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FINAL ANNUAL ACCOUNTS OF THE EUROPEAN COMMUNITIES

FINANCIAL YEAR 2005

VOLUME I

CONSOLIDATED FINANCIAL STATEMENTS
AND CONSOLIDATED REPORTS
ON IMPLEMENTATION OF THE BUDGET

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EUROPEAN COMMISSION

FINAL ANNUAL ACCOUNTS OF THE EUROPEAN COMMUNITIES

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Volume I

CONSOLIDATED FINANCIAL STATEMENTS AND CONSOLIDATED REPORTS ON IMPLEMENTATION OF THE BUDGET

FINAL ANNUAL ACCOUNTS

FINANCIAL YEAR 2005

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PRINCIPAL EVENTS AND KEY POINTS

THE CHANGE TO ACCRUAL ACCOUNTING AND ITS IMPACT

Why change?
The European Communities undertook to fall into line with the approach adopted by many States, and supported by international bodies such as IFAC[1] and OECD, by modernising their accounts. This entailed a change from a system of accounts focusing on a cash-based description of budget expenditure and revenue operations to an accrual accounting system.

The objective was to provide better information to management for their decision making and to improve the transparency and quality of the accounting information presented annually. The new system should ensure that both the internal users of the system and the external readers of the accounts have more reliable and relevant information.

The work done
The work started in earnest in 2003 with the commencement of the "modernisation of the accounting system" project, which had the aim of placing the European Communities at the forefront of the international movement towards the modernisation of public sector accounting.

As planned, in January 2005 the new accounting system came into use, together with a new set of accounting rules and a new chart of accounts. Thus these are the first set of financial statements prepared under the new accrual accounting rules (the budget accounts are still based on movements of cash.) These new rules and methods are inspired by internationally accepted standards for the public sector - the IPSAS - and, for accounting transactions that are not yet covered by IPSAS, on the relevant International Accounting Standards ("IAS")/ International Financial Reporting Standards ("IFRS".) These rules have been adopted by the Accounting Officer of the Commission after receiving the opinion of an Advisory Expert Group for Accounting Standards that provided independent professional guidance. The IT architecture was updated to ensure that each accounting event, and not just cash movement, would be fully registered when it occurs. Improvements will continue to be made to the IT systems to further the integration of systems and to provide better management reporting. Finally, the scope of consolidation was extended in 2005 to include the various Communities' agencies for the first time.

The end result was the preparation of a balance sheet at 31/12/2004 based on the new accounting rules.

The main impact of the changes
The first impact to be noted is that the balance sheet and off-balance sheet presented here in relation to the prior year (2004) will differ from those published in the 2004 annual accounts, since they are prepared under different rules. The Communities have thus taken the original 2004 figures, as prepared under the old rules and made adjustments to bring them into line with the new rules.

The application of accrual accounting principles essentially means that income and expenditure is recorded in the accounts when it is earned/incurred and not just if cash is received/paid. The four biggest impacts on the financial statements of this change of accounting rules were as follows:

1. **Pre-financing:** An asset called pre-financing is now recognised on the Communities' balance sheet representing advances paid to beneficiaries with the intention to provide them with a float. The amount on the balance sheet represents money that the beneficiary has not yet used or for which (s)he has not yet submitted reports/claims detailing how this money was spent. Total pre-financing at 31/12/2004 was EUR 28 billion, which is a significant addition to the balance sheet (see PART I, Section E, notes **3.5 & 3.9**).

[1] International Federation of Accountants.

2. **Current Payables:** Amounts are now recognised in the accounting system as costs and payables as soon as they are deemed incurred and eligible by the authorising services. Because of the new IT tools and rules, the restated balance sheet at 31/12/2004 shows a figure of EUR 9.4 billion recorded as current payables (see PART I, Section E, note **3.18.2**).
3. **Cut-off:** A key element of accrual accounting is ensuring that income and expenses are recorded in the accounting period to which they relate. Therefore, a significant exercise was performed by the European Communities to estimate the accounting entries that needed to be made at year-end to ensure that the correct split of income and expenses between the two years was made. These types of transactions are known as "cut-off" transactions and a common example is that electricity costs for December 2004 should be included in the accounts of 2004 even if no invoice is received until 2005 and no payment is made until 2005. The inclusion of these amounts has meant an inclusion of accrued expenses at 31/12/2004 of EUR 64.2 billion (see PART I, Section E, note **3.18.4**)
4. **Pension receivable from Member States:** As part of the application the new accounting rules, it was decided by the Commission's Accounting Officer, following advice from and discussions with the Advisory Expert Group for Accounting Standards, that the guarantee given by Member States to fund the pensions does not meet the criteria necessary for it to be recognised as a receivable on the balance sheet. The removal of this asset from the balance sheet at 31/12/2004 has reduced total assets by EUR 26 billion - (see PART I, Section E, note **3.12**).

A full explanation of the impact of the changes is given in PART I, Section **E2**.

Amounts to be called up from Members States

Based on new rules, the Communities must evaluate and recognise in its financial statements the expenditure to be financed by the general budget but which has not yet been declared by the year-end. Thus very many expenses are recognised under accrual accounting rules in the year N although they may be actually paid in year N+1 using the budget of year N+1. Nevertheless, the Communities only call up resources from the Member States when they need money to pay an amount due, so as to give Member States maximum flexibility in managing their public finances. This inclusion in the accounts of the Communities' liabilities, coupled with the fact that the corresponding amounts needed to fund these are only recognised in future years, results in liabilities greatly exceeding assets at the year-end.

To present the facts of this situation in the most comprehensible way for the reader of the accounts, a vertical balance sheet showing the Communities' assets first, then its liabilities was adopted. The difference represents principally the amounts to be called up from Member States. The existence of negative net assets simply reflects the difference between cash-based accounting and accrual accounting for an entity which is financed according to its cash-flow needs. It does not take into account the obligation of Member States to provide the necessary resources in the future to pay for the expenditure incurred when it falls due. It should be remembered that the Communities cannot make a payment unless it was foreseen in the budget and all budgeted expenditure is covered by budgeted revenue from the Member States (see PART I, Section E, note **3.20**).

A new structure

While the budgetary reporting was unaffected by the move to accrual accounting, the new financial statements include much more information than before. Most significantly there are now an economic outturn account, a cashflow table and a statement of changes in net assets to add to the restructured balance sheet and off-balance sheet.

MAIN POINTS OF NOTE IN THE 2005 ANNUAL ACCOUNTS

- The budget surplus has continued to decrease from EUR 2.7 billion to EUR 2.4 billion
- The economic outturn (loss) for the year was EUR 7.8 billion
- Total assets increased from EUR 53.6 billion in 2004 to EUR 58.7 billion, with total liabilities increasing from EUR 105.2 billion to EUR 120.9 billion.

FINAL ANNUAL ACCOUNTS OF THE EUROPEAN COMMUNITIES

FINANCIAL YEAR 2005

PART I

CONSOLIDATED FINANCIAL STATEMENTS OF THE EUROPEAN COMMUNITIES AND EXPLANATORY NOTES

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PART I

A. Balance Sheet

BALANCE SHEET

EUR

		Note	31.12.2005	31.12.2004 Restated
I.	NON-CURRENT ASSETS:		**31,415,180,633.30**	**30,142,730,492.69**
	Intangible fixed assets	*3.1*	26,676,624.50	17,137,089.53
	Tangible fixed assets	*3.2*	4,141,220,250.32	4,084,425,922.70
	Investments	*3.3*	1,874,420,306.00	2,150,177,300.19
	Loans	*3.4*	2,397,326,503.16	2,298,277,591.00
	Long-term pre-financing	*3.5*	22,731,731,325.85	21,284,928,692.20
	Long-term receivables	*3.6*	243,805,623.47	307,783,897.07
II.	CURRENT ASSETS:		**27,291,395,093.09**	**23,450,507,504.46**
	Stocks	*3.7*	126,470,335.92	63,255,048.68
	Short-term investments	*3.8*	1,439,652,311.41	1,442,821,890.84
	Short-term pre-financing	*3.9*	6,633,481,985.52	6,727,929,511.29
	Short-term receivables	*3.10*	7,237,854,523.32	7,139,062,014.64
	Cash & cash equivalents	*3.11*	11,853,935,936.92	8,077,439,039.01
	TOTAL ASSETS		**58,706,575,726.39**	**53,593,237,997.15**
III.	NON-CURRENT LIABILITIES:		**38,025,870,323.61**	**30,556,735,482.10**
	Employee benefits	*3.12*	33,155,884,938.00	26,012,130,886.00
	Provisions for risks and charges	*3.13*	1,096,842,934.71	1,013,020,111.03
	Financial liabilities	*3.14*	1,920,492,514.34	1,688,032,288.29
	Other long-term liabilities	*3.15*	1,852,649,936.56	1,843,552,196.78
IV.	CURRENT LIABILITIES:		**82,825,446,775.06**	**74,633,599,508.87**
	Provisions for risks and charges	*3.16*	275,440,997.63	240,240,253.60
	Financial liabilities	*3.17*	22,018,193.71	152,154,480.63
	Accounts payable	*3.18*	82,527,987,583.72	74,241,204,774.64
	TOTAL LIABILITIES		**120,851,317,098.67**	**105,190,334,990.97**
	NET ASSETS		**(62,144,741,372.28)**	**(51,597,096,993.82)**
	Reserves	*3.19*	2,808,609,579.99	2,567,532,141.28
	Amounts to be called from Member States:	*3.20*	(64,953,350,952.27)	(54,164,629,135.10)
	*Staff Pensions (long-term)**		*(33,155,884,938.00)*	*(26,012,130,886.00)*
	*Other amounts***		*(31,797,466,014.27)*	*(28,152,498,249.10)*
V.	NET ASSETS***		**(62,144,741,372.28)**	**(51,597,096,993.82)**

* Under Article 83 of the Staff Regulation, the Member States shall jointly guarantee the liability for pensions.

