

# MANAGEMENT REPORT FOR THE YEAR ENDING 31 DECEMBER 2005

## 1 PRINCIPAL ACTIVITIES

The ECB's activities in 2005 are described in detail in the relevant chapters of the Annual Report.

## 2 FINANCIAL ACCOUNTS

Under Article 26.2 of the Statute of the ESCB, the Annual Accounts of the ECB are drawn up by the Executive Board, in accordance with the principles established by the Governing Council. The Accounts are subsequently approved by the Governing Council and then published.

## 3 PROVISION FOR FOREIGN EXCHANGE RATE, INTEREST RATE AND GOLD PRICE RISKS

Since most of the ECB's assets and liabilities are periodically revalued at current market exchange rates and security prices, the ECB's profitability is strongly affected by exchange rate exposures and, to a lesser extent, interest rate exposures. These exposures stem mainly from its holdings of foreign reserve assets held in US dollars, Japanese yen and gold, which are predominantly invested in interest-bearing instruments.

Taking into account the ECB's large exposure to these risks and the current size of its revaluation accounts, the Governing Council decided to establish a provision against foreign exchange rate, interest rate and gold price risks. As at 31 December 2005, an amount of €992 million was recorded in this provision, which had the effect of reducing net profit for the year to exactly zero.

This provision will be used to cover realised and unrealised losses, in particular valuation losses not covered by the revaluation accounts. Its size will be reviewed annually.

## 4 FINANCIAL RESULT

Had the provision against foreign exchange rate, interest rate and gold price risks not been established, the ECB's net profit for 2005 would have been €992 million. In 2004, the ECB reported a net loss of €1,636 million.

The loss in 2004 was mainly due to the appreciation of the euro. This resulted in write-downs in the euro value of the ECB's holdings of US dollar-denominated assets, which were expensed in the Profit and Loss Account. The average cost of assets and liabilities denominated in US dollars in the books of the ECB was also adjusted to the year-end exchange rate.

In 2005, the depreciation of the euro vis-à-vis the US dollar and gold resulted in a substantial increase in the related revaluation accounts, but with no concomitant effect on the Profit and Loss Account. The harmonised accounting policies for the ECB and the Eurosystem, which are described in the notes to the Annual Accounts, are based primarily on the principle of prudence. In particular, they aim to ensure that unrealised gains arising from the revaluation of assets and liabilities are not recognised as income and are therefore not distributable as profit. Conversely, unrealised losses resulting from revaluations are expensed in the Profit and Loss Account at the end of the year.

In 2005 net interest income increased mainly due to a rise in US dollar interest rates, after historically low levels of domestic and foreign interest rates in 2004. Net interest income includes €868 million earned on the ECB's share of euro banknotes in circulation.

Total administrative expenses of the ECB, including depreciation, declined by 7% from €374 million in 2004 to €348 million in 2005. Staff costs decreased primarily due to a change in the accounting treatment applied to the recognition of net actuarial gains/losses in respect of the ECB's retirement plan and other post-employment benefits. The pension charge in 2004 was considerably higher due to the

recognition of €23.7 million in net actuarial losses in their entirety in the year in which they arose. From 2005 onwards, net actuarial gains and losses exceeding a prescribed limit are to be amortised over the expected average remaining working lives of the participating employees.

This decrease in staff costs was, however, partially offset by the effect of an increase in staff numbers on total salaries.

Other administrative expenses also declined, primarily due to a reduction in consultancy and professional fees.

In 2005 the emoluments of the Executive Board amounted in total to €2.1 million (2004: €2.1 million).

## **5 INVESTMENT ACTIVITIES AND RISK MANAGEMENT**

The ECB's foreign reserves portfolio consists of foreign reserve assets transferred to it by the Eurosystem NCBs in accordance with the provisions of Article 30 of the Statute of the ESCB, and the income thereon. Its purpose is to fund the ECB's operations in the foreign exchange market for the purposes set out in the Treaty.

The ECB's own funds portfolio reflects the investment of its paid-up capital, the general reserve fund and income accumulated on the portfolio in the past. Its purpose is to provide the ECB with a reserve to meet possible losses.

The ECB's investment activities and its management of the associated risks are described in greater detail in Chapter 2.

## **6 GOVERNANCE OF THE ECB**

Information relating to the governance of the ECB is given in Chapter 7.

## **7 EMPLOYEES**

The average number of staff employed by the ECB rose from 1,261 in 2004 to 1,331 in 2005. For further details, see the notes on the Profit and Loss Account and Chapter 7, Section 2, which also describes the ECB's human resources strategy.

## BALANCE SHEET AS AT 31 DECEMBER 2005

ASSETS	NOTE NUMBER	2005 €	2004 €
<b>Gold and gold receivables</b>	<b>1</b>	<b>10,064,527,857</b>	<b>7,928,308,842</b>
<b>Claims on non-euro area residents denominated in foreign currency</b>	<b>2</b>		
Receivables from the IMF		170,162,349	163,794,845
Balances with banks and security investments, external loans and other external assets		31,062,557,242	26,938,993,980
		<b>31,232,719,591</b>	<b>27,102,788,825</b>
<b>Claims on euro area residents denominated in foreign currency</b>	<b>2</b>	<b>2,908,815,389</b>	<b>2,552,016,565</b>
<b>Claims on non-euro area residents denominated in euro</b>	<b>3</b>		
Balances with banks, security investments and loans		13,416,711	87,660,507
<b>Other claims on euro area credit institutions denominated in euro</b>	<b>4</b>	<b>25,000</b>	<b>25,000</b>
<b>Intra-Eurosystem claims</b>	<b>5</b>		
Claims related to the allocation of euro banknotes within the Eurosystem		45,216,783,810	40,100,852,165
Other claims within the Eurosystem (net)		5,147,038,409	3,410,918,324
		<b>50,363,822,219</b>	<b>43,511,770,489</b>
<b>Other assets</b>	<b>6</b>		
Tangible fixed assets		175,237,902	187,318,304
Other financial assets		6,888,490,580	6,308,075,905
Accruals and prepaid expenses		1,091,945,157	770,894,480
Sundry		4,397,807	6,933,022
		<b>8,160,071,446</b>	<b>7,273,221,711</b>
<b>Loss for the year</b>		<b>0</b>	<b>1,636,028,702</b>
<b>Total assets</b>		<b>102,743,398,213</b>	<b>90,091,820,641</b>

