

# MANAGEMENT REPORT FOR THE YEAR ENDING 31 DECEMBER 2006

## 1 NATURE OF THE BUSINESS

The ECB's activities in 2006 are described in detail in the relevant chapters of the Annual Report.

## 2 OBJECTIVES AND TASKS

The ECB's objectives and tasks are described in the Statute of the ESCB (Articles 2 and 3). Furthermore, an overview of these objectives is included in the President's foreword to the Annual Report.

## 3 KEY RESOURCES, RISKS AND PROCESSES

### GOVERNANCE OF THE ECB

Information relating to the governance of the ECB is given in Chapter 8.

### MEMBERS OF THE EXECUTIVE BOARD

The members of the Executive Board are appointed from among persons of recognised standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of the Heads of State or Government, upon a recommendation from the EU Council after it has consulted the European Parliament and the Governing Council.

The terms and conditions of members' employment are determined by the Governing Council, based on a proposal from a Committee comprising three members appointed by the Governing Council and three members appointed by the EU Council.

### EMPLOYEES

The average number of staff (full-time equivalent) employed on permanent or fixed-term contracts by the ECB rose from 1,331 in 2005 to 1,360 in 2006. At the end of that year 1,367 staff were employed. For further details,

see the notes on the Profit and Loss Account and Chapter 8, Section 2, which also describes the ECB's human resources strategy.

### INVESTMENT ACTIVITIES AND RISK MANAGEMENT

The ECB's foreign reserves portfolio consists of foreign reserve assets transferred to it by the euro area NCBs in accordance with the provisions of Article 30 of the Statute of the European System of Central Banks and of the European Central Bank, and the income thereon. It serves 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 counterpart of the provision against foreign exchange, interest rate and gold price risks, the general reserve fund and income accumulated on the portfolio in the past. Its purpose is to provide the ECB with income to contribute to the coverage of its operating expenses.

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

### THE BUDGET PROCESS

The Budget Committee (BUCOM), composed of ECB and euro area NCB experts, is a key contributor to the ECB's financial governance process. In accordance with Article 15 of the Rules of Procedure, BUCOM supports the Governing Council by providing a detailed evaluation of annual ECB budget proposals and requests for supplementary budget funding by the Executive Board, prior to their submission to the Governing Council for approval. Spending against agreed budgets is monitored regularly by the Executive Board, taking into account the advice of the ECB's internal controlling function, and by the Governing Council with the assistance of BUCOM.

## 4 FINANCIAL RESULT

### 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 then approved by the Governing Council and subsequently published.

### 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.

In 2005, taking into account the ECB's large exposure to these risks and the size of its revaluation accounts, the Governing Council decided to establish a provision against foreign exchange rate, interest rate and gold price risks. Consequently, as at 31 December 2005, an amount of €992 million was recorded in this provision. As at 31 December 2006, an additional amount of €1,379 million was recorded, increasing its size to €2,371 million and, as in 2005, reducing net profit 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 and continuing requirement is reviewed annually.

### FINANCIAL RESULT FOR 2006

Had the provision against foreign exchange rate, interest rate and gold price risks not been

increased in 2006, the ECB would have reported a net profit of €1,379 million.

In 2006, the appreciation of the euro vis-à-vis the Japanese yen resulted in write-downs in the euro value of the ECB's holdings of yen-denominated assets of some €0.6 billion, which were expensed in the Profit and Loss Account.

In 2006 net interest income increased to €1,972 million from €1,270 in 2005, owing mainly to (a) an increase in euro banknotes in circulation and in the marginal rate for the Eurosystem's main refinancing operations, which determines the remuneration that the ECB receives on its share of euro banknotes in the Eurosystem; and (b) a rise in US dollar interest rates.

Net realised gains arising from financial operations rose from €149 million in 2005 to €475 million in 2006. The depreciation of the euro vis-à-vis gold, in conjunction with increased volumes of gold sales in 2006, resulted in greater realised gains. These sales were conducted in accordance with the Central Bank Gold Agreement of 27 September 2004, of which the ECB is a signatory.

Total administrative expenses of the ECB, including depreciation, increased from €348 million in 2005 to €361 million in 2006.

Staff costs rose primarily owing to an increase in the average number of staff employed during the year and an increased pension charge in 2006. The emoluments of the Executive Board amounted to a total of €2.2 million (2005: €2.1 million).