** The Parliament has adopted a budget on 15 December 2005 which provides for the payment of the Communities' short-term liabilities from own resources to be collected by, or called up from, the Member States in 2006.

*** For more details please see the Statement of changes in Net Assets

PART I

B. Economic Outturn Account (including Segment Reporting)

ECONOMIC OUTTURN ACCOUNT

EUR

	Note	2005
OPERATING REVENUE:	4.1	**107,890,098,965.56**
Own Resource and contributions revenue:		***103,964,129,385.85***
GNI resources		70,861,050,698.58
VAT resources		16,018,121,497.86
Traditional own resources		14,264,712,942.61
Budgetary adjustments		2,606,103,308.82
Contributions of Third countries (including EFTA countries)		214,140,937.98
Operating revenue:		***3,925,969,579.71***
Fines		719,616,062.54
Recovery of expenses		1,385,693,507.89
Revenues from administrative operations		895,083,199.67
Other operating revenue		925,576,809.61
OPERATING EXPENSES		**107,597,505,955.88**
Administrative expenses:	4.2	***6,127,531,024.91***
Staff expenses		3,612,990,701.52
Fixed asset related expenses		320,308,630.81
Other administrative expenses		2,194,231,692.58
Operating expenses:	4.3	***101,469,974,930.97***
Direct centralised management		11,281,191,742.49
Indirect centralised management		350,673,116.96
Decentralised management		1,732,823,172.49
Shared management		86,925,465,101.27
Joint management		248,168,777.58
Other operating expenses	4.4	931,653,020.18
SURPLUS FROM OPERATING ACTIVITIES		**292,593,009.68**
Financial operations revenue	4.5	399,088,528.72
Financial operations expenses	4.6	(368,650,139.19)
Increase in pension liability	3.12	(8,044,529,533.33)
(DEFICIT) FROM NON-OPERATING ACTIVITIES		**(7,721,498,134.12)**
SHARE OF NET (DEFICIT) ASSOCIATES & JOINT VENTURES	4.7	**(90,966,231.35)**
(DEFICIT) FROM ORDINARY ACTIVITIES		**(7,812,464,365.47)**
ECONOMIC RESULT FOR THE YEAR		**(7,812,464,365.47)**

SEGMENT REPORTING

This report gives the split of the operating revenues and expenses by policy area, based on the Activity Based Budget structure, within the Commission. These policy areas can be grouped under three larger headings - Activities within the European Union, Activities outside the European Union and Services & other.

"Activities within the European Union" is the largest of these headings as it covers the many policy areas within the European Union. "Activities outside the European Union" concerns the policies operated outside the Union, such as trade and aid. "Services & other" are the internal and horizontal activities necessary for the functioning of the Communities' Institutions and bodies.

The consolidated agencies are integrated into the same policy area as the Commission activity from which they receive their main Communities' subsidy. Other Institutions, aside from the Commission are grouped in a specific policy area. The various policy areas represent gross figures before consolidation eliminations and the consolidation eliminations are done globally in one column.

Note that own resources and contributions are not split amongst the various activities as these are calculated, collected and managed by central Commission services. They are shown here so as to allow for comparison of the net result with the Economic Outturn Account.

SEGMENT REPORTING – SUMMARY

EUR

	Activities within the EU	Activities outside the EU	Services & Other	ECSC in Liquidation	Other Institutions	Consolidation eliminations	TOTAL
Operating revenue:							
Fines	719,616,062.54						719,616,062.54
Recovery of expenses	1,353,084,760.41	36,722,410.81	1,290,942.71			(5,404,606.04)	1,385,693,507.89
Revenues from administrative operations	89,082,518.18	62,742,860.77	597,208,561.21	(53,875,000.00)	261,789,487.91	(61,865,228.40)	895,083,199.67
Other operating revenue	688,188,532.20	272,916,001.90	460,493,351.82		305,161.77	(496,326,238.08)	925,576,809.61
TOTAL OPERATING REVENUES	**2,849,971,873.33**	**372,381,273.48**	**1,058,992,855.74**	**(53,875,000.00)**	**262,094,649.68**	**(563,596,072.52)**	**3,925,969,579.71**
Administrative expenses:	***1,809,140,421.50***	***890,182,701.55***	***1,382,452,884.00***	***5,648.00***	***2,120,615,781.21***	***(74,866,411.35)***	***6,127,531,024.91***
Staff expenses	1,344,955,579.32	620,812,260.57	617,749,601.28		1,036,675,272.43	(7,202,012.08)	3,612,990,701.52
Fixed asset related expenses	59,471,934.18	52,618,748.62	98,316,368.04	5,648.00	109,895,931.97		320,308,630.81
Other administrative expenses	404,712,908.00	216,751,692.36	666,386,914.68		974,044,576.81	(67,664,399.27)	2,194,231,692.58
Operating expenses:	***94,580,031,861.20***	***5,613,725,860.31***	***1,764,946,870.63***			***(488,729,661.17)***	***101,469,974,930.97***
Direct centralised management	6,548,039,671.23	3,479,353,565.16	1,493,894,876.89			(240,096,370.79)	11,281,191,742.49
Indirect centralised management	293,199,308.89	298,361,244.31	1,886,514.00			(242,773,950.24)	350,673,116.96
Decentralised management	378,103,058.75	1,354,720,113.74					1,732,823,172.49
Shared management	86,925,465,101.27						86,925,465,101.27
Joint management	21,703,755.76	226,465,021.82					248,168,777.58
Other operating expenses	413,520,965.30	254,825,915.28	269,165,479.74			(5,859,340.14)	931,653,020.18
TOTAL OPERATING EXPENSES	**96,389,172,282.70**	**6,503,908,561.86**	**3,147,399,754.63**	**5,648.00**	**2,120,615,781.21**	**(563,596,072.52)**	**107,597,505,955.88**
NET OPERATING EXPENSES	**(93,539,200,409.37)**	**(6,131,527,288.38)**	**(2,088,406,898.89)**	**(53,880,648.00)**	**(1,858,521,131.53)**	-	**(103,671,536,376.17)**
Own resource and contributions revenue							103,964,129,385.85
Surplus from operating activities							**292,593,009.68**
Net financial revenue							30,438,389.53
Increase in pension liability							(8,044,529,533.33)
Share of associates/joint venture results							(90,966,231.35)
Economic result for the year							**(7,812,464,365.47)**

SEGMENT REPORTING - ACTIVITIES WITHIN THE EU

EUR

	Economic & Financial affairs	Enterprise & Industry	Competition	Employment	Agriculture	Transport & Energy	Environment	Research	Information Society
Operating revenue:									
Fines	0.00	0.00	699,616,062.54	0.00	0.00	0.00	0.00	0.00	0.00
Recovery of expenses	268,064.24	1,411,811.20	0.00	69,163,331.89	1,095,501,773.52	2,827,282.13	204,297.96	(1,503,012.75)	3,613,410.74
Revenues from administrative operations	0.00	3,137,099.27	0.00	373,252.58	0.00	318,726.24	30,420.36	53,874,389.18	0.00
Other operating revenue	943,047.15	106,245,197.98	6,125,594.59	34,792,023.86	21,463,750.70	48,081,050.89	37,864,063.91	214,975,609.38	7,744,634.28
TOTAL OPERATING REVENUES	**1,211,111.39**	**110,794,108.45**	**705,741,657.13**	**104,328,608.33**	**1,116,965,524.22**	**51,227,059.26**	**38,098,782.23**	**267,346,985.81**	**11,358,045.02**
Administrative expenses:	***46,199,829.19***	***153,298,881.17***	***64,600,631.78***	***92,340,382.46***	***104,677,605.13***	***126,763,660.30***	***85,759,340.45***	***192,972,695.88***	***111,446,861.32***
Staff expenses	40,170,815.78	112,782,404.99	60,914,198.97	73,291,049.30	93,011,388.22	105,529,494.62	63,297,071.72	144,070,879.70	85,744,021.81
Fixed asset related expenses	0.00	5,333,212.01	0.00	562,643.68	0.00	492,141.91	620,795.93	0.00	31,272.69
Other administrative expenses	6,029,013.41	35,183,264.17	3,686,432.81	18,486,689.48	11,666,216.91	20,742,023.77	21,841,472.80	48,901,816.18	25,671,566.82
Operating expenses:	***59,307,959.45***	***195,709,789.69***	***452,045.97***	***10,986,548,855.98***	***54,319,611,969.20***	***1,079,402,884.03***	***226,522,697.46***	***2,573,004,377.31***	***848,420,984.23***
Centralised direct management	59,307,959.45	153,040,733.18	452,045.97	179,672,789.83	36,689,337.94	1,023,432,786.76	193,960,751.76	2,572,954,268.52	847,440,934.53
Centralised indirect management	0.00	0.00	0.00	1,525,090.20	0.00	5,677,018.73	16,882,600.85	0.00	0.00
Decentralised management	0.00	0.00	0.00	0.00	226,312,553.13	4,751,688.31	0.00	0.00	0.00
Shared management	0.00	0.00	0.00	10,788,124,831.35	54,040,432,329.95	0.00	0.00	0.00	0.00
Joint management	0.00	0.00	0.00	0.00	0.00	21,703,755.76	0.00	0.00	0.00
Other operating expenses	0.00	42,669,056.51	0.00	17,226,144.60	16,177,748.18	23,837,634.47	15,679,344.85	50,108.79	980,049.70
TOTAL OPERATING EXPENSES	**105,507,788.64**	**349,008,670.86**	**65,052,677.75**	**11,078,889,238.44**	**54,424,289,574.33**	**1,206,166,544.33**	**312,282,037.91**	**2,765,977,073.19**	**959,867,845.55**
NET OPERATING EXPENSES	**(104,296,677.25)**	**(238,214,562.41)**	**640,688,979.38**	**(10,974,560,630.11)**	**(53,307,324,050.11)**	**(1,154,939,485.07)**	**(274,183,255.68)**	**(2,498,630,087.38)**	**(948,509,800.53)**