LIABILITIES	NOTE NUMBER	2005 €	2004 €
<b>Banknotes in circulation</b>	7	45,216,783,810	40,100,852,165
<b>Liabilities to other euro area residents denominated in euro</b>	8	1,050,000,000	1,050,000,000
<b>Liabilities to non-euro area residents denominated in euro</b>	9	649,304,896	137,462,706
<b>Liabilities to euro area residents denominated in foreign currency</b>	10	0	4,967,080
<b>Liabilities to non-euro area residents denominated in foreign currency</b> Deposits, balances and other liabilities	10	855,933,000	1,254,905,957
<b>Intra-Eurosystem liabilities</b> Liabilities equivalent to the transfer of foreign reserves	11	39,782,265,622	39,782,265,622
<b>Other liabilities</b> Accruals and income collected in advance Sundry	12	1,331,685,870 632,012,224 1,963,698,094	1,136,708,542 265,799,279 1,402,507,821
<b>Provisions</b>	13	1,027,507,143	52,396,126
<b>Revaluation accounts</b>	14	8,108,628,098	1,921,117,190
<b>Capital and reserves</b> Capital Reserves	15	4,089,277,550 0 4,089,277,550	4,089,277,550 296,068,424 4,385,345,974
<b>Total liabilities</b>		<b>102,743,398,213</b>	<b>90,091,820,641</b>

## PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING 31 DECEMBER 2005

	NOTE NUMBER	2005 €	2004 €
Interest income on foreign reserve assets		889,408,789	422,418,698
Interest income arising from the allocation of euro banknotes within the Eurosystem		868,451,848	733,134,472
Other interest income		1,794,267,421	1,456,650,188
<i>Interest income</i>		<i>3,552,128,058</i>	<i>2,612,203,358</i>
Remuneration of NCBs' claims in respect of foreign reserves transferred		(710,160,404)	(693,060,433)
Other interest expense		(1,572,338,709)	(1,229,369,015)
<i>Interest expense</i>		<i>(2,282,499,113)</i>	<i>(1,922,429,448)</i>
<b>Net interest income</b>	<b>18</b>	<b>1,269,628,945</b>	<b>689,773,910</b>
Realised gains/losses arising from financial operations	<b>19</b>	149,369,135	136,045,810
Write-downs on financial assets and positions	<b>20</b>	(97,494,081)	(2,093,285,109)
Transfer to/from provisions for foreign exchange rate and price risks		(992,043,443)	0
<b>Net result of financial operations, write-downs and risk provisions</b>		<b>(940,168,389)</b>	<b>(1,957,239,299)</b>
<b>Net expense from fees and commissions</b>	<b>21</b>	<b>(182,373)</b>	<b>(261,517)</b>
<b>Other income</b>	<b>22</b>	<b>18,281,961</b>	<b>5,956,577</b>
<b>Total net income</b>		<b>347,560,144</b>	<b>(1,261,770,329)</b>
Staff costs	<b>23</b>	(153,048,314)	(161,192,939)
Administrative expenses	<b>24</b>	(158,457,219)	(176,287,651)
Depreciation of tangible fixed assets		(31,888,637)	(33,655,824)
Banknote production services	<b>25</b>	(4,165,974)	(3,121,959)
<b>Profit/(loss) for the year</b>		<b>0</b>	<b>(1,636,028,702)</b>

Frankfurt am Main, 7 March 2006

EUROPEAN CENTRAL BANK

Jean-Claude Trichet  
President

# ACCOUNTING POLICIES<sup>1</sup>

## FORM AND PRESENTATION OF THE FINANCIAL STATEMENTS

The financial statements of the European Central Bank (ECB) have been designed to present fairly the financial position of the ECB and the results of its operations. They have been drawn up in accordance with the following accounting policies<sup>2</sup>, which the Governing Council considers to be appropriate to the nature of central bank activity.

## ACCOUNTING PRINCIPLES

The following accounting principles have been applied: economic reality and transparency, prudence, recognition of post-balance-sheet events, materiality, the accruals principle, going concern, consistency and comparability.

## BASIS OF ACCOUNTING

The accounts have been prepared on a historical cost basis, modified to include market valuation of marketable securities, gold and all other on-balance-sheet and off-balance-sheet assets and liabilities denominated in foreign currency. Transactions in financial assets and liabilities are reflected in the accounts on the basis of the date on which they are settled.

## GOLD AND FOREIGN CURRENCY ASSETS AND LIABILITIES

Assets and liabilities denominated in foreign currency are converted into euro at the exchange rate prevailing on the Balance Sheet date. Income and expenses are converted at the exchange rate prevailing at the time of the transaction. The revaluation of foreign exchange assets and liabilities, including on-balance-sheet and off-balance-sheet instruments, is performed on a currency-by-currency basis.

Revaluation to the market price for assets and liabilities denominated in foreign currency is treated separately from the exchange rate revaluation.

Gold is valued at the market price prevailing at the year-end. No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is

accounted for on the basis of the price in euro per fine ounce of gold, which, for the year ending 31 December 2005, was derived from the exchange rate of the euro against the US dollar on 30 December 2005.

## SECURITIES

All marketable securities and similar assets are valued at the mid-market prices prevailing at the Balance Sheet date on a security-by-security basis. For the year ending 31 December 2005, mid-market prices on 30 December 2005 were used. Non-marketable securities are valued at cost.