## BALANCE SHEET AS AT 31 DECEMBER 2006

ASSETS	NOTE NUMBER	2006 €	2005 €
<b>Gold and gold receivables</b>	<b>1</b>	<b>9,929,865,976</b>	<b>10,064,527,857</b>
<b>Claims on non-euro area residents denominated in foreign currency</b>	<b>2</b>		
Receivables from the IMF		414,768,308	170,162,349
Balances with banks and security investments, external loans and other external assets		29,313,377,277	31,062,557,242
		<b>29,728,145,585</b>	<b>31,232,719,591</b>
<b>Claims on euro area residents denominated in foreign currency</b>	<b>2</b>	<b>2,773,828,417</b>	<b>2,908,815,389</b>
<b>Claims on non-euro area residents denominated in euro</b>	<b>3</b>		
Balances with banks, security investments and loans		4,193,677	13,416,711
<b>Other claims on euro area credit institutions denominated in euro</b>	<b>4</b>	<b>33,914</b>	<b>25,000</b>
<b>Intra-Eurosystem claims</b>	<b>5</b>		
Claims related to the allocation of euro banknotes within the Eurosystem		50,259,459,435	45,216,783,810
Other claims within the Eurosystem (net)		3,545,868,495	5,147,038,409
		<b>53,805,327,930</b>	<b>50,363,822,219</b>
<b>Other assets</b>	<b>6</b>		
Tangible fixed assets		175,180,989	175,237,902
Other financial assets		8,220,270,389	6,888,490,580
Off-balance-sheet instruments revaluation differences		29,518,315	0
Accruals and prepaid expenses		1,094,509,354	679,603,366
Sundry		5,580,697	4,397,807
		<b>9,525,059,744</b>	<b>7,747,729,655</b>
<b>Total assets</b>		<b>105,766,455,243</b>	<b>102,331,056,422</b>

LIABILITIES	NOTE NUMBER	2006 €	2005 €
<b>Banknotes in circulation</b>	7	50,259,459,435	45,216,783,810
<b>Liabilities to other euro area residents denominated in euro</b>	8	1,065,000,000	1,050,000,000
<b>Liabilities to non-euro area residents denominated in euro</b>	9	105,121,522	649,304,896
<b>Liabilities to non-euro area residents denominated in foreign currency</b>	10		
Deposits, balances and other liabilities		330,955,249	855,933,000
<b>Intra-Eurosystem liabilities</b>	11		
Liabilities equivalent to the transfer of foreign reserves		39,782,265,622	39,782,265,622
<b>Other liabilities</b>	12		
Accruals and income collected in advance		1,262,820,884	919,344,079
Sundry		899,170,800	632,012,224
		<b>2,161,991,684</b>	<b>1,551,356,303</b>
<b>Provisions</b>	13	2,393,938,510	1,027,507,143
<b>Revaluation accounts</b>	14	5,578,445,671	8,108,628,098
<b>Capital and reserves</b>	15		
Capital		4,089,277,550	4,089,277,550
<b>Profit for the year</b>		<b>0</b>	<b>0</b>
<b>Total liabilities</b>		<b>105,766,455,243</b>	<b>102,331,056,422</b>

## PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING 31 DECEMBER 2006

	NOTE NUMBER	2006 €	2005 €
Interest income on foreign reserve assets		1,318,243,236	889,408,789
Interest income arising from the allocation of euro banknotes within the Eurosystem		1,318,852,000	868,451,848
Other interest income		2,761,697,060	1,794,267,421
<i>Interest income</i>		<i>5,398,792,296</i>	<i>3,552,128,058</i>
Remuneration of NCBs' claims in respect of foreign reserves transferred		(965,331,593)	(710,160,404)
Other interest expense		(2,461,625,254)	(1,572,338,709)
<i>Interest expense</i>		<i>(3,426,956,847)</i>	<i>(2,282,499,113)</i>
<b>Net interest income</b>	<b>20</b>	<b>1,971,835,449</b>	<b>1,269,628,945</b>
Realised gains/losses arising from financial operations	21	475,380,708	149,369,135
Write-downs on financial assets and positions	22	(718,467,508)	(97,494,081)
Transfer to/from provisions for foreign exchange rate and price risks		(1,379,351,719)	(992,043,443)
<b>Net result of financial operations, write-downs and risk provisions</b>		<b>(1,622,438,519)</b>	<b>(940,168,389)</b>
<b>Net expense from fees and commissions</b>	<b>23</b>	<b>(546,480)</b>	<b>(182,373)</b>
<b>Income from equity shares and participating interests</b>	<b>24</b>	<b>911,866</b>	<b>853,403</b>
<b>Other income</b>	<b>25</b>	<b>11,407,583</b>	<b>17,428,558</b>
<b>Total net income</b>		<b>361,169,899</b>	<b>347,560,144</b>
Staff costs	26	(160,847,043)	(153,048,314)
Administrative expenses	27	(166,426,595)	(158,457,219)
Depreciation of tangible fixed assets		(29,162,141)	(31,888,637)
Banknote production services	28	(4,734,120)	(4,165,974)
<b>Profit for the year</b>		<b>0</b>	<b>0</b>

Frankfurt am Main, 27 February 2007

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.

