

**European Bank
for Reconstruction and Development**

The Municipal Finance Facility Special Fund

**Annual Financial Report
31 December 2007**

European Bank for Reconstruction and Development

The Municipal Finance Facility Special Fund

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Income statement For the year ended 31 December 2007	Note	Year to 31 December 2007 €000	Year to 31 December 2006 €000
Interest and similar income		593	405
Maturity enhancement fees payable	3	(258)	(202)
Municipality financial incentive fees payable	3	(70)	-
Performance fees payable	3	(254)	-
Disbursements for technical cooperation	4	(187)	(430)
Other operating expenses	5	(12)	-
Net loss for the year		(188)	(227)

Balance sheet At 31 December 2007	Note	31 December 2007 €000	31 December 2006 €000
Assets			
Placements with credit institutions		14,758	13,883
Other financial assets	6	142	26
Contributions receivable	7	18,000	19,000
Total assets		32,900	32,909
Liabilities and contributor's resources			
Other financial liabilities	8	512	333
Total liabilities		512	333
Contributions	7	33,000	33,000
Reserves and retained earnings		(612)	(424)
Total contributor's resources		32,388	32,576
Total liabilities and contributor's resources		32,900	32,909

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Statement of changes in contributor's resources For the year ended 31 December 2007

	Contributions	Accumulated loss	Total
	€000	€000	€000
At 31 December 2005	30,000	(197)	29,803
Contribution agreement	3,000	-	3,000
Loss for the year	-	(227)	(227)
At 31 December 2006	33,000	(424)	32,576
Loss for the year	-	(188)	(188)
At 31 December 2007	33,000	(612)	32,388

Statement of cash flows

For the year ended 31 December 2007

	Year to 31 December 2007	Year to 31 December 2006
	€000	€000
Cash flows from operating activities		
Operating loss for the year	(188)	(227)
Adjustment for:		
Interest income	(593)	(405)
	(781)	(632)
Interest income received	477	391
Operating loss before changes in operating assets	(304)	(241)
Increase in operating liabilities:		
Accrued expenses	179	91
Net cash used in operating activities	(125)	(150)
Cash flows from financing activities		
Contributions	1,000	-
Net cash from financing activities	1,000	-
Net increase/(decrease) in cash and cash equivalents	875	(150)
Cash and cash equivalents at beginning of year	13,883	14,033
Cash and cash equivalents at 31 December	14,758	13,883

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Accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below.

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) 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.

Standards, amendments to published standards and interpretations effective in 2007

In the current year, the Fund has adopted IFRS 7, Financial Instruments: Disclosures which is effective for accounting periods beginning on or after 1 January 2007, and the related amendment to IAS 1, Presentation of Financial Statements. The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Fund's financial instruments and management of capital.

Standards early adopted by the Fund

No standards were early adopted by the Fund in 2007.

Standards, amendments to published standards and interpretations effective in 2007 but not relevant to the Fund's operations

The following interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2007 but they are not relevant to the Fund's operations:

- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies;
- IFRIC 8, Scope of IFRS 2;
- IFRIC 9, Re-assessment of Embedded Derivatives; and
- IFRIC 10, Interim Financial Reporting and Impairment.

Standards, amendments to published standards and interpretations that are not yet effective and have not been early adopted by the Fund

The following standards are mandatory for the Fund's accounting periods beginning on or after 1 January 2008 or later periods, but the Fund has not early adopted them:

IFRS 8, Operating Segments which is effective for accounting periods beginning on or after 1 January 2009, replaces IAS 14 and requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Financial information is required to be reported on the basis that it is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. The Fund has assessed the impact of IFRS 8 and concluded that it is not expected to impact the operating segments of the Fund and that the main additional disclosures will be in relation to the determination and measurement of the Fund's operating segments. The Fund will apply IFRS 8 from its accounting period beginning 1 January 2009.

IAS 27, Consolidated and Separate Financial Statements which is effective for accounting periods beginning on or after 1 July 2009, reduces the alternatives in accounting for subsidiaries in consolidated financial statements and in accounting for subsidiaries in the separate financial statements of a parent, venturer or investor. The standard specifies the circumstances in which an entity must consolidate the financial statements of a subsidiary; the accounting for the changes in the level of ownership interest in a subsidiary; the accounting for the loss of control of a subsidiary; and the information that an entity must disclose to enable users of the financial statements to evaluate the nature of the relationship between the entity and its subsidiary. The Fund will apply IAS 27 from its accounting period beginning 1 January 2010 but it is currently not applicable to the Fund as there are no subsidiaries.