	Joint Research Centre	Fisheries	Internal Market	Regional Policy	Taxation & Customs	Education & Culture	Health & Consumer protection	Justice, Freedom & Security	Total Activities within the EU
Operating revenue:									
Fines	0.00	20,000,000.00	0.00	0.00	0.00	0.00	0.00	0.00	719,616,062.54
Recovery of expenses	197,689.90	(577,716.70)	0.00	123,765,779.64	214,784.18	57,757,136.14	99,895.16	140,233.16	1,353,084,760.41
Revenues from administrative operations	26,916,536.65	0.00	0.00	0.00	3,706,530.65	674,748.67	0.00	50,814.58	89,082,518.18
Other operating revenue	12,811,935.20	776.79	7,153.49	2,432.19	461,868.81	131,777,307.45	34,783,584.53	30,108,501.00	688,188,532.20
TOTAL OPERATING REVENUES	**39,926,161.75**	**19,423,060.09**	**7,153.49**	**123,768,211.83**	**4,383,183.64**	**190,209,192.26**	**34,883,479.69**	**30,299,548.74**	**2,849,971,873.33**
Administrative expenses:	***324,372,209.78***	***32,051,379.81***	***44,690,462.16***	***57,972,095.34***	***47,405,108.82***	***156,840,485.76***	***115,039,261.94***	***52,709,530.21***	***1,809,140,421.50***
Staff expenses	191,769,343.19	25,946,002.86	41,167,654.18	49,647,357.38	39,143,285.61	89,648,655.85	82,770,631.38	46,051,323.76	1,344,955,579.32
Fixed asset related expenses	44,625,365.19	0.00	4,395.68	0.00	3,445,604.19	1,330,513.59	2,055,405.38	970,583.93	59,471,934.18
Other administrative expenses	87,977,501.40	6,105,376.95	3,518,412.30	8,324,737.96	4,816,219.02	65,861,316.32	30,213,225.18	5,687,622.52	404,712,908.00
Operating expenses:	***60,714,249.27***	***697,841,194.30***	***4,552,640.19***	***21,526,122,538.25***	***31,530,486.25***	***1,211,876,717.33***	***307,247,898.55***	***451,164,573.74***	***94,580,031,861.20***
Centralised direct management	(30,348,138.27)	215,276,482.20	4,552,640.19	94,989,892.49	31,530,486.25	791,695,562.00	283,223,089.90	90,168,048.53	6,548,039,671.23
Centralised indirect management	0.00	0.00	0.00	(601,257.04)	0.00	269,715,856.15	0.00	0.00	293,199,308.89
Decentralised management	0.00	0.00	0.00	147,021,849.64	0.00	16,967.67	0.00	0.00	378,103,058.75
Shared management	0.00	470,531,514.01	0.00	21,272,810,053.16	0.00	(543,390.71)	0.00	354,109,763.51	86,925,465,101.27
Joint management	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	21,703,755.76
Other operating expenses	91,062,387.54	12,033,198.09	0.00	11,902,000.00	0.00	150,991,722.22	24,024,808.65	6,886,761.70	413,520,965.30
TOTAL OPERATING EXPENSES	**385,086,459.05**	**729,892,574.11**	**49,243,102.35**	**21,584,094,633.59**	**78,935,595.07**	**1,368,717,203.09**	**422,287,160.49**	**503,874,103.95**	**96,389,172,282.70**
NET OPERATING EXPENSES	**(345,160,297.30)**	**(710,469,514.02)**	**(49,235,948.86)**	**(21,460,326,421.76)**	**(74,552,411.43)**	**(1,178,508,010.83)**	**(387,403,680.80)**	**(473,574,555.21)**	**(93,539,200,409.37)**

SEGMENT REPORTING - ACTIVITIES OUTSIDE THE EU

EUR

	External Relations	Trade	Development	Enlargement	Humanitarian Aid	Total Activities outside the EU
Operating revenue:						
Recovery of expenses	8,350,389.23	(46,083.70)	19,226,652.13	9,131,176.72	60,276.43	36,722,410.81
Revenues from administrative operations	60,781,919.99	0.00	(1,666.30)	1,962,607.08	0.00	62,742,860.77
Other operating revenue	6,204,915.71	12,110.81	1,301,147.76	265,258,510.04	139,317.58	272,916,001.90
TOTAL OPERATING REVENUES	**75,337,224.93**	**-33,972.89**	**20,526,133.59**	**276,352,293.84**	**199,594.01**	**372,381,273.48**
Administrative expenses:	***626,640,536.51***	***47,074,129.27***	***131,434,686.78***	***67,097,824.88***	***17,935,524.11***	***890,182,701.55***
Staff expenses	410,582,923.68	42,521,599.62	117,424,692.35	37,307,451.22	12,975,593.70	620,812,260.57
Fixed asset related expenses	51,282,367.01	0.00	0.00	1,336,381.61	0.00	52,618,748.62
Other administrative expenses	164,775,245.82	4,552,529.65	14,009,994.43	28,453,992.05	4,959,930.41	216,751,692.36
Operating expenses:	***2,082,953,186.40***	***10,013,446.62***	***780,048,497.43***	***2,205,715,297.71***	***534,995,432.15***	***5,613,725,860.31***
Direct centralised management	1,776,530,787.59	9,450,379.12	652,893,731.15	505,802,026.55	534,676,640.75	3,479,353,565.16
Indirect centralised management	36,126,501.89	0.00	25,091,165.92	237,143,576.50	0.00	298,361,244.31
Decentralised management	135,528,670.41	0.00	50,981,058.43	1,168,210,384.90	0.00	1,354,720,113.74
Joint management	121,491,031.79	563,067.50	53,531,324.69	50,879,597.84	0.00	226,465,021.82
Other operating expenses	13,276,194.72	0.00	(2,448,782.76)	243,679,711.92	318,791.40	254,825,915.28
TOTAL OPERATING EXPENSES	**2,709,593,722.91**	**57,087,575.89**	**911,483,184.21**	**2,272,813,122.59**	**552,930,956.26**	**6,503,908,561.86**
NET OPERATING EXPENSES	**(2,634,256,497.98)**	**(57,121,548.78)**	**(890,957,050.62)**	**(1,996,460,828.75)**	**(552,731,362.25)**	**(6,131,527,288.38)**