## INCOME RECOGNITION

Income and expenses are recognised in the period in which they are earned or incurred. Realised gains and losses arising from the sale of foreign exchange, gold and securities are taken to the Profit and Loss Account. Such realised gains and losses are calculated by reference to the average cost of the respective asset.

Unrealised gains are not recognised as income but are transferred directly to a revaluation account.

Unrealised losses are taken to the Profit and Loss Account if they exceed previous revaluation gains registered in the corresponding revaluation account. Unrealised losses in any one security, currency or in gold are not netted against unrealised gains in other securities, currencies or gold. In the event of an unrealised loss on any item at the year-end, the average cost of that item is reduced to the year-end exchange rate and/or market price.

<sup>1</sup> The detailed accounting policies of the ECB are laid down in a Decision of the Governing Council of the ECB of 5 December 2002 (ECB/2002/11), OJ L 58, 3.3.2003, pp. 38-59, as amended.

<sup>2</sup> These policies are consistent with the provisions of Article 26.4 of the Statute of the ESCB, which require a harmonised approach to the rules governing the accounting and financial reporting of Eurosystem operations.

Premiums or discounts arising on purchased securities are calculated and presented as part of interest income and are amortised over the remaining life of the assets.

### **REVERSE TRANSACTIONS**

Reverse transactions are operations whereby the ECB buys or sells assets under a repurchase agreement or conducts credit operations against collateral.

Under a repurchase agreement, securities are sold for cash with a simultaneous agreement to repurchase them from the counterparty at an agreed price on a set future date. Repurchase agreements are recorded as collateralised inward deposits on the liability side of the Balance Sheet and also lead to an interest expense in the Profit and Loss Account. Securities sold under such an agreement remain on the Balance Sheet of the ECB.

Under a reverse repurchase agreement, securities are bought for cash with a simultaneous agreement to sell them back to the counterparty at an agreed price on a set future date. Reverse repurchase agreements are recorded as collateralised loans on the asset side of the Balance Sheet but are not included in the ECB's security holdings. They give rise to interest income in the Profit and Loss Account.

Reverse transactions (including security lending transactions) conducted under an automated security lending programme are recorded on the Balance Sheet only where collateral is provided to the ECB in the form of cash over the maturity of the transaction. In 2005 the ECB did not receive any collateral in the form of cash over the maturity of such transactions.

### **OFF-BALANCE-SHEET INSTRUMENTS**

Currency instruments, namely foreign exchange forward transactions, forward legs of foreign exchange swaps and other currency instruments involving an exchange of one currency for another at a future date, are included in the net foreign currency position for the purpose of

calculating foreign exchange gains and losses. Interest rate instruments are revalued on an item-by-item basis. Outstanding interest rate futures positions are recorded in off-balance-sheet accounts. Daily changes in the variation margin are recorded in the Profit and Loss Account.

### **POST-BALANCE-SHEET EVENTS**

Assets and liabilities are adjusted for events that occur between the annual Balance Sheet date and the date on which the Governing Council approves the financial statements, if such events materially affect the condition of assets and liabilities at the Balance Sheet date.

### **INTRA-ESCB BALANCES/INTRA-EUROSYSTEM BALANCES**

Intra-ESCB transactions are cross-border transactions that occur between two EU central banks. These transactions are processed primarily via TARGET – the Trans-European Automated Real-time Gross settlement Express Transfer system (see Chapter 2) – and give rise to bilateral balances in accounts held between those EU central banks connected to TARGET. These bilateral balances are then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. This position in the books of the ECB represents the net claim or liability of each NCB against the rest of the ESCB.

Intra-ESCB balances of the euro area NCBs with the ECB (except for the capital of the ECB and positions resulting from the transfer of foreign reserve assets to the ECB) are described as intra-Eurosystem claims or liabilities and are presented in the Balance Sheet of the ECB as a single net asset or liability position.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a single net asset under "Claims related to the allocation of euro banknotes within the Eurosystem" (see "Banknotes in circulation" in the notes on accounting policies).

Intra-ESCB balances of non-euro area NCBS (Danmarks Nationalbank, Sveriges Riksbank and the Bank of England) with the ECB are disclosed under “Liabilities to non-euro area residents denominated in euro”.

### TREATMENT OF FIXED ASSETS

Fixed assets, with the exception of land, are valued at cost less depreciation. Land is valued at cost. Depreciation is calculated on a straight-line basis, beginning in the quarter after acquisition and continuing over the expected economic lifetime of the asset, as follows:

Computers, related hardware and software, and motor vehicles	4 years
Equipment, furniture and plant in building	10 years
Capitalised building and refurbishment expenditure	25 years
Fixed assets costing less than €10,000	Written off in the year of acquisition

The depreciation period for capitalised building and refurbishment expenditure relating to the ECB’s existing premises has been reduced in order to ensure that these assets are completely written off before the ECB moves to its new premises.

### THE ECB’S RETIREMENT PLAN AND OTHER POST-EMPLOYMENT BENEFITS

The ECB operates a defined benefit scheme for its staff. This is funded by assets held in a long-term employee-benefit fund. The ECB has modified its accounting policy with effect from 1 January 2005. The effects on the financial statements are outlined below.

#### Balance Sheet

The liability now recognised in the Balance Sheet in respect of the defined benefit plans is the present value of the defined benefit obligation at the Balance Sheet date, less the fair value of plan assets used to fund the obligation, adjusted for unrecognised actuarial gains or losses.

The defined benefit obligation is calculated annually by independent actuaries using the

projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows, using interest rates of high-quality corporate bonds that are denominated in euro and have similar terms of maturity to the term of the related pension liability.

Actuarial gains and losses can arise from experience adjustments (where actual outcomes are different from the actuarial assumptions previously made) and changes in actuarial assumptions.