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Accounting policies (continued)

IAS 32 and IAS 1 (Amendment), Puttable Financial Instruments and Obligations Arising on Liquidation, is effective for accounting periods beginning on or after 1 January 2009. It allows particular types of financial instruments that meet the definition of a financial liability but represent the residual interest in the net assets of the entity to be classified as equity instruments. Financial instruments that may be classified as equity instruments are those that meet the definition of puttable financial instruments, or instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation. The Fund will apply IAS 32 and IAS 1 (Amendment) from its accounting period beginning 1 January 2009; the Fund's initial interpretation is that it will not have any significant impact on the Fund's financial statements.

Standards, amendments to published standards and interpretations that are not yet effective but not relevant to the Fund's operations

The following standards, amendments to published standards and interpretations are mandatory for the Fund's accounting periods beginning on or after 1 January 2008 or later periods but are not relevant to the Fund's operations:

- IFRS 2 (Amendment), Vesting Conditions and Cancellations (effective for accounting periods beginning on or after 1 January 2009);
- IFRS 3, Business Combinations (effective for accounting periods beginning on or after 1 July 2009);
- IAS 23 (Amendment), Borrowing Costs (effective for accounting periods beginning on or after 1 January 2009);
- IFRIC 11, IFRS 2 Group and Treasury Share Transactions (effective for accounting periods beginning on or after 1 March 2007);
- IFRIC 12, Service Concession Arrangements (effective for accounting periods beginning on or after 1 January 2008);
- IFRIC 13, Customer Loyalty Programmes (effective for accounting periods beginning on or after 1 July 2008); and
- IFRIC 14, IAS 19 - The Limit on a Defined Benefit Asset (effective for accounting periods beginning on or after 1 January 2008).

B. Contributions

Contributions are recognised as receivable in 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 have not been discounted on a present value basis as there has been no indication as to the precise payment date of outstanding contributions. The Fund is satisfied that they will be realised for the amounts stated in the financial statements.

C. 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.

D. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, which are available for use at short notice and which are subject to insignificant risk of changes in value. This definition includes balances of cash and current accounts with foreign banks.

E. Taxation

In accordance with Article 53 of the Agreement Establishing the Bank dated 29 May 1990, 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.

F. Comparatives

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

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Financial risk management

The purpose of the Fund is to alleviate the financing problems of small and medium-sized municipalities within the EU Accession countries. To achieve this, the resources of the Fund may be used to provide technical assistance and financial incentives to partner banks participating in the Municipal Finance Facility which provides financing to small and medium sized municipalities, municipally owned companies and private companies providing municipal services.

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

A. Credit risk

Credit risk is the potential loss that could result from the default of counterparty or the deterioration of its creditworthiness, which could materialise in its downgrading by a rating agency, at any time until the maturity of the longest-dated transaction outstanding with that counterparty.

The Fund is exposed to credit risk as set out in the following table because counterparties could default on their contractual obligations.

Maximum exposure to credit risk before collateral held and other credit enhancements

	2007	2006
	€000	€000
Placements with credit institutions	14,758	13,883
Other financial assets	142	26
Contributions receivable	18,000	19,000
Maximum credit exposure	32,900	32,909

For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet.

Credit risk: management and measurement

Placements with credit institutions

The Bank's Treasury Credit Risk Management team assesses the creditworthiness of financial institutions through the synthesis of externally provided credit research and market data and with reference to external rating benchmarks from approved rating agencies to determine if the counterparties are adequate.

Placements with Credit institutions are rated between AAA (excellent) and A- (very good) by Standard & Poor's.

Other financial assets and contributions receivable

Other financial assets represent interest income receivable from the Fund's placements with credit institutions. Contributions receivable represent unpaid pledged amounts from the contributor. All are risk rated between 1 to 3 (AAA to A in terms of S&P equivalent)

B. Market risk

Market risk is the potential loss that could result from adverse market movements. The market risk relevant for the Fund is interest rate risk. The Fund does not hold any assets of non-euro denomination, nor does it have any non-euro commitments, hence, it is not exposed to foreign exchange risk.