SEGMENT REPORTING - SERVICES & OTHER

	Press & Communication	Anti-Fraud Office	Co-ordination	Personnel & Administration	Eurostat	Budget	Audit	Other	Total Services & Other
Operating revenue:									
Recovery of expenses	254,215.17	11,015.16	1,863.82	1,059,619.16	(185,770.60)	150,000.00	0.00	0.00	1,290,942.71
Revenues from administrative operations	95,190.18	3,523,760.83	1,322,227.41	557,920,364.69	352.24	34,346,665.86	0.00	0.00	597,208,561.21
Other operating revenue	862,671.22	18,764.17	403,925.30	31,078,188.31	868,179.59	10,585,303.45	19.09	416,676,300.69	460,493,351.82
TOTAL OPERATING REVENUES	**1,212,076.57**	**3,553,540.16**	**1,728,016.53**	**590,058,172.16**	**682,761.23**	**45,081,969.31**	**19.09**	**416,676,300.69**	**1,058,992,855.74**
Administrative expenses:	***89,419,856.47***	***40,610,680.45***	***150,294,222.02***	***1,011,508,432.30***	***58,596,845.23***	***48,657,820.36***	***7,447,379.66***	***(24,082,352.49)***	***1,382,452,884.00***
Staff expenses	58,300,245.12	29,732,231.14	129,417,384.41	298,586,990.65	55,477,451.07	39,086,578.59	7,019,015.87	129,704.43	617,749,601.28
Fixed asset related expenses	1,164,191.40	42,659.29	0.00	97,109,517.35	0.00	0.00	0.00	0.00	98,316,368.04
Other administrative expenses	29,955,419.95	10,835,790.02	20,876,837.61	615,811,924.30	3,119,394.16	9,571,241.77	428,363.79	(24,212,056.92)	666,386,914.68
Operating expenses:	***59,553,544.34***	***5,863,831.35***	***551,345.73***	***51,155,987.10***	***70,448,743.57***	***1,352,046,593.25***	***15,995.00***	***225,310,830.29***	***1,764,946,870.63***
Direct centralised management	57,845,829.45	5,863,831.35	0.00	49,824,082.51	68,507,973.48	1,313,199,252.25	0.00	(1,346,092.15)	1,493,894,876.89
Indirect centralised management	1,630,514.00	0.00	0.00	256,000.00	0.00	0.00	0.00	0.00	1,886,514.00
Other operating expenses	77,200.89	0.00	551,345.73	1,075,904.59	1,940,770.09	38,847,341.00	15,995.00	226,656,922.44	269,165,479.74
TOTAL OPERATING EXPENSES	**148,973,400.81**	**46,474,511.80**	**150,845,567.75**	**1,062,664,419.40**	**129,045,588.80**	**1,400,704,413.61**	**7,463,374.66**	**201,228,477.80**	**3,147,399,754.63**
NET OPERATING EXPENSES	**(147,761,324.24)**	**(42,920,971.64)**	**(149,117,551.22)**	**(472,606,247.24)**	**(128,362,827.57)**	**(1,355,622,444.30)**	**(7,463,355.57)**	**215,447,822.89**	**(2,088,406,898.89)**

PART I

C. Cashflow table

CASHFLOW TABLE

EUR

	Note	2005
CASHFLOWS FROM ORDINARY ACTIVITIES		
Deficit from ordinary activities:		(7,812,464,365.47)
Cashflows from operating activities:	*5.2*	
Amortisation		6,842,720.30
Depreciation		277,733,537.93
Impairment of investments		(11,983,099.95)
(Increase)/decrease in investments		(62,602,039.59)
(Increase)/decrease in loans		(99,048,912.16)
(Increase)/decrease in long-term pre-financing		(1,446,802,633.65)
(Increase)/decrease in long-term receivables		63,978,273.60
(Increase)/decrease in stocks		(63,215,287.24)
(Increase)/decrease in short-term pre-financing		94,447,525.77
(Increase)/decrease in short-term receivables		(98,792,508.68)
Increase/(decrease) in long-term employee benefits		7,143,754,052.00
Increase/(decrease) in long-term provisions		83,822,823.68
Increase/(decrease) in long-term financial liabilities		232,460,226.05
Increase/(decrease) in other long-term liabilities		9,097,739.78
Increase/(decrease) in short-term provisions		35,200,744.03
Increase/(decrease) in short-term financial liabilities		(130,136,286.92)
Increase/(decrease) in accounts payable		8,286,782,809.08
2004 Budgetary surplus taken as non cash revenue in 2005		(2,736,707,563.42)
Other non-cash movements		1,527,550.43
Cashflows from investing activities:	*5.3*	
(Increase)/decrease in intangible & tangible fixed assets		(350,910,120.82)
(Increase)/decrease in investments		76,469,510.70
(Increase)/decrease in cash investments		3,169,579.43
NET CASHFLOW FROM ORDINARY ACTIVITIES		**3,502,624,274.88**
NET INCREASE/(DECREASE) IN CASH & CASH EQUIVALENTS		**3,502,624,274.88**
CASH & CASH EQUIVALENTS AT THE BEGININNG OF THE YEAR*	*3.11*	*8,667,335,685.27*
CASH & CASH EQUIVALENTS AT THE END OF THE YEAR*	*3.11*	**12,169,959,960.15**

* Includes the cash of the Guarantee Fund (see note **3.11**)

PART I

D. Statement of changes in net assets

STATEMENT OF CHANGES IN NET ASSETS

EUR

	Reserves		Accumulated Surplus/(Deficit)	Economic outturn of the year	Total
	Fair value reserve	Other reserves			
BALANCE AS AT 31 DECEMBER 2004*	**0.00**	**1,055,268,223.85**	**9,258,037,564.68**	**4,194,018,305.10**	**14,507,324,093.63**
Changes in accounting policies**	88,457,197.90	1,423,806,719.53	(67,616,685,004.88)	0.00	(66,104,421,087.45)
BALANCE AS AT 31 DECEMBER 2004 (restated)	**88,457,197.90**	**2,479,074,943.38**	**(58,358,647,440.20)**	**4,194,018,305.10**	**(51,597,096,993.82)**
Movement in Guarantee Fund reserve		145,081,942.86	(145,081,942.86)		0.00
Fair value movements	(7,094,661.12)				(7,094,661.12)
Other		(450,782.03)	9,072,993.58		8,622,211.55
Allocation of the Economic Result 2004		103,540,939.00	1,353,769,802.68	(1,457,310,741.68)	0.00
Budget result 2004 credited to Member States				(2,736,707,563.42)	(2,736,707,563.42)
Economic outturn for the year				(7,812,464,365.47)	(7,812,464,365.47)
BALANCE AS AT 31 DECEMBER 2005	**81,362,536.78**	**2,727,247,043.21**	**(57,140,886,586.80)**	**(7,812,464,365.47)**	**(62,144,741,372.28)**

* The economic outturn for 2004 and the other reserves and surpluses were based on the accounting rules and scope of consolidation in place then. The adjustments made to create the opening balance sheet at 31 December 2004 under the new accounting rules have been included in the reserves and/or the accumulated surplus figure. For more details please see Section **E2**, and notes **E3.19 & E3.20**.

** Please see Section **E2** Impact of the transition to accrual accounting for more details on these changes

PART I

E. Notes to the financial statements

1. Accounting policies
2. Impact of the transition to accrual accounting
3. Notes to the Balance Sheet
4. Notes to the Economic Outturn Account
5. Notes to the Cashflow table
6. Off-Balance Sheet and notes
7. Financial risk management
8. Related party disclosures
9. Events after the balance sheet date
10. Consolidated entities
11. Non-consolidated entities

1. ACCOUNTING POLICIES

1.1 LEGAL PROVISIONS AND THE FINANCIAL REGULATION

The accounts are kept in accordance with Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 (OJ L 248 of 16 September 2002, p. 1, with a corrigendum in OJ L 25 of 30 January 2003, p. 43) on the Financial Regulation applicable to the general budget of the European Communities and Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of this Financial Regulation.

Article 133 of the Financial Regulation states that the Accounting Officer of the Commission adopts the accounting rules and methods to be applied by all the institutions and bodies. Thus, he adopted the new Communities' accounting rules on 28 December 2004. These new accrual-based accounting policies are inspired by International Public Sector Standards (IPSAS) or by default, International Financial Reporting Standards (IFRS) as respectively issued by the International Public Sector Accounting Standard Board (IPSASB) and International Accounting Standard Board (IASB). These rules have been adopted by the Accounting Officer of the Commission after receiving the opinion of an Advisory Expert Group for Accounting Standards that provided independent professional guidance.

The valuation and accounting rules adopted by the Accounting Officer of the Commission are applied in all the European Institutions and bodies currently falling within the scope of consolidation in order to establish a uniform set of rules for accounting, valuation and presentation of the accounts with a view to harmonising the process for drawing up the financial statements and consolidation.

The Commission's Accounting Officer must submit the consolidated provisional accounts to the Court of Auditors for audit by 31 March of the following year. The Commission must adopt the final consolidated accounts by 31 July and they are then published in the Official Journal by 31 October together with the Court of Auditors' statement of assurance.

Both the provisional and final annual accounts for 2005 are presented as follows: Volume I contains the consolidated accounts, and Volume II the Commission's accounts.

1.2 ACCOUNTING PRINCIPLES

The objective of financial statements is to provide information about the financial position, performance and cashflows of an entity that is useful to a wide range of users. For a public sector entity such as the European Communities, the objectives are more specifically to provide information useful for decision making, and to demonstrate the accountability of the entity for the resources entrusted to it.

If they are to present a true and fair view, financial statements must not only supply relevant information to describe the nature and range of an Institution's and Agencies' activities, explain how it is financed and supply definitive information on its operations, but do so in a clear and comprehensible manner which allows comparisons between financial years. It is with these goals in mind that the present document has been drawn up.

The accounting system of the European Institutions and Agencies comprises general accounts and budget accounts. These accounts are kept in euro on the basis of the calendar year. The **budget accounts** give a detailed picture of the implementation of the budget. They are based on the modified cash accounting principle.[2] The **general accounts** allow for the preparation of the financial statements as they show all charges and income for the financial year and are designed to establish the financial position in the form of a balance sheet at 31 December.