## RECOGNITION OF ASSETS AND LIABILITIES

An asset or liability is only recognised in the Balance Sheet when it is probable that any associated future economic benefit will flow to or from the ECB, substantially all of the associated risks and rewards have been transferred to the ECB, and the cost or value of the asset or the amount of the obligation can be measured reliably.

## 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.

With effect from 1 January 2007, the basis for recording foreign exchange transactions, financial instruments denominated in foreign currency and related accruals in the accounts of Eurosystem central banks has changed. Early application was permitted, and the ECB introduced the change as at 1 October 2006,

with the following effects. With the exception of securities, transactions are now recorded in off-balance-sheet accounts on the trade date. At settlement date the off-balance-sheet entries are reversed and transactions are booked on-balance-sheet. Purchases and sales of foreign currency affect the net foreign currency position on the trade date, rather than on the spot settlement date as has been the case hitherto, and realised results arising from sales are also calculated on the trade date. Accrued interest, premiums and discounts related to financial instruments denominated in foreign currency are calculated and booked daily, and the foreign currency position is also affected daily by these accruals instead of changing only when interest cash flows actually occur, as was the case previously. Retrospective application of this change in accounting policies to earlier periods is not practicable.

## 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 on the recording date. 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

- 1 The detailed accounting policies of the ECB are laid down in Decision ECB/2002/11, OJ L 58, 3.3.2003, p. 38, as amended. With effect from 1 January 2007, this Decision has been repealed and replaced by Decision ECB/2006/17, OJ L 348, 11.12.2006, p. 38.
- 2 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.

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 2006, was derived from the exchange rate of the euro against the US dollar on 29 December 2006.

### 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 2006, mid-market prices on 29 December 2006 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.

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 2006 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. Daily changes in the variation margin of open interest rate futures contracts are recorded in the Profit and Loss Account. The valuation of forward transactions in securities is based on a generally accepted valuation method using observable market prices and the discount factors from the settlement date to the valuation date.

### 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 (Denmarks Nationalbank and the Bank of England) with the ECB, arising from their participation in TARGET, are disclosed under “Liabilities to non-euro area residents denominated in euro”. On 31 December 2006, Sveriges Riksbank ceased to participate in TARGET.

### 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.

### BALANCE SHEET

The liability 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.

#### **PROFIT AND LOSS ACCOUNT**

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

- (a) the current service cost of the benefits accruing for the year;
- (b) interest at the discount rate on the defined benefit obligation;
- (c) the expected return on the plan assets; and
- (d) 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

3 Decision ECB/2001/15 of 6 December 2001 on the issue of euro banknotes, OJ L 337, 20.12.2001, p. 52, 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 Decision ECB/2001/16 of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002, OJ L 337, 20.12.2001, p. 55, as amended.

notes on accounting policies). Interest income on these claims is included within the item “Net interest income”. Until 2005, this income was distributed separately to the NCBs in the form of an interim distribution after the end of each quarter.<sup>6</sup> For 2006 onwards, the Governing Council has decided that this income is due to the NCBs in the financial year in which it accrues, but is to be distributed on the second working day of the following year.<sup>7</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 subject to any decisions by the Governing Council to make transfers to a provision for foreign exchange rate, interest rate and gold price risks and to charge costs incurred by the ECB in connection with the issue and handling of euro banknotes against this income.

## **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.

6 Decision ECB/2002/9 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, OJ L 323, 28.11.2002, p. 49.

7 Decision ECB/2005/11 of 17 November 2005 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, OJ L 311, 26.11.2005, p. 41. This Decision repealed Decision ECB/2002/9.

## NOTES ON THE BALANCE SHEET

### I GOLD AND GOLD RECEIVABLES

As at 31 December 2006 the ECB held 20.6 million ounces of fine gold (2005: 23.1 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 decrease in the euro value of this holding due to these sales was partially compensated by a significant rise in the price of gold during 2006 (see “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

<i>Claims on non-euro area residents</i>	2006 €	2005 €	Change €
Current accounts	1,388,630,590	5,149,756,962	(3,761,126,372)
Money market deposits	1,352,326,756	1,182,580,317	169,746,439
Reverse repurchase agreements	330,983,321	1,306,216,228	(975,232,907)
Security investments	26,241,436,610	23,424,003,735	2,817,432,875
<b>Total</b>	<b>29,313,377,277</b>	<b>31,062,557,242</b>	<b>(1,749,179,965)</b>