Until 2005 the ECB disclosed this defined benefit obligation and the fair value of plan assets separately (gross presentation). Moreover, all actuarial gains and losses were recognised in the Profit and Loss Account in the year in which they occurred. Consequently, the comparative figures for 2004 have been reclassified to bring them into line with the revised accounting policy. Since all actuarial gains and losses were previously recognised in their entirety in the year in which they arose, no prior year adjustment to the Profit and Loss Account was required in this respect.

#### Profit and Loss Account

The net amount now charged to the Profit and Loss Account comprises:

- the current service cost of the benefits accruing for the year;
- interest at the discount rate on the defined benefit obligation;
- the expected return on the plan assets; and
- any actuarial gains and losses recognised in the Profit and Loss Account, using a “10% corridor” approach.

#### “10% corridor” approach

Net cumulative unrecognised actuarial gains and losses which exceed the greater of (a) 10% of the present value of the defined benefit obligation and (b) 10% of the fair value of plan

assets, are to be amortised over the expected average remaining working lives of the participating employees.

#### *Pensions of Executive Board members and other post-retirement obligations*

Unfunded arrangements are in place for the pensions of members of the Executive Board and disability benefit provisions for the staff. The expected costs of these benefits are accrued over the Executive Board/staff members' terms of office/employment using an accounting approach similar to that of defined benefit pension plans. Actuarial gains and losses are recognised in the same manner as outlined above.

These obligations are valued annually by independent actuaries to establish the appropriate liability in the financial statements.

#### **BANKNOTES IN CIRCULATION**

The ECB and the 12 euro area NCBs, which together comprise the Eurosystem, issue euro banknotes.<sup>3</sup> The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month in accordance with the banknote allocation key<sup>4</sup>.

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, which is disclosed under the Balance Sheet liability item "Banknotes in circulation". The ECB's share of the total euro banknote issue is backed by claims on the NCBs. These claims, which bear interest,<sup>5</sup> are disclosed under the sub-item "Intra-Eurosystem claims: claims related to the allocation of euro banknotes within the Eurosystem" (see "Intra-ESCB balances/intra-Eurosystem balances" in the notes on accounting policies). Interest income on these claims is included within the item "Net interest income". The Governing Council decided in 2002 that this income would be distributed separately to the NCBs in the form of an interim distribution after the end of each quarter.<sup>6</sup> It is distributed in full unless the

ECB's net profit for the year is less than its income earned on euro banknotes in circulation, and also after any decision by the Governing Council to make transfers to a provision for foreign exchange rate, interest rate and gold price risks, and subject to any decision by the Governing Council to charge against this income costs incurred by the ECB in connection with the issue and handling of euro banknotes.

#### **OTHER ISSUES**

Taking account of the ECB's role as a central bank, the Executive Board considers that the publication of a cash flow statement would not provide the readers of the financial statements with any additional relevant information.

In accordance with Article 27 of the Statute of the ESCB, and on the basis of a recommendation of the Governing Council, the EU Council has approved the appointment of KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft as the external auditors of the ECB for a five-year period up to the end of the financial year 2007.

3 ECB Decision of 6 December 2001 on the issue of euro banknotes (ECB/2001/15), OJ L 337, 20.12.2001, pp. 52-54, as amended.

4 "Banknote allocation key" means the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in that total.

5 ECB Decision of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002 (ECB/2001/16), OJ L 337, 20.12.2001, pp. 55-61, as amended.

6 ECB Decision of 21 November 2002 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the national central banks of the participating Member States (ECB/2002/9), OJ L 323, 28.11.2002, pp. 49-50. This Decision was repealed by Decision ECB/2005/11, OJ L 311, 26.11.2005, p. 41, which became effective on 18 November 2005. From 2006, this distribution will occur at the end of the year only.

## NOTES ON THE BALANCE SHEET

### 1 GOLD AND GOLD RECEIVABLES

As at 31 December 2005 the ECB held 23.1 million ounces of fine gold (2004: 24.7 million ounces). The reduction was due to gold sales in accordance with the Central Bank Gold Agreement of 27 September 2004, of which the ECB is a signatory. The overall value of the holding increased compared with end-2004 due to a significant rise in the price of gold during 2005 (see “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

### 2 CLAIMS ON NON-EURO AREA AND EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

#### *Receivables from the IMF*

This asset represents the ECB’s holdings of special drawing rights (SDRs) as at 31 December 2005. It arises as the result of a two-way SDR buying and selling arrangement with the International Monetary Fund (IMF), whereby the IMF is authorised to arrange sales or purchases of SDRs against euro, on behalf of the ECB, within minimum and maximum holding levels. The SDR is defined in terms of a basket of currencies. Its value is determined as the weighted sum of the exchange rates of four major currencies (euro, Japanese yen, pound sterling and US dollar). For accounting purposes, SDRs are treated as a foreign currency (see “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

#### *Balances with banks and security investments, external loans and other external assets Claims on euro area residents denominated in foreign currency*

These claims consist of balances with banks and loans denominated in foreign currency, and investments in securities denominated in US dollars and Japanese yen, as follows:

<i>Claims on non-euro area residents</i>	2005 €	2004 €	Change €
Current accounts	5,149,756,962	2,682,171,017	2,467,585,945
Money market deposits	1,182,580,317	848,227,002	334,353,315
Reverse repurchase agreements	1,306,216,228	2,408,046,989	(1,101,830,761)
Security investments	23,424,003,735	21,000,548,972	2,423,454,763
<b>Total</b>	<b>31,062,557,242</b>	<b>26,938,993,980</b>	<b>4,123,563,262</b>

<i>Claims on euro area residents</i>	2005 €	2004 €	Change €
Current accounts	25,019	26,506	(1,487)
Money market deposits	2,908,790,370	2,547,022,979	361,767,391
Reverse repurchase agreements	0	4,967,080	(4,967,080)
<b>Total</b>	<b>2,908,815,389</b>	<b>2,552,016,565</b>	<b>356,798,824</b>

The increase in these positions in 2005 is primarily due to the year-end revaluation of the ECB’s US dollar-denominated assets (see “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

### 3 CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN EURO

As at 31 December 2005 this claim consisted of bank deposits with non-euro area residents.