2 This differs from cash-based accounting because of elements such as carryovers.

Article 124 of the Financial Regulation sets out the accounting principles to be applied in drawing up the financial statements:

- going concern basis;
- prudence;
- consistent accounting methods;
- comparability of information;
- materiality;
- no netting;
- reality over appearance;
- accrual-based accounting.

As the financial statements for 2005 have been prepared on a different basis than in 2004, i.e. full accrual accounting, in accordance with the Communities' accounting rules, adjustments were made to the original balance sheet at 31 December 2004 so as to arrive at the opening, accrual based, balance sheet at 31 December 2004 (for example, the inclusion of pre-financing amounts.) These adjustments are explained in more detail in note E2.

1.3 CONSOLIDATION

The scope of consolidation of the European Communities comprises 26 controlled entities, one associate and one joint venture. The complete list of consolidated entities can be found in note **E10**. In comparison with 2004, the scope of consolidation has been extended by 16 controlled entities in order to comply with the updated European Communities' accounting rules.

Controlled entities

Controlled entities are all entities over which the European Communities have the power to govern the financial and operating policies so as to be able to benefit from these entities' activities. This power must be presently exercisable. The most common indicator of control, majority of voting rights, is in most of the cases not applicable for the European Communities as there are normally no capitalistic links between the entities.

The European Institutions falling within the scope of consolidation have been created through their founding treaties. They represent the basis of the organisational structure of the European Communities and contribute incontestably to the European Communities' objectives. These Institutions can therefore be considered as being under the exclusive control of the European Communities.

Under the same approach, all Communities Agencies created through a secondary act of legislation are considered as under the exclusive control of the European Communities and therefore are, for the first time, included in the consolidation scope. Furthermore the European Coal and Steel Communities in Liquidation (ECSC) is also considered as a controlled entity. However, the Office for Harmonisation in the Internal Market (Alicante) and the Community Plant Variety Office (Angers), which do not receive any subsidies from the General Budget of the Communities, are not consolidated in the 2005 accounts.

Controlled entities are consolidated using the full consolidation method. All inter-company transactions and balances between European Communities' controlled entities are eliminated. Unrealised gains and losses on inter-entity transactions are not material and have therefore not been eliminated.

Associates

Associates are all entities over which the European Communities have significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost.

The European Communities' share of their associates' post-acquisition profits or losses is recognised in the economic outturn account, and their share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Distributions received from an associate reduce the carrying amount of the investment.

Unrealised gains and losses on transactions between the European Communities and their associate are not material and have therefore not been eliminated.

The accounting policies of associates may differ from those adopted by the European Communities for like transactions and events in similar circumstances. For practicable reasons, no adjustments were made to the associates' financial statements used in applying the equity method.

In cases where the European Communities hold 20% or more of a venture capital fund, the Communities do not seek to exert significant influence. Such funds are therefore treated as assets available for sale and the equity method is not applied.

Joint ventures

A joint venture is a contractual arrangement whereby the European Communities and one or more parties (the "venturers") undertake an economic activity which is subject to joint control. Joint control is the contractually agreed sharing of control over an economic activity. Interests in jointly controlled entities are accounted for by the equity method of accounting and are initially recognised at cost.

The European Communities' interest of the profits or losses of their jointly controlled entities is recognised in the economic outturn account, and their interest of movements in reserves is recognised in reserves. The cumulative movements are adjusted against the carrying amount of the interest.

Unrealised gains and losses on transactions between the European Communities and their jointly controlled entity are not material and have therefore not been eliminated.

The accounting policies of joint ventures may differ from those adopted by the European Communities for like transactions and events in similar circumstances. For practicable reasons, no adjustments were made to the joint ventures' financial statements used in applying the equity method.

Non-consolidated entities

Not consolidated in the accounts of the European Communities are the funds managed by the Communities on behalf of both the Joint Sickness Insurance Scheme for staff of the European Communities, and the European Development Fund. At 31 December 2005 the total assets of both were EUR 260 million and EUR 3.5 billion respectively - see note E 11.

1.4 CURRENCY AND BASIS FOR CONVERSION

Functional and reporting currency

The consolidated financial statements are presented in euros, which is the European Communities' functional and reporting currency.

Transactions and balances

Foreign currency transactions are translated into euros using the exchange rates prevailing at the dates of the transactions.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the economic outturn account.

Year-end balances of monetary assets and liabilities denominated in foreign currencies are converted into euros on the basis of the exchange rates applying on 31 December 2005:

EURO Exchange Rate at 31 December 2005			
CYP	0.5735	LTL	3.4528
CZK	29.0000	MTL	0.4293
DKK	7.4605	PLN	3.8600
EEK	15.6466	SKK	37.8800
GBP	0.6853	SIT	239.5000
HUF	252.8700	SEK	9.3885
LVL	0.6962	USD	1.1797

Different conversion methods apply to the following headings:

- tangible and intangible assets, which retain their value in euros at the rate that applied at the date when they were purchased; and

- pre-financing paid under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund, which are converted at the exchange rates applying on the 10th day of the month following the month in which they are granted.

Changes in the fair value of monetary securities denominated in foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security, and other changes in the carrying amount of the security. Translation differences are recognised in the economic outturn account, and other changes in carrying amount are recognised in the fair value reserve. Translation differences on non-monetary financial assets and liabilities held at fair value through profit or loss are recognised in the economic outturn account. Translation differences on non-monetary financial assets classified as available-for-sale are included in the fair value reserve.

1.5 BALANCE SHEET

1.5.1 Intangible fixed assets

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (4 years). Internally produced intangible assets are currently expensed in the economic outturn account.

Costs associated with developing or maintaining computer software programmes are recognised as expenses as incurred.

1.5.2 Tangible fixed assets

Property, plant and equipment

All property, plant and equipment are stated at historical cost less depreciation (excluding land, works of art and assets under construction) and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the European Communities and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the economic outturn account during the financial period in which they are incurred.

Land, works of art and assets under construction are not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Depreciation rates

Type of asset	Straight line depreciation rate
Intangible assets	25%
Buildings	4%
Plant, machinery and equipment	10% to 25%
Furniture	10% to 25%
Fixtures and fittings	10% to 33%
Vehicles	25%
Computer hardware	25%
Other fixed assets	10% to 33%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the economic outturn account.

Leases

Leases of tangible assets, where the European Communities have substantially all the risks and rewards of ownership, are classified as financial leases. Financial leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The rental obligations, net of finance charges, are included in other liabilities (long and short-term.) The interest element of the finance cost is charged to the economic outturn account over the lease period so as to produce a constant periodic interest rate on the remaining balance of the liability for each period. The assets acquired under financial leases are depreciated over the shorter of the assets' useful life and the lease term.

Leases where the lessor retains a significant portion of the risks and rewards inherent to ownership are classified as operating leases. Payments made under operating leases are charged to the economic outturn account on a straight-line basis over the period of the lease.

1.5.3 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

1.5.4 Investments

Investments in Associates and interests in Joint Ventures

Investments in associates and interests in joint ventures are accounted for by using the equity method.

Investments in Venture Capital Funds

Classification and measurement

Investments in Venture Capital Funds are classified as available-for-sale assets and accordingly, should be carried at fair value with gains and losses arising from changes in the fair value (including translation differences) recognised in the fair value reserve.

Fair value considerations

Since they do not have a quoted market price in an active market and in the absence of any reliable valuation technique, investments in Venture Capital Funds are valued on a line-by-line basis at the lower of cost or attributable net asset value ("NAV") as reported by the fund manager up to the balance sheet date, thus excluding any attributable unrealised gain that may be prevailing in the underlying investment portfolio. Investments in Venture Capital Funds in existence for less than two years at balance sheet date are valued based on the same principles, except in the case of unrealised losses due only to administrative expenses where, in view of the early stage of the underlying investment portfolio, these unrealised losses are not taken into account.

It should be noted that a "fair value method" has been recently developed by the European Investment Fund in compliance with IAS 39. However, this method can only be applied to the European Communities' investments in venture capital funds at the year-end 2005. Indeed, based on the data collected in 2004, it is not possible to restate the value of investments in Venture Capital Funds at previous year-end. Consequently and for comparability reasons, the current valuation method, as described in the above paragraph, has been consistently applied at year end 2005. The fair value resulting from the application of the "fair value method" is disclosed in note **E 3.3.3.1** for information purposes only. The change from the current valuation method to this "fair value method" will be effective on 1 January 2006 and the related adjustment will be recognised in the fair value reserve.

Under the "new method", the fair value of investments in Venture Capital Funds is achieved by applying the aggregated Net Asset Value ("NAV") concept, which implicitly assumes that if the NAVs of the funds can be considered as compliant with IAS 39, then the aggregation of the NAVs of all funds will itself be compliant with IAS 39.

In accordance with this method, the funds are classified into three categories:
- Category I - funds that have adopted the fair value requirements of IAS 39.
- Category II - funds that have adopted other valuation guidelines (i.e. AFIC, BVCA & EVCA valuation guidelines) or standards that can be considered as in line with IAS 39.
- Category III - funds that have not adopted the fair value requirements of IAS 39 or any other valuation guidelines in line with IAS 39.

For Categories I & II, unrealised gains from the fair value measurement are recognised in reserves and unrealised losses are assessed for impairment so as to determine whether they are recognised as impairment losses in the economic outturn account or as changes in the fair value reserve.