### 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 2006. 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).

<i>Claims on euro area residents</i>	2006 €	2005 €	Change €
Current accounts	18,535	25,019	(6,484)
Money market deposits	2,621,949,594	2,908,790,370	(286,840,776)
Reverse repurchase agreements	151,860,288	0	151,860,288
<b>Total</b>	<b>2,773,828,417</b>	<b>2,908,815,389</b>	<b>(134,986,972)</b>

The decrease in these positions in 2006 is primarily due to the depreciation of the US dollar and, to a lesser extent, the Japanese yen against the euro (see “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

The ECB’s net foreign currency holdings<sup>8</sup> of US dollars and Japanese yen, as at 31 December 2006, were as follows:

	(million currency units)
US dollars	35,000
Japanese yen	856,308

### 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:

<sup>8</sup> Net assets denominated in the respective foreign currency that are subject to foreign currency revaluation. These are included under the captions “Claims on non-euro area residents denominated in foreign currency”, “Claims on euro area residents denominated in foreign currency”, “Accruals and prepaid expenses”, “Liabilities to non-euro area residents denominated in foreign currency” and “Accruals and income collected in advance”, also taking into account foreign exchange forward and swap transactions under off-balance-sheet items. The effects of the price revaluation gains on securities denominated in foreign currency are not included.

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

As at 31 December 2006 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 2006 this claim consisted of bank deposits with euro area residents.

### 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 was due from the euro area NCBs in respect of interim distributions of the ECB’s income derived from banknotes. This represented the interim distributions of such income to the euro area NCBs for the first three quarters of the year, which were subsequently recalled. Such interim distributions have ceased since 2006 (see “Banknotes in circulation” in the notes on accounting policies and note 20, “Net interest income”).

	2006 €	2005 €
Due from euro area NCBs in respect of TARGET	83,764,470,700	75,906,443,905
Due to euro area NCBs in respect of TARGET	(80,218,602,205)	(71,393,877,603)
Net TARGET position	3,545,868,495	4,512,566,302
Due from/(to) euro area NCBs in respect of the interim distribution of the ECB’s income derived from banknotes	0	634,472,107
Other claims within the Eurosystem (net)	3,545,868,495	5,147,038,409

### 6 OTHER ASSETS

#### TANGIBLE FIXED ASSETS

These assets comprised the following main items on 31 December 2006:

	2006 €	2005 €	Change €
<b>Cost</b>			
Land and buildings	160,272,602	158,681,104	1,591,498
Computer hardware and software	157,573,338	147,880,213	9,693,125
Equipment, furniture, plant in building and motor vehicles	26,670,476	26,238,407	432,069
Assets under construction	28,790,200	11,576,491	17,213,709
Other fixed assets	1,232,143	1,126,210	105,933
<b>Total cost</b>	<b>374,538,759</b>	<b>345,502,425</b>	<b>29,036,334</b>
<b>Accumulated depreciation</b>			
Land and buildings	(39,696,727)	(29,694,172)	(10,002,555)
Computer hardware and software	(135,057,096)	(117,129,048)	(17,928,048)
Equipment, furniture, plant in building and motor vehicles	(24,471,251)	(23,308,719)	(1,162,532)
Other fixed assets	(132,696)	(132,584)	(112)
<b>Total accumulated depreciation</b>	<b>(199,357,770)</b>	<b>(170,264,523)</b>	<b>(29,093,247)</b>
<b>Net book value</b>	<b>175,180,989</b>	<b>175,237,902</b>	<b>(56,913)</b>

The increase in “Land and buildings” at cost is due mainly to the acquisition of a new official residence for Presidents of the ECB in December 2006. The original residence, purchased in 2001, was sold in January 2007.

The increase in the category “Assets under construction” relates mainly to initial works at the site of the new ECB premises. Transfers from this category to the relevant fixed asset captions will occur once the assets are in use.

#### OTHER FINANCIAL ASSETS

The main components of this item are as follows:

	2006 €	2005 €	Change €
Securities denominated in euro	7,303,413,758	5,710,256,343	1,593,157,415
Reverse repurchase agreements in euro	874,669,464	1,136,043,600	(261,374,136)
Other financial assets	42,187,167	42,190,637	(3,470)
Total	8,220,270,389	6,888,490,580	1,331,779,809

- (a) Securities denominated in euro and reverse repurchase agreements in euro constitute the investment of the ECB’s own funds (see note 12, “Other liabilities”). The increase in securities held was due mainly to the investment in the own funds portfolio of the counterpart of the ECB’s provision against foreign exchange, interest rate and gold price risks established by the ECB in 2005.
- (b) The ECB holds 3,211 shares in the BIS, which are included at the acquisition cost of €41.8 million.