### 4 OTHER CLAIMS ON EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

As at 31 December 2005 this claim consisted of a bank deposit with a euro area resident.

### 5 INTRA-EUROSYSTEM CLAIMS

#### *Claims related to the allocation of euro banknotes within the Eurosystem*

This item consists of the claims of the ECB vis-à-vis the euro area NCBs relating to the

allocation of euro banknotes within the Eurosystem (see “Banknotes in circulation” in the notes on accounting policies).

#### *Other claims within the Eurosystem (net)*

This item consists of the TARGET balances of the euro area NCBs vis-à-vis the ECB and amounts due in respect of the interim distributions of the ECB’s income derived from banknotes. As at 31 December 2005 an amount of €634 million (2004: €536 million) was due from the euro area NCBs in respect of interim distributions of the ECB’s income derived from banknotes. This represents the interim distributions of such income to the euro area NCBs for the first three quarters of the year, which were subsequently recalled (see “Banknotes in circulation” in the notes on accounting policies and note 18, “Net interest income”).

	2005 €	2004 €
Due from euro area NCBs in respect of TARGET	75,906,443,905	64,024,554,579
Due to euro area NCBs in respect of TARGET	(71,393,877,603)	(61,149,859,140)
Net TARGET position	4,512,566,302	2,874,695,439
Due from/(to) euro area NCBs in respect of the interim distribution of the ECB’s income derived from banknotes	634,472,107	536,222,885
Other claims within the Eurosystem (net)	5,147,038,409	3,410,918,324

## 6 OTHER ASSETS

### *Tangible fixed assets*

These assets comprised the following main items on 31 December 2005:

	Net book value as at 31 Dec. 2005 €	Net book value as at 31 Dec. 2004 €	Change €
Land and buildings	128,986,932	135,997,016	(7,010,084)
Computer hardware and software	30,751,165	43,089,388	(12,338,223)
Equipment, furniture, plant in building and motor vehicles	2,929,688	3,809,292	(879,604)
Assets under construction	11,576,491	3,215,050	8,361,441
Other fixed assets	993,626	1,207,558	(213,932)
Total	175,237,902	187,318,304	(12,080,402)

The decrease in this item is principally due to the absence of major additions in land and buildings or computer hardware and software in 2005, in contrast to 2004.

The increase in the category “Assets under construction” relates mainly to the new ECB premises. Transfers from this category to the relevant fixed asset captions are effected once the assets are in use.

### *Other financial assets*

The main components of this item are as follows:

	2005 €	2004 €	Change €
Securities denominated in euro	5,710,256,343	5,399,222,333	311,034,010
Reverse repurchase agreements in euro	1,136,043,600	869,977,933	266,065,667
Other financial assets	42,190,637	38,875,639	3,314,998
Total	6,888,490,580	6,308,075,905	580,414,675

- (a) Securities denominated in euro and reverse repurchase agreements in euro constitute the investment of the ECB's own funds (see also note 12, "Other liabilities").
- (b) At end-2004, the investment portfolios relating to the ECB's retirement plan, amounting to €120.2 million, were classified under this item. These have now been reclassified as part of the pension scheme net liability under "Other liabilities" (see "The ECB's retirement plan and other post-employment benefits" in the notes on accounting policies).
- (c) In 2005 the ECB acquired 211 additional shares in the Bank for International Settlements (BIS). This brought the ECB's total holding to 3,211 shares, which are included at the acquisition cost of €41.8 million.

#### *Accruals and prepaid expenses*

In 2005 this position included accrued interest receivable on the ECB's claims related to the allocation of euro banknotes within the Eurosystem for the final quarter (see "Banknotes in circulation" in the notes on accounting policies).

Also included under this item is accrued interest on securities and other financial assets.

#### *Sundry*

Included in this item is a claim against the German Federal Ministry of Finance in respect of recoverable value added tax and other indirect taxes paid. Such taxes are refundable under the terms of Article 3 of the Protocol on the privileges and immunities of the European Communities, which applies to the ECB by virtue of Article 40 of the Statute of the ESCB.

## **7 BANKNOTES IN CIRCULATION**

This item consists of the ECB's share of the total euro banknotes in circulation (see "Banknotes in circulation" in the notes on accounting policies).

## **8 LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO**

This item comprises deposits by members of the Euro Banking Association (EBA) which are used in order to provide the ECB with collateral in respect of the EBA's payments settled through the TARGET system.

## **9 LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO**

These liabilities principally represent balances held at the ECB by non-euro area NCBs arising from transactions processed via the TARGET system (see "Intra-ESCB balances/intra-Eurosystem balances" in the notes on accounting policies).

## **10 LIABILITIES TO EURO AREA AND NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**

The liabilities arising from repurchase agreements conducted with euro area and non-euro area residents in connection with the management of the foreign currency reserves of the ECB are as follows:

<i>Liabilities to euro area residents</i>	2005 €	2004 €	Change €
Repurchase agreements	0	4,967,080	(4,967,080)

  

<i>Liabilities to non-euro area residents</i>	2005 €	2004 €	Change €
Repurchase agreements	855,933,000	1,254,905,957	(398,972,957)

## 11 INTRA-EUROSYSTEM LIABILITIES

These represent the liabilities to the euro area NCBs that arose from the transfer of foreign reserve assets to the ECB when they joined the Eurosystem. In 2004, two adjustments were made to these balances to reflect (a) the five-yearly adjustment of the weighting in the ECB's capital key on 1 January 2004 and (b) the accession of ten new Member States on 1 May 2004, which also altered the ECB's capital key weighting. The combined effect of the two adjustments was to reduce these balances from €40.5 to €39.8 billion. No further adjustments took place in 2005.