The fair valued attributable NAV is determined through applying either the European Communities' percentage ownership in the fund to the NAV reflected in the most recent report or, to the extent available, the precise share value at the same date, submitted by the respective Fund Manager.

Investments belonging to category III are valued at cost less impairment.

Other investments

Classification

The European Communities classify their investments in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. The classification of the investments is determined at initial recognition and re-evaluated at each balance sheet date.

(i) *Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by the European Communities. Derivatives are also categorised as held for trading unless they qualify for hedge accounting. Assets in this category are classified as current assets if they are expected to be realised within 12 months of the balance sheet date.

(ii) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Communities provide money, goods or services directly to a debtor with no intention of trading the receivable. They are included in non-current assets, except for maturities within 12 months of the balance sheet date.

(iii) *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the European Communities has the positive intention and ability to hold to maturity. During this financial year, the European Communities did not hold any investments in this category.

(iv) *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the Communities intend to dispose of the investment within 12 months of the balance sheet date.

Initial recognition and measurement

Purchases and sales of financial assets at fair value through profit or loss, held-to-maturity and available-for-sale are recognised on trade-date – the date on which the European Communities commit to purchase or sell the asset. Loans are recognised when cash is advanced to the borrowers. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the economic outturn account.
The fair value of a financial asset on initial recognition is normally the transaction price (i.e. the fair value of the consideration received). However, when a long-term loan that carries no interest or an interest below market conditions is granted, its fair value can be estimated as the present value of all future cash receipts discounted using the prevailing market rate of interest for a similar instrument with a similar credit rating.

In the case of loans to officials granted by the ECSC in liquidation, the transaction price is used as fair value at inception independently from any preferential interest rate granted, for practicable reasons and based on materiality considerations.

Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the European Communities have transferred substantially all risks and rewards of ownership.

Subsequent measurement

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value.

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the economic outturn account in the period in which they arise.

Changes in the fair value of monetary financial assets denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the asset and other changes in the carrying amount of the asset. The translation differences are recognised in the economic outturn account, and other changes in carrying amount are recognised in the fair value reserve. Changes in the fair value of non-monetary financial assets classified as available-for-sale are recognised in the fair value reserve.

When financial assets classified as available-for-sale are sold or impaired, the cumulative fair value adjustments previously recognised in the fair value reserve should be recognised in the economic outturn account.

Interest on available-for-sale financial assets calculated using the effective interest method is recognised in the economic outturn account. Dividends on available-for-sale equity instruments are recognised when the European Communities right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the European Communities establish a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

In cases where the fair value of investments in equity instruments that do not have quoted market price in an active market is not reliably measurable, these investments are valued at cost less impairment.

Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. In the case of loans granted on borrowed funds, the effective interest method may not be applied separately to loans and borrowings, based on materiality considerations. The transaction costs incurred by the European Communities and then recharged to the beneficiary of the loan are directly recognised in the economic outturn account.

Impairment of financial assets

The European Communities assess at each balance sheet date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

(i) Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred)

discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the economic outturn account. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.
The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.
If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the economic outturn account.

(ii) Assets carried at fair value

In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the economic outturn account - is removed from reserves and recognised in the economic outturn account. Impairment losses recognised in the economic outturn account on equity instruments are not reversed through the economic outturn account. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the economic outturn account.

1.5.5 Stocks

Stocks are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. In exceptional cases, the Weighted Average Cost formula (WAC) can be applied. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses.

When stocks are held for distribution at no charge or for a nominal charge, they are measured at the lower of cost and current replacement cost. Current replacement cost is the cost the European Communities would incur to acquire the asset on the reporting date.

1.5.6 Pre-financing amounts

Pre-financing is a payment intended to provide the beneficiary with a cash advance, i.e. a float. It may be split into a number of payments over a period defined in the particular pre-financing agreement. The float or advance is repaid or used for the purpose for which it was provided during the period defined in the agreement. If the beneficiary does not incur eligible expenditures, he has the obligation to return the pre-financing advance to the European Communities. The amount of the pre-financing is reduced (wholly or partially) by the acceptance of eligible costs and amounts returned.

At year-end outstanding pre-financing amounts are valued at the original amount(s) paid less: amounts returned, eligible amounts cleared, estimated eligible amounts not yet cleared at year-end, and value reductions.

Interest on pre-financing is recognised as it is earned in accordance with the provisions of the relevant agreement. An estimate of the accrued interest revenue, based on the most reliable information, is made at the year-end and included in the balance sheet. Guarantees related to pre-financing amounts are disclosed in the off-balance sheet as contingent assets.

1.5.7 Receivables

Receivables are carried at original amount less write-down for impairment. A write-down for impairment of receivables is established when there is objective evidence that the European Communities will not be able to collect all amounts due according to the original terms of receivables. The amount of the write-down is the difference between the asset's carrying amount and the recoverable amount, being the present value of expected future cash flows, discounted at the market rate of interest for similar borrowers. The amount of the write-down is recognised in the economic outturn account statement. Also recognised is a general write-down in value of 20% per year for outstanding recovery orders not already subject to a specific write-down.

See also note **1.5.13** below concerning the treatment of accrued income recognised at year-end

1.5.8 Cash & cash equivalents

Cash and cash equivalents are defined as short-term assets. They include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within financial liabilities under current liabilities on the balance sheet.

1.5.9 Employee benefits

Pension obligations

The European Communities operate defined benefit pension plans. A defined benefit plan is a pension plan that generally defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less any fair value of plan assets. The defined benefit obligation is calculated 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 outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately in the economic outturn account.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

1.5.10 Provisions for risks and charges

Provisions for risks and charges are recognised when the European Communities have a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

The amount of the provision is the best estimate of the expenditures expected to be required to settle the present obligation at the reporting date. Where the provision involves a large number of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities ("expected value" method).

Where the effect of the time value of money is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. The discount rate used is a rate that reflects current market assessments of the time value of money and the risks specific to the liability but not the risks for which future cash flows estimates have been adjusted.

1.5.11 Financial liabilities

Financial liabilities include borrowings and held for trading liabilities.

Borrowings are composed of borrowings from credit institutions and debts evidenced by certificates. Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred, then subsequently carried at amortised cost using the effective interest method; any difference between proceeds, net of transaction costs, and the redemption value is recognised in the economic outturn account over the period of the borrowings using the effective interest method. They are classified as non-current liabilities, except for maturities less than 12 months after the balance sheet date.

In the case of loans granted on borrowed funds, the effective interest method may not be applied separately to loans and borrowings, based on materiality considerations. The transaction costs incurred by the European Communities and then recharged to the beneficiary of the loan are directly recognised in the economic outturn account.

Held for trading liabilities include derivatives that do not qualify for hedge accounting when their fair value is negative. They follow the same accounting treatment as held for trading assets, see note **1.5.4.**

1.5.12 Payables

A significant amount of the payables of the Communities are not related to the purchase of goods or services - instead they are unpaid cost claims from beneficiaries of grants or other Communities funding. They are recorded as payables for the requested amount when the cost claim is received and, after verification, accepted as eligible by the relevant financial agents. At this stage they are valued at the accepted and eligible amount.

Payables arising from the purchase of goods and services are recognised at invoice reception for the original amount and corresponding expenses are entered in the accounts when the supplies are delivered and accepted by the European Communities.

1.5.13 Separation of accounting periods - accrued and deferred income and charges

As part of the move to accrual accounting, one important aspect is the exercise of ensuring that transactions made during the year are recorded in the correct accounting year - a cut-off exercise: transactions must be recognised in the period to which they relate.

In particular an assessment has to be made concerning eligible expenses incurred by beneficiaries of Communities' funds but not yet reported to the Communities (accrued charges). Different methods are used depending on the type of activities and information available so as to arrive at the best estimate of these amounts. Conversely, some expenses are recorded in current year although they relate to subsequent periods (deferred charges) and those have to be identified and included in the relevant period.

Revenue should also be accounted for in the period to which it relates. At year-end, when an invoice is not sent and the service has been rendered or the supplies have been delivered or a contractual agreement exists (i.e., by reference to a treaty), the amount should be assessed and recognised in the financial statements as an accrued revenue.

In addition, at year-end, when an invoice is sent although it does not relate to the reporting period, the amount should be deferred and recognised as a decrease in revenues. The objective is to reduce revenues for the amount equal to the deferral.

Since this is the first year of such an exercise, and given the particularities of the Communities' activities, there are no benchmark methods available to compare these methods of estimation to.

1.6 ECONOMIC OUTTURN ACCOUNT

1.6.1 Revenue

Exchange revenue

Revenue from the sale of goods is recognised when the significant risk and rewards of ownership of the goods are transferred to the purchaser.

Revenue associated with a transaction involving the provision of services is recognised by reference to the stage of completion of the transaction at the reporting date.

Non-exchange revenue

This makes up the vast majority of the Communities' revenue and includes mainly direct and indirect taxes and own resource amounts. In addition to taxes the European Communities may also receive payments from other parties, such as duties, fines and donations.