#### OFF-BALANCE-SHEET INSTRUMENTS REVALUATION DIFFERENCES

This item is composed of valuation changes in foreign exchange swap and forward transactions that were outstanding on 31 December 2006 (see note 19, “Foreign exchange swap and

forward transactions”). These differences arise from the conversion of such transactions into euro equivalent at the exchange rates prevailing on the Balance Sheet date, compared with the euro values at which the transactions are carried in the accounts (see “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

#### ACCRUALS AND PREPAID EXPENSES

In 2005, accrued interest receivable on the ECB’s claims related to the allocation of euro banknotes within the Eurosystem (see “Banknotes in circulation” in the notes on accounting policies) was reported on a gross basis under “Accruals and prepaid expenses” and “Accruals and income collected in advance”. This interest is now disclosed on a net basis under “Accruals and prepaid expenses” in order better to reflect economic reality. For comparison purposes, €412,341,791 has been reclassified from the 2005 balance shown under “Accruals and income collected in advance” to “Accruals and prepaid expenses”, reducing the balance of both these positions accordingly.

Also included under this item is accrued interest, including the amortisation of discounts, on securities and other financial assets.

#### SUNDRY

This item includes 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 (8%) 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 NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

This position consists of repurchase agreements conducted with non-euro area residents in connection with the management of the foreign currency reserves of the ECB.

## 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. No adjustments were made in 2006.

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 20, “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
Central Bank and Financial Services Authority of Ireland	0.9219	513,006,858
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
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, including the amortisation of coupon bond premiums, and outstanding repurchase transactions of €772 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:

	2006 € millions	2005 € millions
Present value of obligations	258.5	223.5
Fair value of plan assets	(195.3)	(161.2)
Unrecognised actuarial gains/(losses)	17.3	6.5
Liability recognised in the Balance Sheet	80.5	68.8

The present value of the obligations includes unfunded obligations of €32.6 million (2005: €30.4 million) relating to the pensions of Executive Board members and to staff disability provisions.

The amounts recognised in the Profit and Loss Account in 2006 and 2005 in respect of “Current service cost”, “Interest on obligation” and “Expected return on plan assets” are as follows:

	2006 € millions	2005 € millions
Current service cost	27.3	24.6
Interest on obligation	6.8	6.2
Expected return on plan assets	(6.7)	(5.2)
Net actuarial (gains)/losses recognised in year	0	0
Total included in “Staff costs”	27.4	25.6

Under the 10% corridor approach (see “The ECB’s retirement plan and other post-employment benefits” in the notes on accounting policies), no actuarial gains were recognised in the Profit and Loss Account in 2006.

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

	2006 € millions	2005 € millions
Opening defined benefit obligation	223.5	178.5
Service cost	27.3	24.6
Interest cost	6.8	6.2
Contributions paid by plan participants	10.4	9.3
Other net changes in liabilities representing plan participants’ contributions	3.7	6.1
Benefits paid	(2.6)	(2.2)
Actuarial (gains)/losses	(10.6)	1.0
Closing defined benefit obligation	258.5	223.5

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

	2006 € millions	2005 € millions
Opening fair value of plan assets	161.2	120.2
Expected return	6.7	5.2
Actuarial gains/(losses)	0.2	7.5
Contributions paid by employer	15.4	14.7
Contributions paid by plan participants	10.3	9.3
Benefits paid	(2.2)	(1.8)
Other net changes in assets representing plan participants’ contributions	3.7	6.1
Closing fair value of plan assets	195.3	161.2

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.

	2006 %	2005 %
Discount rate	4.60	4.10
Expected return on plan assets	6.00	6.00
Future salary increases	2.00	2.00
Future pension increases	2.00	2.00

### 13 PROVISIONS

Taking into account the ECB’s large exposure to foreign exchange rate, interest rate and gold price risks, and the size of its revaluation accounts, the Governing Council deemed it appropriate to establish a provision against these risks. Consequently, as at 31 December 2005, an amount of €992 million was recorded in this provision. As at 31 December 2006, an additional amount of €1,379 million was recorded, increasing its size to €2,371 million and, as in 2005, 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 is 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 is included in this item, together with other miscellaneous provisions.