These balances are remunerated at the latest available marginal rate for the Eurosystem's main refinancing operations, adjusted to reflect a zero return on the gold component (see note 18, "Net interest income").

	Capital key %	€
Nationale Bank van België/ Banque Nationale de Belgique	2.5502	1,419,101,951
Deutsche Bundesbank	21.1364	11,761,707,508
Bank of Greece	1.8974	1,055,840,343
Banco de España	7.7758	4,326,975,513
Banque de France	14.8712	8,275,330,931
Central Bank and Financial Services Authority of Ireland	0.9219	513,006,858
Banca d'Italia	13.0516	7,262,783,715
Banque centrale du Luxembourg	0.1568	87,254,014
De Nederlandsche Bank	3.9955	2,223,363,598
Oesterreichische Nationalbank	2.0800	1,157,451,203
Banco de Portugal	1.7653	982,331,062
Suomen Pankki – Finlands Bank	1.2887	717,118,926
<b>Total</b>	<b>71.4908</b>	<b>39,782,265,622</b>

## 12 OTHER LIABILITIES

This item consists mainly of interest due to the NCBs in respect of their claims relating to the foreign reserves transferred (see note 11, "Intra-Eurosystem liabilities"). Also included within this balance are (a) other accruals and outstanding repurchase transactions of €556 million conducted in connection with the management of the ECB's own funds (see

note 6, "Other assets") and (b) the net liability in respect of the ECB's pension obligations.

### *The ECB's retirement plan and other post-employment benefits*

The amounts recognised in the Balance Sheet in respect of the ECB's pension obligations (see "The ECB's retirement plan and other post-employment benefits" in the notes on accounting policies) are as follows:

	2005 € millions	2004 € millions
Present value of obligations	223.5	178.5
Fair value of plan assets	(161.2)	(120.2)
Unrecognised actuarial gains/(losses)	6.5	0
Liability recognised in the Balance Sheet	68.8	58.3

Included in the present value of the obligations are unfunded obligations relating to the pensions of Executive Board members and staff disability provisions of €30.4 million (2004: €23.0 million).

The amounts recognised in the Profit and Loss Account in 2005 and the amounts that would have been recognised in 2004 in respect of "Current service cost", "Interest on obligation" and "Expected return on plan assets" are as follows:

	2005 € millions	2004 € millions
Current service cost	24.6	17.6
Interest on obligation	6.2	4.8
Expected return on plan assets	(5.2)	(4.2)
Net actuarial (gains)/losses recognised in year	0	23.7
Total included in "Staff costs"	25.6	41.9

Changes in the present value of the defined benefit obligation are as follows:

	2005 € millions	2004 € millions
Opening defined benefit obligation	178.5	123.4
Service cost	24.6	17.6
Interest cost	6.2	4.8
Contributions paid by plan participants	9.3	8.4
Other net changes in liabilities representing plan participants' contributions	6.1	1.8
Benefits paid	(2.2)	(1.0)
Actuarial (gains)/losses	1.0	23.5
Closing defined benefit obligation	223.5	178.5

Changes in the fair value of plan assets are as follows:

	2005 € millions	2004 € millions
Opening fair value of plan assets	120.2	91.8
Expected return	5.2	4.2
Actuarial gains/(losses)	7.5	(0.2)
Contributions paid by employer	14.7	14.6
Contributions paid by plan participants	9.3	8.4
Benefits paid	(1.8)	(0.4)
Other net changes in assets representing plan participants' contributions	6.1	1.8
Closing fair value of plan assets	161.2	120.2

In preparing the valuations referred to in this note, the actuaries have used assumptions which the Executive Board has accepted for the purposes of accounting and disclosure.

The principal assumptions used for the purposes of calculating the staff scheme liability are as follows. The expected rate of return on plan assets is used by the actuaries for the purpose of calculating the annual charge to the Profit and Loss Account.

	2005 %	2004 %
Discount rate	4.10	4.50
Expected return on plan assets	6.00	6.00
Future salary increases	2.00	3.75
Future pension increases	2.00	2.25

### 13 PROVISIONS

Taking into account the ECB's large exposure to foreign exchange rate, interest rate and gold price risks, and the current size of its revaluation accounts, the Governing Council deemed it appropriate to establish a provision against these risks. As at 31 December 2005, an amount of €992 million was recorded in this provision, which had the effect of reducing net profit to exactly zero.

The provision will be used to fund future realised and unrealised losses, in particular valuation losses not covered by the revaluation accounts. The size and continuing requirement of this provision will be reviewed annually, based on the ECB's assessment of its future exposure to foreign exchange rate, interest rate and gold price risks. This assessment is based on generally accepted methods for estimating financial risks.

An appropriate provision against the contractual obligation of the ECB to restore its current premises to their original condition when they are vacated and the ECB moves to its final site and other provisions are included in this item.

### 14 REVALUATION ACCOUNTS

These accounts represent revaluation reserves arising from unrealised gains on assets and liabilities.

	2005 €	2004 €	Change €
Gold	4,362,459,301	1,853,957,106	2,508,502,195
Foreign currency	3,737,934,137	0	3,737,934,137
Securities	8,234,660	67,160,084	(58,925,424)
Total	8,108,628,098	1,921,117,190	6,187,510,908

The foreign exchange rates used for the year-end revaluation were as follows:

Exchange rates	2005	2004
US dollars per euro	1.1797	1.3621
Japanese yen per euro	138.90	139.65
Euro per SDR	1.2099	1.1396
Euro per fine ounce of gold	434.856	321.562

## 15 CAPITAL AND RESERVES

### Capital

The subscribed capital of the ECB is €5.565 billion. Paid-up capital amounts to €4.089 billion. The euro area NCBs have fully paid up their share of the capital, amounting to €3.978 billion (no changes having occurred in 2005), as follows:<sup>7</sup>

