit Committee of the Board. The report includes a summary of key factors affecting the portfolio and provides analysis and commentary on trends within the portfolio and various sub-portfolios. It also includes reporting on compliance with all portfolio risk limits including an explanation of any limit breaches.

EBRD internal ratings

Probability of default (PD)
The Bank assigns its internal risk ratings to all counterparties, including borrowers, investee companies, guarantors and sovereigns in the Banking portfolio. Risk ratings reflect the financial strength of the counterparty as well as consideration of any implicit support, for example from a major shareholder. The sovereign rating takes into consideration the ratings assigned by external rating agencies. For non-sovereign operations, probability of default ratings are normally capped by the sovereign rating, except where the Bank has recourse to a guarantor from outside the country which may have a better rating than the local sovereign rating.

The table below shows the Bank's internal probability of default rating scale from 1.0 (lowest risk) to 8.0 (highest risk) and how this maps to the external ratings of Standard & Poor's (S&P). References to risk rating through this text relate to probability of default ratings unless otherwise specified.

EBRD risk rating category	EBRD risk rating	External rating equivalent	Category name	Broader category
1	1.0	AAA	Excellent	Investment Grade
2	1.7 2.0 2.3/2.5	AA+ AA AA-	Very Strong	Investment Grade
3	2.7 3.0 3.3	A+ A A-	Strong	Investment Grade
4	3.7 4.0 4.3	BBB+ BBB BBB-	Good	Investment Grade
5	4.7 5.0 5.3	BB+ BB BB-	Fair	Risk class 5
6	5.7 6.0 6.3	B+ B B-	Weak	Risk class 6
7	6.7 7.0 7.3	CCC+ CCC CCC-/CC/C	Special Attention	Classified
8	8.0	D	Expected Loss/Impaired	Classified

Credit risk exposures

Placements with credit institutions
The Fund's placements with credit institutions were all classified at the internal risk rating categories of 2 and 3 (approximately AA+ to A- in terms of the S&P equivalent).

Other financial assets
Other financial assets represent interest receivable from the Fund's placements with credit institutions.

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.

Equity price risk
Equity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

The Fund's share investments are measured at nil value at the end of the year.

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 and equity investments are financed from the resources of the Fund, which comprises contributions received and investment income.

Accordingly, the Fund cannot commit more than the available resources and cannot borrow funds to finance operations. The Fund also 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.

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 7 April 1999 and is administered, inter alia, in accordance with the AEB and under the terms of the Rules and Regulations of the Fund. On 19 April 1999, the Bank entered into a contribution arrangement 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 Fund comprises two windows: (i) the Loan, Guarantee and Leasing Window (incorporating the Rural Sub-Window and the SME Energy Efficiency Sub-Window) and (ii) the Equity Window.

2. President's responsibilities

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

3. Disbursements for technical cooperation

	Commitments approved € 000	Disbursements € 000	Undrawn commitments € 000
Total projects			
At 31 December 2012	58,018	53,010	5,008
Movement in the year	2,086	4,479	(2,393)
At 31 December 2013	60,104	57,489	2,615
Movement in the year	5,484	4,690	794
At 31 December 2014	**65,588**	**62,179**	**3,409**

4. Share investments

IFRS 7 specifies classification of fair values on the basis of a three-level hierarchy of valuation methodologies. The classifications are determined based on whether the inputs used in the measurement of fair values are observable or unobservable. The fair values of the Fund's share investments have been classified as Level 3, that is, those which have fair values determined by inputs not based on observable market data.

No reasonably plausible alternative valuations have been determined, as the effect on the financial statements is considered immaterial.

The table below provides information about the Fund's share investments.

	2014	2013
	€ 000	€ 000
Outstanding disbursements		
At 1 January	**876**	876
At 31 December	**876**	876
Fair value adjustment		
At 1 January	**(876)**	(876)
Movement in fair value revaluation	**-**	-
At 31 December	**(876)**	(876)
Fair value at 31 December	**-**	-

5. Other financial liabilities

	2014	2013
	€ 000	€ 000
Disbursements for technical cooperation payable	**4,684**	3,363
Incentive fees payable	**682**	3,181
Performance fees payable	**-**	102
Operating expenses payable	**-**	23
At 31 December	**5,366**	6,669

6. Undrawn commitments

	2014	2013
	€ 000	€ 000
Undrawn share commitments	**-**	819
Disbursements for technical cooperation	**3,409**	2,615
Incentive fees	**13,701**	16,044
Performance fees	**1,132**	1,365
At 31 December	**18,242**	20,843

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

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

All assets and liabilities on the balance sheet are classified as current for both 2013 and 2014.

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. Events after the reporting period

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

10. 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. There were no management fees paid by the Fund to the Bank in 2014 (2013: €22,900) and no amount is payable by the Fund to the Bank at 31 December 2014 (2013: €22,900). External auditor's remuneration in 2014 of €7,200 (2013: €6,500) is payable by the Bank from this management fee. 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) completes its first four-year term in 2014 and has been re-appointed for the five year period 2015 - 2019.

Contributions received and receivable from the contributor are outlined in note 8.

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 SME Finance Facility Special Fund ("the Fund") for the year ended 31 December 2014 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 10. 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 the International 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 SME Finance Facility Special Fund as at 31 December 2014 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
8 April 2015