Market risk management and measurement

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

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Financial risk management (continued)

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 summaries the Fund's exposure to interest rate risks. Included in the table are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Non-interest- bearing funds €000	Total €000
Interest rate risk at 31 December 2007				
Assets				
Placements with credit institutions	14,758	-	-	14,758
Other financial assets	-	-	142	142
Contributions receivable	-	-	18,000	18,000
Total assets	14,758	-	18,142	32,900
Liabilities and contributor's resources				
Other financial liabilities	-	-	(512)	(512)
Total contributor's resources	-	-	(32,388)	(32,388)
Total liabilities and contributor's resources	-	-	(32,900)	(32,900)
Interest sensitivity gap at 31 December 2007	14,758	-	(14,758)	-

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Non-interest- bearing funds €000	Total €000
Interest rate risk at 31 December 2006				
Assets				
Placements with credit institutions	3,471	10,412	-	13,883
Other financial assets	-	-	26	26
Contributions receivable	-	-	19,000	19,000
Total assets	3,471	10,412	19,026	32,909
Liabilities and contributor's resources				
Other financial liabilities	-	-	(333)	(333)
Total contributor's resources	-	-	(32,576)	(32,576)
Total liabilities and contributor's resources	-	-	(32,909)	(32,909)
Interest sensitivity gap at 31 December 2006	3,471	10,412	(13,883)	-

The effective interest rate at 31 December 2007 for placements with credit institutions was 4.43 per cent (2006: 3.55 per cent).

Interest rate sensitivity analysis

Based on analysis of historic data, a parallel shift of +118 basis points (bp)/-118bp (2006: +88bp/-88bp) in euro market interest rates from the year end rate of 4.68 per cent is considered reasonably possible over a 12 month period. To illustrate the interest rate risk, at 31 December 2007 if euro interest rates strengthened by 118bp (2006: 88bp), with all other variables held constant, operating income would have been €174,000 higher (2006: €122,000). Conversely, if euro interest rates had weakened by 118bp (2006: 88bp), with all other variables held constant, operating income would have been €174,000 lower (2006: €122,000).

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Financial risk management (continued)

C. Liquidity risk

Liquidity is the availability of sufficient funds to meet deposit withdrawals and other financial commitments as they fall due.

Liquidity risk management process

A portion of the Fund's cash is held on account with credit institutions and is immediately available to meet financial commitments of the Fund. Surplus cash, based on forecast cash requirements, is held on one and three month placements as appropriate.

Liquidity position

The table below provides an analysis of assets, liabilities and contributor's resources 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. 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. Figures in the table represent undiscounted cashflows.

	Up to and including 1 month €000	Over 1 month and up to and including 3 months €000	Maturity undefined €000	Total €000
Liquidity position at 31 December 2007				
Assets				
Placements with credit institutions	14,758	-	-	14,758
Other financial assets	142	-	-	142
Contributions receivable	-	-	18,000	18,000
Total assets	14,900	-	18,000	32,900
Liabilities and contributor's resources				
Other financial liabilities	(106)	(406)	-	(512)
Total contributor's resources	-	-	(32,388)	(32,388)
Total liabilities and contributor's resources	(106)	(406)	(32,388)	(32,900)
Net liquidity position at 31 December 2007	14,794	(406)	(14,388)	-
Cumulative net liquidity position at 31 December 2007	14,794	14,388	-	-
Liquidity position at 31 December 2006				
Assets				
Placements with credit institutions	3,471	10,412	-	13,883
Other financial assets	22	4	-	26
Contributions receivable	-	-	19,000	19,000
Total assets	3,493	10,416	19,000	32,909
Liabilities and contributor's resources				
Other financial liabilities	(217)	(116)	-	(333)
Total contributor's resources	-	-	(32,576)	(32,576)
Total liabilities and contributor's resources	(217)	(116)	(32,576)	(32,909)
Net liquidity position at 31 December 2006	3,276	10,300	(13,576)	-
Cumulative net liquidity position at 31 December 2006	3,276	13,576	-	-

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Financial risk management (continued)

D. Capital Management

The capital of the fund comprises pledged contributions net of accumulated losses of the Fund. Under the Rules and Regulations of the Fund, the Fund resources may be used for technical assistance, performance fees, financial incentives, loan guarantees and/or other approved incentives. The fund is not subject to any external capital requirement constraints; however, commitments for technical cooperation and incentive payments cannot exceed the available fund balance. In 2006 and 2007 this limit was not exceeded.