## 14 REVALUATION ACCOUNTS

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

	2006 €	2005 €	Change €
Gold	4,861,575,989	4,362,459,301	499,116,688
Foreign currency	701,959,896	3,737,934,137	(3,035,974,241)
Securities	14,909,786	8,234,660	6,675,126
<b>Total</b>	<b>5,578,445,671</b>	<b>8,108,628,098</b>	<b>(2,530,182,427)</b>

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

Exchange rates	2006	2005
US dollars per euro	1.3170	1.1797
Japanese yen per euro	156.93	138.90
Euro per SDR	1.1416	1.2099
Euro per fine ounce of gold	482.688	434.856

## 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 2006), as follows:<sup>9</sup>

	Capital key %	€
Nationale Bank van België/ Banque Nationale de Belgique	2.5502	141,910,195
Deutsche Bundesbank	21.1364	1,176,170,751
Central Bank and Financial Services Authority of Ireland	0.9219	51,300,686
Bank of Greece	1.8974	105,584,034
Banco de España	7.7758	432,697,551
Banque de France	14.8712	827,533,093
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 7% of their subscribed capital as a contribution to the operational costs of the ECB. Including the amounts received from the ten new non-euro area NCBs, this contribution amounted to a total of €111,050,988 at end-2006, unchanged from 2005. 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>

<sup>9</sup> Individual amounts are shown rounded to the nearest euro. Totals in the tables of this section may not add up due to rounding.



## 16 POST-BALANCE-SHEET EVENTS

### CHANGES TO THE ECB'S CAPITAL KEY

#### BACKGROUND

Pursuant to Article 29 of the ESCB Statute, the shares of the NCBs in the ECB's capital key are weighted according to the shares of the respective Member States in the EU's total population and GDP in equal measure, as notified to the ECB by the European Commission. These weights are adjusted every five years and whenever new Member States join the EU. Based on Council Decision 2003/517/EC of 15 July 2003 on the statistical data to be used for the adjustment of the key for subscription to the capital of the European Central Bank, the NCBs' capital key shares were adjusted on 1 January 2007, upon the accession of Bulgaria and Romania as new Member States, as follows:

	From 1 May 2004 to 31 December 2006 %	From 1 January 2007 %
Nationale Bank van België/ Banque Nationale de Belgique	2.5502	2.4708
Deutsche Bundesbank	21.1364	20.5211
Central Bank and Financial Services Authority of Ireland	0.9219	0.8885
Bank of Greece	1.8974	1.8168
Banco de España	7.7758	7.5498
Banque de France	14.8712	14.3875
Banca d'Italia	13.0516	12.5297
Banque centrale du Luxembourg	0.1568	0.1575
De Nederlandsche Bank	3.9955	3.8937
Oesterreichische Nationalbank	2.0800	2.0159
Banco de Portugal	1.7653	1.7137
Banka Slovenije	-	0.3194
Suomen Pankki – Finlands Bank	1.2887	1.2448
<b>Subtotal for euro area NCBs</b>	<b>71.4908</b>	<b>69.5092</b>
Bulgarian National Bank	-	0.8833
Česká národní banka	1.4584	1.3880
Danmarks Nationalbank	1.5663	1.5138
Eesti Pank	0.1784	0.1703
Central Bank of Cyprus	0.1300	0.1249
Latvijas Banka	0.2978	0.2813
Lietuvos bankas	0.4425	0.4178
Magyar Nemzeti Bank	1.3884	1.3141
Central Bank of Malta	0.0647	0.0622

Narodowy Bank Polski	5.1380	4.8748
Banca Națională a României	-	2.5188
Banka Slovenije	0.3345	-
Národná banka Slovenska	0.7147	0.6765
Sveriges Riksbank	2.4133	2.3313
Bank of England	14.3822	13.9337
<b>Subtotal for non-euro area NCBs</b>	<b>28.5092</b>	<b>30.4908</b>
<b>Total</b>	<b>100.0000</b>	<b>100.0000</b>

#### ENTRY OF SLOVENIA INTO THE EURO AREA

Pursuant to Council Decision 2006/495/EC of 11 July 2006, taken in accordance with Article 122(2) of the Treaty, Slovenia adopted the single currency on 1 January 2007. In accordance with Article 49.1 of the Statute of the ESCB and the legal acts adopted by the Governing Council on 30 December 2006<sup>10</sup>, Banka Slovenije paid up an amount of €17,096,556 as at 1 January 2007, representing the remainder of its capital subscription to the ECB. On 2 and 3 January 2007, in accordance with Article 30.1 of the Statute of the ESCB, Banka Slovenije transferred foreign reserve assets with a total value equivalent to €191,641,809 to the ECB. The total amount transferred was determined by multiplying the euro value, at the exchange rates prevailing on 29 December 2006, of the foreign reserve assets already transferred to the ECB by the ratio between the number of shares subscribed by Banka Slovenije and the number of shares already paid up by the other NCBs without a derogation. These foreign reserve assets comprised amounts of US dollars in the form of cash, and gold, in proportions of 85 to 15 respectively.