	Capital key %	€
Nationale Bank van België/ Banque Nationale de Belgique	2.5502	141,910,195
Deutsche Bundesbank	21.1364	1,176,170,751
Bank of Greece	1.8974	105,584,034
Banco de España	7.7758	432,697,551
Banque de France	14.8712	827,533,093
Central Bank and Financial Services Authority of Ireland	0.9219	51,300,686
Banca d'Italia	13.0516	726,278,371
Banque centrale du Luxembourg	0.1568	8,725,401
De Nederlandsche Bank	3.9955	222,336,360
Oesterreichische Nationalbank	2.0800	115,745,120
Banco de Portugal	1.7653	98,233,106
Suomen Pankki – Finlands Bank	1.2887	71,711,893
<b>Total</b>	<b>71.4908</b>	<b>3,978,226,562</b>

The 13 non-euro area NCBs are required to pay up a minimal percentage of their subscribed capital as a contribution to the operational costs of the ECB. In 2004, this percentage was increased from 5% to 7%. Including the amounts received from the ten new non-euro area NCBs, this contribution amounted to a total of €111,050,988 at end-2004. There were no changes during 2005. Unlike the euro area NCBs, the non-euro area NCBs are not entitled to receive any share of the distributable profits of the ECB, including income arising from the allocation of euro banknotes within the Eurosystem, nor are they liable to fund any loss of the ECB.

Non-euro area NCBs have paid up the following amounts:

	Capital key %	€
Česká národní banka	1.4584	5,680,860
Danmarks Nationalbank	1.5663	6,101,159
Eesti Pank	0.1784	694,916
Central Bank of Cyprus	0.1300	506,385
Latvijas Banka	0.2978	1,160,011
Lietuvos bankas	0.4425	1,723,656
Magyar Nemzeti Bank	1.3884	5,408,191
Central Bank of Malta	0.0647	252,024
Narodowy Bank Polski	5.1380	20,013,889
Banka Slovenije	0.3345	1,302,967
Národná banka Slovenska	0.7147	2,783,948
Sveriges Riksbank	2.4133	9,400,451
Bank of England	14.3822	56,022,530
<b>Total</b>	<b>28.5092</b>	<b>111,050,988</b>

## OFF-BALANCE-SHEET INSTRUMENTS

### 16 AUTOMATIC SECURITY LENDING PROGRAMME

As part of the management of the ECB's own funds, the ECB has concluded an automatic security lending programme agreement, whereby an appointed agent enters into security lending transactions on behalf of the ECB with a number of counterparties, designated by the ECB as eligible counterparties. Under this agreement, reverse transactions with a value of €0.9 billion (2004: €1 billion) were outstanding as at 31 December 2005 (see "Reverse transactions" in the notes on accounting policies).

### 17 INTEREST RATE FUTURES

In 2005 foreign currency interest rate futures were used as part of the management of the ECB's foreign reserves. As at 31 December 2005, the following transactions were outstanding:

Foreign currency interest rate futures	Contract value €
Purchases	5,021,586,677
Sales	100,873,103

<sup>7</sup> Individual amounts are shown rounded to the nearest euro. Totals in the tables of this section may not add up due to rounding.

## NOTES ON THE PROFIT AND LOSS ACCOUNT

### 18 NET INTEREST INCOME

#### *Interest income on foreign reserve assets*

This item includes interest income, net of interest expense, in respect of the assets and liabilities denominated in foreign currency, as follows:

	2005 €	2004 €	Change €
Interest on current accounts	7,519,063	3,744,188	3,774,875
Money market deposit income	124,214,410	49,854,512	74,359,898
Reverse repurchase agreements	153,568,329	63,759,141	89,809,188
Net income on securities	641,956,243	317,073,827	324,882,416
<b>Total interest income on foreign reserve assets</b>	<b>927,258,045</b>	<b>434,431,668</b>	<b>492,826,377</b>
Interest expense on current accounts	(221,697)	(32,020)	(189,677)
Repurchase agreements	(37,562,595)	(11,947,990)	(25,614,605)
Other interest expense (net)	(64,964)	(32,960)	(32,004)
<b>Interest income on foreign reserve assets (net)</b>	<b>889,408,789</b>	<b>422,418,698</b>	<b>466,990,091</b>

Interest income increased significantly during 2005 due to rising interest rates on US dollar-denominated assets.

#### *Interest income arising from the allocation of euro banknotes within the Eurosystem*

This item consists of the interest income relating to the ECB's 8% share in the total euro banknote issue. Interest on the claims of the ECB in respect of its share of banknotes is earned at the latest available marginal rate for the Eurosystem's main refinancing operations. This income is distributed to the NCBs as outlined under "Banknotes in circulation" in the notes on accounting policies.

Based on the ECB's estimated financial result for 2005, the Governing Council decided in December 2005:

(a) to recall the three quarterly interim distributions already paid to the NCBs during the year, amounting to €634 million in total;

(b) to withhold the final quarterly interim distribution of €234 million.

#### *Remuneration of NCBs' claims in respect of foreign reserves transferred*

Remuneration paid to euro area NCBs on their claims on the ECB in respect of the foreign reserve assets transferred under Article 30.1 of the Statute of the ESCB is disclosed under this item.

#### *Other interest income and Other interest expense*

These items include interest income of €1.6 billion (2004: €1.2 billion) and expenses of €1.5 billion (2004: €1.1 billion) on balances arising from TARGET. Interest income and expenses in respect of other assets and liabilities denominated in euro are also shown here.

### 19 REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

Net realised gains arising from financial operations in 2005 were as follows:

	2005 €	2004 €	Change €
Net realised price gains on securities	14,854,774	94,643,135	(79,788,361)
Net realised gold price and exchange rate gains/(losses)	134,514,361	41,402,675	93,111,686
Realised gains arising from financial operations	149,369,135	136,045,810	13,323,325

## 20 WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS

	2005 €	2004 €	Change €
Unrealised price losses on securities	(97,487,772)	(28,485,006)	(69,002,766)
Unrealised exchange rate losses	(6,309)	(2,064,800,103)	2,064,793,794
Total	(97,494,081)	(2,093,285,109)	1,995,791,028

This expense is primarily due to the write-down of the average acquisition cost of the ECB's US dollar security holdings to their end-of-year prices.