GNI based resources and VAT resources

Receivables and related revenues are recognised when the European Communities send out a call for funds to the Member States claiming their contribution. They are measured at their "called amount". As VAT and GNI resources are based on estimates, they may be revised as changes occur until the final data are issued by the Member States. The effect of a change in estimate is included when determining the net surplus or deficit for the period in which the change occurred.

Traditional own resources

Receivables and related revenues are recognised when the relevant monthly A statements (including duties collected and amounts due that are guaranteed and not contested) are received from the Member States. At the reporting date, revenue collected by the Member States for the period but not yet paid to the European Communities are estimated and recognised as accrued revenue. The quarterly B statements (including duties neither collected nor guaranteed, as well as guaranteed amounts that have been contested by the debtor) received from the Member States are recognised as revenue less collection costs (25%). In addition a value reduction is recognised for the amount of the estimated recovery gap in the economic outturn account.

Fines

Receivables and related revenues are recognised when the Communities' decision imposing a fine has been taken and it is officially notified to the addressee. If there are doubts about the undertaking's solvency, a value reduction on the entitlement should be recognised.

After the decision to impose a fine, the debtors have two months from the date of notification:

- either to accept the decision, in which case they must pay the fine within the time limit laid down and the amount is definitively collected by the Communities;

- or not to accept the decision, in which case they lodge an appeal under Communities' law.

However, the principal of the fine must be paid within the time limit laid down as the appeal does not have suspensory effect (Article 242 of the EC Treaty). The debtors have two options; they can present a bank guarantee for the amount or pay the fine provisionally.

If the undertaking appeals against the decision, and has already provisionally paid the fine, the amount is recorded as a contingent liability. However, since an appeal against a Communities' decision by the addressee does not have suspensory effect, the cash received is used to clear the receivable. If a guarantee is received instead of payment, it is recorded as a contingent asset.

If there is a risk that the Court of First Instance may not rule in favour of the Communities, a provision is recognised to cover this risk in the cases where provisional payment has already been received. If a guarantee had been given instead, then the receivable outstanding is written-down as required. The accumulated interest received by the European Communities on the bank accounts where received payments are deposited is recognised as revenue, and any contingent liability is increased accordingly.

Interest income and expense

Interest income and expense are recognised in the economic outturn account using the effective interest method. This is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument (or, when appropriate, a shorter period) to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the European Communities estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but do not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

In the case of loans granted on borrowed funds, the effective interest method may not be applied separately to loans and borrowings, based on materiality considerations. The transaction costs incurred by the European Communities and then recharged to the beneficiary of the loan are directly recognised in the economic outturn account.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Dividend income

Dividend income is recognised when the right to receive payment is established.

1.6.2 Expenditure

Exchange expenses arising from the purchase of goods are recognised when the supplies are delivered and accepted by the European Communities. They are valued at original invoice cost.

Non-exchange expenses are specific to the European Communities and account for the majority of its expenditure. They relate to transfers to beneficiaries and can be of three types: entitlements, transfers under agreement and, discretionary grants, contributions and donations.

Transfers are recognised as expenses in the period during which the events giving rise to the transfer occurred, as long as the nature of the transfer is allowed by regulation (Financial Regulation, Staff Regulations, or other regulation) or a contract has been signed authorising the transfer; any eligibility criteria have been met by the beneficiary; and a reasonable estimate of the amount can be made.

When any request for payment or cost claim is received and meets the recognition criteria, it is recognised as an expense for the eligible amount. At year-end incurred eligible expenses already due to the beneficiaries but not yet reported are estimated and recorded as accrued expenses.

1.7 CONTINGENT ASSETS AND LIABILITIES

Contingent assets

A contingent asset is a possible asset that arises from past events and of which the existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the European Communities. A contingent asset is disclosed when an inflow of economic benefits or service potential is probable.

Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognised in the financial statements of the period in which the change occurs.

Contingent liabilities

A contingent liability is a possible obligation that arises from past events and of which the existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the European Communities; or a present obligation that arises from past events but is not recognised because: it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation or, in the extremely rare circumstances where the amount of the obligation cannot be measured with sufficient reliability.

A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.

Contingent liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of resources embodying economic benefits or service potential will be required for an item dealt with as contingent liability, a provision is recognised in the financial statements of the period in which the change of probability occurs.

Commitments for future funding

A commitment for future funding represents a legal or constructive commitment, usually contractual, that the European Communities have entered into and which may require a future outflow of resources.

Guarantees

Guarantees are possible assets or obligations that arise from past events and whose existence will be confirmed by the occurrence or non-occurrence of the object of the guarantee. Guarantees thus qualify as contingent assets or liabilities. A guarantee is settled when the object of the guarantee no longer exists. It is crystallised when the conditions are fulfilled for calling a payment from the guarantor.

1.8 USE OF ESTIMATES

In accordance with generally accepted accounting principles, the financial statements necessarily include amounts based on estimates and assumptions by management based on the most reliable information available. Significant estimates include, but are not limited to, amounts for pensions, provisions for future charges, valuation of publications stocks, financial risk on inventories and accounts receivables, accrued income and charges, contingent assets and liabilities, and degree of impairment of fixed assets. Actual results could differ from those estimates. Changes in estimates are reflected in the period in which they become known.

2. IMPACT OF THE TRANSITION TO ACCRUAL ACCOUNTING

2.1 BASIS OF PREPARATION

The Communities' opening balance sheet has been prepared in accordance with the new accounting rules adopted on 28 December 2004, which apply for the first time for the financial year 2005.

2.2 PRESENTATION OF THE FINANCIAL STATEMENTS

The annual accounts include the following primary statements: balance sheet, economic outturn account, statement of changes in net assets and cashflow table.

2.3 EQUITY RECONCILIATION

OPENING BALANCE SHEET

EUR

		Note	31.12.2004 Restated	Adjustments	31.12.2004
I.	**NON-CURRENT ASSETS:**		**30,142,730,492.69**	**(4,143,923,005.85)**	**34,286,653,498,54**
	Intangible fixed assets		17,137,089.53	10,795,517.23	6,341,572.30
	Tangible fixed assets	*2.3.1*	4,084,425,922.70	257,822,280.52	3,826,603,642.18
	Investments	*2.3.2*	2,150,177,300.19	123,900,459.79	2,026,276,840.40
	Loans	*2.3.3*	2,298,277,591.00	(30,831,701.00)	2,329,109,292.00
	Long-term pre-financing	*2.3.4*	21,284,928,692.20	21,284,928,692.20	0.00
	Long-term receivables	*2.3.5*	307,783,897.07	(25,790,538,254.59)	26,098,322,151.66
II.	**CURRENT ASSETS:**		**23,450,507,504.46**	**7,700,336,944.33**	**15,750,170,560.13**
	Stocks		63,255,048.68	(5,972,804.31)	69,227,852.99
	Short-term investments	*2.3.2*	1,442,821,890.84	46,841,216.60	1,395,980,674.24
	Short-term pre-financing	*2.3.4*	6,727,929,511.29	6,727,929,511.29	0.00
	Short-term receivables	*2.3.5*	7,139,062,014.64	263,155,996.45	6,875,906,018.19
	Cash & cash equivalents	*2.3.6*	8,077,439,039.01	668,383,024.30	7,409,056,014.71
	TOTAL ASSETS		**53,593,237,997.15**	**3,556,413,938.48**	**50,036,824,058.67**
III.	**NON-CURRENT LIABILITIES:**		**30,556,735,482.10**	**(1,143,539,962.90)**	**31,700,275,445.00**
	Employee benefits		26,012,130,886.00	3,744,986.00	26,008,385,900.00
	Provisions for risks and charges	*2.3.7*	1,013,020,111.03	(1,254,230,501.43)	2,267,250,612.46
	Financial liabilities	*2.3.8*	1,688,032,288.29	109,698,482.45	1,578,333,805.84
	Other long-term liabilities		1,843,552,196.78	(2,752,929.92)	1,846,305,126.70
IV.	**CURRENT LIABILITIES:**		**74,633,599,508.87**	**70,804,374,988.83**	**3,829,224,520.04**
	Provisions for risks and charges	*2.3.7*	240,240,253.60	240,240,253.60	0.00
	Financial liabilities	*2.3.8*	152,154,480.63	(74,095,519.37)	226,250,000.00
	Accounts payable	*2.3.9*	74,241,204,774.64	70,638,230,254.60	3,602,974,520.04
	TOTAL LIABILITIES		**105,190,334,990.97**	**69,660,835,025.93**	**35,529,499,965.04**
	NET ASSETS		**(51,597,096,993.82)**	**(66,104,421,087.45)**	**14,507,324,093.63**
	Reserves	*2.3.10*	2,567,532,141.28	1,512,263,917.43	1,055,268,223.85
	Amounts to be called from Member States:	*2.3.10*	(54,164,629,135.10)	(67,616,685,004.88)	13,452,055,869.78
	Staff pensions (long-term)		*(26,012,130,886.00)*	*0.00*	*(26,012,130,886.00)*
	Other		*(28,152,498,249.10)*	*(67,616,685,004.88)*	*39,464,186,755.78*
V.	**NET ASSETS**		**(51,597,096,993.82)**	**(66,104,421,087.45)**	**14,507,324,093.63**

The table above summarises the impact of the changes made to restate the balance sheet as at 31 December 2004 under the new accounting rules.