Banka Slovenije was credited with a claim in respect of the paid-up capital and foreign reserve assets equivalent to the amounts

<sup>10</sup> Decision ECB/2006/30 of 30 December 2006 on Banka Slovenije's paying-up of capital, transfer of foreign reserve assets and contribution to the European Central Bank's reserves and provisions, OJ L 24, 31.1.2007, p. 17; Agreement of 30 December 2006 between the European Central Bank and Banka Slovenije regarding the claim credited to Banka Slovenije by the European Central Bank under Article 30.3 of the Statute of the European System of Central Banks and of the European Central Bank, OJ C 17, 25.1.2007, p. 26.

transferred. The latter is to be treated in an identical manner to the existing claims of the other participating NCBs (see note 11, “Intra-Eurosystem liabilities”).

## EFFECT OF CHANGES

### CAPITAL OF THE ECB

The enlargement of the European Union through the accession of Bulgaria and Romania and the concomitant change in the subscribed capital and capital key of the ECB, in conjunction with Slovenia joining the euro area, resulted in an increase of €37,858,680 in the ECB’s paid-up capital.

### NCBs’ CLAIMS EQUIVALENT TO THE FOREIGN RESERVE ASSETS TRANSFERRED TO THE ECB

The change in NCBs’ weightings in the ECB’s capital key and Banka Slovenije’s transfer of foreign reserve assets increased the NCBs’ claims by €259,568,376.

## OFF-BALANCE-SHEET INSTRUMENTS

### 17 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 €2.2 billion (2005: €0.9 billion) were outstanding as at 31 December 2006 (see “Reverse transactions” in the notes on accounting policies).

### 18 INTEREST RATE FUTURES

In 2006 interest rate futures were used as part of the management of the ECB’s foreign

reserves and own funds. As at 31 December 2006, the following transactions were outstanding:

Foreign currency interest rate futures	Contract value €
Purchases	9,192,862,566
Sales	367,444,345

Euro interest rate futures	Contract value €
Purchases	40,000,000
Sales	147,500,000

### 19 FOREIGN EXCHANGE SWAP AND FORWARD TRANSACTIONS

Foreign exchange swap and forward transaction claims of €207 million and liabilities of €204 million remained outstanding as at 31 December 2006. These transactions were conducted in the context of the management of the ECB’s foreign reserves.

## NOTES ON THE PROFIT AND LOSS ACCOUNT

### 20 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:

	2006 €	2005 €	Change €
Interest on current accounts	15,399,229	7,519,063	7,880,166
Money market deposit income	195,694,549	124,214,410	71,480,139
Reverse repurchase agreements	201,042,718	153,568,329	47,474,389
Net income on securities	934,077,489	641,956,243	292,121,246
Net interest income on forward and swap transactions in foreign currencies	3,853,216	0	3,853,216
<b>Total interest income on foreign reserve assets</b>	<b>1,350,067,201</b>	<b>927,258,045</b>	<b>422,809,156</b>
Interest expense on current accounts	(225,549)	(221,697)	(3,852)
Repurchase agreements	(31,598,416)	(37,562,595)	5,964,179
Net interest expense on forward and swap transactions in foreign currencies	0	(64,964)	64,964
<b>Interest income on foreign reserve assets (net)</b>	<b>1,318,243,236</b>	<b>889,408,789</b>	<b>428,834,447</b>

Interest income increased significantly during 2006 due to rising interest rates on US dollar-denominated assets.

#### INTEREST INCOME ARISING FROM THE ALLOCATION OF EURO BANKNOTES WITHIN THE EUROSISTEM

This item consists of the interest income relating to the ECB's 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. The increase in income in 2006 reflected both the

general increase in euro banknotes in circulation and the increases in the ECB's main refinancing rate. This income is distributed to the NCBs as described in "Banknotes in circulation" in the notes on accounting policies.

Based on the ECB's estimated financial result for 2006, the Governing Council decided to withhold distribution of the whole of this income.

#### 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 €2.5 billion (2005: €1.6 billion) and expenses of €2.4 billion (2005: €1.5 billion) on balances arising from TARGET. Interest income and expenses in respect of other assets and liabilities denominated in euro are also shown here.