The Municipal Finance Facility Special Fund

Notes to the financial statements

1 Creation of the Special Fund

The creation of The Municipal Finance Facility Special Fund (“the Fund”) was approved by the Board of Directors (“the Board”) of the European Bank for Reconstruction and Development at its meeting of 29 April 2003 and is administered, *inter alia*, under the terms of Rules and Regulations of such Special Fund approved by the Board on that date. On 12 December 2003, the Bank entered into a contribution agreement (“the Agreement”) in respect of the Fund with the European Community (“EC”).

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is 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, Slovakia and Slovenia (“the Accession countries”).

2 President’s responsibilities

The President of the Bank is responsible for preparing the financial statements in accordance with 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.

3 Maturity enhancement fees, municipality financial incentives and performance 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 the maturity of the sub-loan and paid to the partner bank. Partner banks retain maturity enhancement fees whereas municipality financial incentives are paid to the partner bank on account for the sub-borrower. Maturity enhancement fees are paid either annually or semi-annually. Municipality financial incentives are payable following final disbursement of the sub-loan.

Performance fees are calculated as 2.5 per cent of the total commitment of each eligible sub-loan and are directly paid to the partner banks following signature of the sub-loan.

4 Disbursements for technical cooperation

	Commitments approved	Disbursements	Undrawn commitments
	€000	€000	€000
Projects in operation			
At 31 December 2005	8,050	(267)	7,783
Restatement of commitments approved *	(1,500)	-	(1,500)
At 1 January 2006	6,550	(267)	6,283
Movement in the year	(2,375)	(430)	(2,805)
At 31 December 2006	4,175	(697)	3,478
Movement in the year	(652)	(187)	(839)
At 31 December 2007	3,523	(884)	2,639

*Commitments have been restated to reflect donor approved maximum limits rather than the Bank’s internal commitment budgets.

5 Other operating expenses

Other operating expenses comprise administrative expenses directly relating to the Fund and include a management fee payable to the Bank which is set at 1.25 per cent of each contribution instalment. External auditors’ remuneration of €6,300 (2006: €7,400) is payable by the Bank from this management fee.

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Notes to the financial statements (continued)

6 Other financial assets

	2007	2006
	€000	€000
Interest receivable on placements	142	26
At 31 December	142	26

7 Contributions

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

	2007	2006
	€000	€000
Cumulative contributions received	15,000	14,000
Contributions receivable	18,000	19,000
Total contributions at 31 December	33,000	33,000

A contribution of €1 million from the EC was received on 21 February 2007 (2006: Nil).

8 Other financial liabilities

	2007	2006
	€000	€000
Maturity enhancement fees payable	152	116
Municipality financial incentive fees payable	63	-
Performance fees payable	31	-
Disbursements for technical cooperation	266	217
At 31 December	512	333

9 Undrawn commitments

	2007	Restated 2006
	€000	€000
Maturity enhancement fees payable	2,419	3,594
Municipality financial incentive fees payable	2,574	1,750
Performance fees payable	1,017	975
Disbursements for technical cooperation	2,639	3,478
At 31 December	8,649	9,797

10 Segment information

In accordance with IAS 14, the primary segment of the Fund is business operation and the secondary segment is geographical. At 31 December 2007, the activities of the Fund comprised a single primary segment (Banking operations) and one geographic region ("the Accession countries"). Consequently, no additional disclosure is required.

11 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.

12 Post balance sheet events

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

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Notes to the financial statements (continued)

13 Related parties

The Fund has no related parties other than the Bank. During the year ended 31 December 2007 the Fund paid the Bank a management fee for operating the Fund of €12,500 (2006: nil). There are no accrued management fees payable by the Fund to the Bank as at 31 December 2007.

Independent auditor's report to 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 for the year ended 31 December 2007 which comprise the income statement, the balance sheet, the statement of changes in contributor's resources, the statement of cash flows, the accounting policies, financial risk management and the notes to the financial statements ("financial statements").

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 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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 Fund at 31 December 2007 and its financial performance and cash flows for the year then ended 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.

Other matters

We also report to you if, in our opinion, the Bank has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

This report, including the opinion, has been prepared for, and only for, the Bank and for the confidential use of the Contributors to the Fund 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.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

5 March 2008

The maintenance and integrity of the EBRD's website is the responsibility of the President; the work carried out by the 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 website. Legislation in the United Kingdom governing preparation and dissemination of financial statements may differ from legislation in other jurisdictions.