## 21 NET EXPENSE FROM FEES AND COMMISSIONS

	2005 €	2004 €	Change €
Income from fees and commissions	473,432	297,964	175,468
Expenses relating to fees and commissions	(655,805)	(559,481)	(96,324)
Net expense from fees and commissions	(182,373)	(261,517)	79,144

Income under this heading arose primarily from penalties imposed on credit institutions for non-compliance with the minimum reserve requirements. Expenses primarily relate to fees payable on current accounts and in connection with the execution of foreign currency interest rate futures (see note 17, "Interest rate futures").

## 22 OTHER INCOME

Other miscellaneous income during the year arose principally from the transfer of unused administrative provisions to the Profit and Loss Account. In particular, following changes in the ECB's tenancy agreements, the reassessment and consequent reduction of the provision against its contractual obligation to restore its

current premises to their original condition when they are vacated, led to an increase in this item.

## 23 STAFF COSTS

Salaries, allowances and staff insurance costs of €126.9 million (2004: €120.0 million) are included under this heading. The emoluments of the Executive Board amounted to a total of €2.1 million (2004: €2.1 million). In 2005, transitional payments made to departing members of the Executive Board and pensions paid to former members or their dependants amounted to €0.4 million in total (2004: €0.5 million).

Salaries and allowances, including the emoluments of holders of senior management positions, are modelled in essence on, and are comparable with, the remuneration scheme of the European Communities.

Also included under this item is an amount of €25.6 million (2004: €41.9 million) recognised in connection with the ECB's retirement plan and other post-employment benefits (see note 12, "Other liabilities").

The reduction in the item "Staff costs" is primarily due to a change in the accounting treatment applied to the recognition of net actuarial gains/losses in respect of the ECB's retirement plan and other post-employment benefits. The pension charge in 2004 was considerably higher due to the recognition of €23.7 million in net actuarial losses in their entirety in the year in which they arose. In 2005, since the 10% corridor approach now applies, no actuarial gains/losses were recognised in the Profit and Loss Account (see note 12, "Other liabilities").

At the end of 2005 the ECB employed 1,351 staff, of whom 131 held managerial positions. The change in the number of staff during 2005 was as follows:

	2005	2004
As at 1 January	1,309	1,213
New staff	82	137
Resignations	40	41
As at 31 December	1,351	1,309
Average number of staff employed	1,331	1,261

## 24 ADMINISTRATIVE EXPENSES

These cover all other current expenses relating to the renting and maintenance of premises, goods and equipment of a non-capital nature, professional fees and other services and supplies, together with staff-related expenses including recruitment, relocation, installation, training and resettlement.

## 25 BANKNOTE PRODUCTION SERVICES

This expense relates to costs arising from cross-border transportation of euro banknotes between NCBs to meet unexpected fluctuations in demand for banknotes. These costs are borne centrally by the ECB.

## NOTE ON PROFIT DISTRIBUTION/ ALLOCATION OF LOSSES

*This note is not part of the financial statements of the ECB for the year 2005.*

### INCOME RELATED TO THE ECB'S SHARE OF TOTAL BANKNOTES IN CIRCULATION

In 2004, following a decision by the Governing Council, income of €733 million earned on the ECB's share of total banknotes in circulation was retained to ensure that the ECB's total profit distribution for the year did not exceed its net profit for the year. Similarly, in 2005 an amount of €868 million was retained. Both amounts represented the full income earned on the ECB's share of total euro banknotes in circulation in the years in question.

### PROFIT DISTRIBUTION/COVERAGE OF LOSSES

Pursuant to Article 33 of the Statute of the ESCB, the net profit of the ECB shall be transferred in the following order:

- (a) an amount to be determined by the Governing Council, which may not exceed 20% of the net profit, shall be transferred to the general reserve fund subject to a limit equal to 100% of the capital; and
- (b) the remaining net profit shall be distributed to the shareholders of the ECB in proportion to their paid-up shares.

In the event of a loss incurred by the ECB, the shortfall may be offset against the general reserve fund of the ECB and, if necessary, following a decision by the Governing Council, against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the NCBs in accordance with Article 32.5 of the Statute.<sup>1</sup>

In 2005 the establishment of a provision against foreign exchange rate, interest rate and gold price risks for the amount of €992 million had the effect of reducing net profit to exactly zero. Consequently, no transfers to the general

reserve fund or profit distribution to the shareholders of the ECB took place. There was also no requirement to offset a loss.

The treatment of the ECB's net profit/loss arising in 2004 and 2005 can therefore be summarised as follows:

	2005 €	2004 €
Net profit/(loss) for the year	0	(1,636,028,702)
Withdrawals from the general reserve fund	0	296,068,424
Transfer from NCBs' pooled monetary income	0	1,339,960,278
Total	0	0

<sup>1</sup> Under Article 32.5 of the Statute of the ESCB, the sum of the NCBs' monetary income shall be allocated to the NCBs in proportion to their paid-up shares in the capital of the ECB.

## Auditor's report

President and Governing Council  
of the European Central Bank

Frankfurt am Main

We have audited the accompanying balance sheet of the European Central Bank as of 31 December 2005 and the related profit and loss account for the year then ended as well as the notes. These annual accounts are the responsibility of the European Central Bank's Executive Board. Our responsibility is to express an opinion on these annual accounts based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the annual accounts give a true and fair view of the financial position of the European Central Bank as of 31 December 2005 and of the results of its operations for the year then ended in accordance with the accounting policies as described in the first part of the notes.

Frankfurt am Main, 7 March 2006

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Wohlmannstetter  
Wirtschaftsprüfer

Dr. Lemnitzer  
Wirtschaftsprüfer