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

Net realised gains arising from financial operations in 2006 were as follows:

	2006 €	2005 €	Change €
Net realised price gains/(losses) on securities and interest rate futures	(103,679,801)	14,854,774	(118,534,575)
Net realised exchange rate and gold price gains	579,060,509	134,514,361	444,546,148
Realised gains arising from financial operations	475,380,708	149,369,135	326,011,573

## 22 WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS

	2006 €	2005 €	Change €
Unrealised price losses on securities	(73,609,623)	(97,487,772)	23,878,149
Unrealised exchange rate losses	(644,857,885)	(6,309)	(644,851,576)
Total	(718,467,508)	(97,494,081)	(620,973,427)

The exchange rate losses are primarily due to the write-down of the average acquisition cost of the ECB's Japanese yen holding to its end-of-year exchange rate, following the depreciation of this currency against the euro over the year.

## 23 NET EXPENSE FROM FEES AND COMMISSIONS

	2006 €	2005 €	Change €
Income from fees and commissions	338,198	473,432	(135,234)
Expenses relating to fees and commissions	(884,678)	(655,805)	(228,873)
Net expense from fees and commissions	(546,480)	(182,373)	(364,107)

Income under this heading includes penalties imposed on credit institutions for non-compliance with the minimum reserve requirements. Expenses relate to fees payable on current accounts and in connection with the execution of foreign currency interest rate futures (see note 18, "Interest rate futures").

## 24 INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS

Dividends received on shares in the BIS (see note 6, "Other assets") were previously included under "Other income" (€853,403 in 2005), but are now shown under this heading.

## 25 OTHER INCOME

Other miscellaneous income during the year arose principally from the transfer of unused administrative provisions to the Profit and Loss Account.

## 26 STAFF COSTS

Salaries, allowances, staff insurance and other miscellaneous costs of €133.4 million (2005: €127.4 million) are included under this heading. Staff costs of €1.0 million incurred in connection with the construction of the new ECB premises have been capitalised and are excluded from this item. No staff costs were capitalised in 2005.

The emoluments of the Executive Board amounted to a total of €2.2 million (2005: €2.1 million). Transitional payments are made to former members of the Executive Board for a period after the end of their terms of office. In 2006 these payments amounted to €0.3 million in total (€0.4 million in 2005). Pension payments of €0.1 million were made to former members of the Executive Board or their dependents during the year (€0.1 million in 2005).

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 €27.4 million (2005: €25.6 million) recognised in connection with the ECB's retirement plan and other post-employment benefits (see note 12, "Other liabilities").

At the end of 2006 the ECB employed the full-time equivalent of 1,367 staff on permanent or fixed-term contracts, of whom 138 held managerial positions. The change in the number of staff during 2006 was as follows:

	2006	2005
As at 1 January	1,351	1,309
New staff <sup>1)</sup>	55	82
Resignations/end of contract <sup>2)</sup>	39	40
As at 31 December	1,367	1,351
Average number of staff employed	1,360	1,331

1) This item also includes the effects of changes from part to full-time employment.

2) This item also includes the effects of changes from full to part-time employment.

The number of staff as at 31 December 2006 includes the full-time equivalent of 63 staff (2005: 59) on unpaid/parental leave. In addition, as at 31 December 2006, the ECB employed the full-time equivalent of 70 staff (2005: 57) on short-term contracts to replace staff on unpaid/parental and maternity leave.

The ECB also offers the possibility to staff from other central banks of the ESCB to undertake temporary assignments at the ECB. 61 ESCB staff participated in this programme as at 31 December 2006 (2005: 46) and their cost is included within this caption.

## 27 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.

## 28 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 2006.*

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

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

In 2005, following a decision by the Governing Council, income of €868 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 2006 an amount of €1,319 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 2006 the funding of the provision against foreign exchange rate, interest rate and gold price risks for the amount of €1,379 million had the effect of reducing net profit to exactly zero. Consequently, as in 2005, no transfers to the

<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.

### Independent auditor's report

President and Governing Council  
of the European Central Bank

Frankfurt am Main

We have audited the accompanying annual accounts of the European Central Bank, which comprise the balance sheet as at 31 December 2006, the profit and loss account for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *The responsibility of the European Central Bank's Executive Board for the annual accounts*

The Executive Board is responsible for the preparation and fair presentation of these annual accounts in accordance with the principles established by the Governing Council, which are set out in Decisions on the annual accounts of the European Central Bank. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of annual accounts 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 annual accounts 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 annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the annual accounts 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 entity'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 annual accounts.


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 annual accounts give a true and fair view of the financial position of the European Central Bank as of 31 December 2006 and of the results of its operations for the year then ended in accordance with the principles established by the Governing Council, which are set out in Decisions on the annual accounts of the European Central Bank.

Frankfurt am Main, 27 February 2007

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft



Wohlmannstetter  
Wirtschaftsprüfer



Dr. Lemnitzer  
Wirtschaftsprüfer