The presentation of the balance at 31 December 2004 (before restatement) differs slightly to that published in the Financial Statements 2004. This is due to the reclassification of certain balances within the balance sheet, made necessary to allow a relevant comparison with the restated figures. The original net assets figure of EUR 14.5 billion (then called "Own Capital") at 31 December 2004 corresponds to the published figure.

Almost the entire impact is noticed in the accounts of the Commission and to a much lesser extent in the ECSC in liquidation. The first time inclusion of the Agencies in the consolidation scope has had a limited impact on the consolidated accounts, the main being an increase in cash balances.

2.3.1 Tangible fixed assets

The main change in accounting policy for tangible fixed assets relates to depreciation policy. Under previous rules, newly acquired assets were depreciated for a full 12 months in the year in which they were purchased (regardless of the date of acquisition). In accordance with the new rules depreciation is applied from the month of acquisition. Historically therefore assets had been "over-depreciated". This and other changes in accounting policies have led to an increase in the net value of tangible fixed assets, by EUR 69 million in the Commission, and EUR 137 million in the Parliament. The balance of the increase primarily relates to the inclusion of the Agencies for the first time.

2.3.2 Investments

The investment portfolio of the Guarantee Fund and of the ECSC in liquidation, made up of debt securities, was previously recorded at the lower of cost (or in case of premiums/ discounts, amortised cost using linear method) or market value. These securities are now classified as available-for-sale assets and consequently carried at their fair value. The impact of the valuation at fair value has been accounted for in the fair value reserve and amounted to EUR 88 million.

The Guarantee Fund was holding three floating rate notes issued by the European Communities for an amount of EUR 21 million, including accrued interests, as at 31 December 2004. These debt securities have been duly eliminated against the corresponding debt evidenced by certificates issued by the Macro Financial Assistance (MFA) program (see note **2.3.8**).

The debt securities, amounting to EUR 38 million, held within the context of budgetary instruments managed by fiduciaries on behalf of the European Commission were included in the net asset calculation of these instruments and as such, classified as short-term receivables as at 31 December 2004. Under the new accounting rules, the components of the budgetary instruments are now classified in the relevant headings of the annual accounts according to their nature and when applicable, residual maturity.

Derivative financial instruments with a positive fair value including accrued interest (EUR 33 million) are recognised as held-for-trading assets whilst previously they were only disclosed as off balance-sheet items. The balance of the movement (EUR 33 million) relates to other reclassifications, revaluations and the inclusion of accrued interest under this heading.

2.3.3 Loans

Loans with special conditions were previously recorded at cost less any provision for impairment. Under the new accounting rules, these loans granted at preferential rates are initially recognised at fair value which, in the case of loans carrying interest below market conditions, corresponds to the net present value of expected cash flows discounted at the average prevailing EIB lending rate of interest for borrowers in the respective countries, then subsequently measured at amortised cost. The provisions for impairment, if any, are based on the provisional or definitive write-offs as provided for under the respective finance contract. The combined impact of the valuation of these loans at their amortised cost (EUR -152 million), on one side, and, of their entire classification as non-current assets since all have final maturities above one year after the balance sheet date (EUR 20 million), on the other side, has been accounted through the accumulated deficit account and amount to EUR -132 million.

Housing loans of the ECSC in liquidation granted at preferential rates were previously recorded at their outstanding nominal amount less any provision for impairment. Under the new accounting rules, these loans are initially recognised at fair value which corresponds to the net present value of expected cash flows discounted at the market rate of interest prevailing for bonds with similar maturities issued by the member states where the borrowers are located, then subsequently measured at amortised cost. The provisions for impairment, if any, are based on the provisional or definitive write-offs as provided for under the respective finance contracts. The impact of the valuation of these loans at their amortised cost amounts to a negative EUR 21 million.

Loans granted from borrowed funds have also been classified as non-current assets when their final maturity was above one year after the balance sheet date, increasing the balance of long-term loans by EUR 123 million and decreasing the one of short-term receivables by the same amount (see note **2.3.5**).

2.3.4 Pre-financing

Financial statements of the European Communities published prior to 2005 included, within short term receivables, a limited number of amounts concerning pre-financing payments made on specific projects (financial intermediaries). During 2004 an inventory of all open pre-financing amounts paid out up to 31 December 2004 was prepared by every Institution and body.

The balance shown for pre-financing as at 31 December 2004 is, however, this total amount outstanding to beneficiaries at that date less accrued charges. These accrued charges represent the estimate of the actual utilisation by the beneficiaries of the pre-financing amounts at this date, for which no cost statements have yet been received by the European Communities.

As many of the projects funded by the European Communities Structural Fund actions are long-term in nature, the related advances are available for more than one year. Thus these pre-financing amounts are shown under both long-term and short-term asset headings.

2.3.5 Receivables

Long-term receivables have greatly decreased as the guarantee from Member States in relation to the Commission's pension obligations towards staff does not meet the accounting criteria, set down by the new accounting rules, necessary to be recognised as an asset. Originally this had amounted to EUR 26 billion at 31 December 2004.

Short term receivables have increased due to the inclusion of accrued own resource income of EUR 2.3 billion at 31 December 2004. The overall movement on the balance however is offset by the transfer of previously included pre-financing amounts, net assets of the budgetary instruments managed by fiduciaries on behalf of the European Communities and portions of loans with final maturity above one year after the balance sheet date, and accrued interest, to separate headings.

2.3.6 Cash and cash equivalents

The biggest impact of the inclusion of the Agencies was under this heading, being EUR 339 million.

Current accounts and short-term deposits, amounting to EUR 323 million, held within the context of budgetary instruments managed by fiduciaries on behalf of the European Communities were included in the net asset calculation of these instruments and as such, classified as short-term receivables as at 31 December 2004. Under the new accounting rules, the components of the budgetary instruments are now classified in the relevant headings of the annual accounts according to their nature and when applicable, residual maturity.

2.3.7 Provisions

The balance on provisions has been revised upward by the application of a more precise discount rate to the dismantling provision for the JRC (EUR 59 million). Following a more detailed review of pending legal cases there has also been an increase in the specific provisions made for these.

The significant change has been that the provisions previously recognised concerning the Guarantee Fund (EUR 1,086 million) and the ECSC in Liquidation (EUR 328 million) no longer meet the requirements to be classed as a provision under the new rules and so are removed from this heading. Reserves for the same amounts are instead recognised.

Additionally financial provisions (EUR 239 million) have been recognised within the context of budgetary instruments whilst previously they were only disclosed as off balance-sheet items. Finally, provisions relating to legal cases of EUR 81 million and provisions of EUR 21 million from other Institutions and agencies were included for the first time (see note **3.13**).

2.3.8 Financial liabilities

As with loans granted, borrowings with final maturity above one year after the balance sheet date have been classified as non-current liabilities, increasing the balance of long-term borrowings by EUR 109 million and decreasing short-term borrowings by the same amount.

Moreover, debts evidenced by certificates issued by the Macro Financial Assistance (MFA) program and recorded as long-term borrowings were subscribed to by the Guarantee Fund. These debts have been duly eliminated against the corresponding assets held by the Guarantee Fund.

Derivative financial instruments with a negative fair value (EUR 19 million) are recognised as held-for-trading liabilities whilst previously they were only disclosed as off balance-sheet items.

2.3.9 Accounts payable

The biggest impact (EUR 70.6 billion) on the balance sheet has been under this heading and it is due primarily to two main exercises introduced by the modernisation project - the recording of invoices and accrued charges:

- In accordance with the Financial Regulation payment appropriations carried over to the following year are entered as budget expenditure. Until the financial year 2004, the contra-entry to these appropriations carried over and not yet used were to be found in the short-term liabilities in the balance sheet. This classification no longer exists, since all outstanding debts have been inventoried. The adjustment is included under "accounts payable." Amounts of EUR 2.8 billion previously reported under this heading and relating to budgetary appropriations to be carried over to the following year are no longer included following the introduction of the new accounting rules.

- All **invoices**, cost claims and credit notes received by the Communities are systematically recorded in the accounting system. This process began in the fourth quarter 2004 and in January 2005 the outstanding amounts of EUR 9.4 billion were transferred into the accounting system for the opening balance sheet.

- **Accrued charges** at 1 January 2005 totalled EUR 64.2 billion and represent the most significant impact on the opening balance sheet in comparison with the published 2004 annual accounts. These relate to current liabilities for amounts already due to eligible beneficiaries (Member States, Institutions, suppliers or service providers, individuals, etc.) but not yet recognised at the reporting date since no cost claim or invoice has been received.

According to the new accounting rules, transactions and events are recorded in the accounting systems and recognised in the financial statements in the period to which they relate. When the amount cannot be recognised within the time frame necessary for the preparation of the financial statements, the amounts that are known with reasonable certainty before the financial statements are completed, should be recognised as accrued expenses. The recognition criteria foresee that an expense is recognised by the European Communities for an amount equal to the estimated amount of the transfer obligation due for the period.

In order to calculate the best estimate of the accrued charges, the Communities did an analysis of all aspects related to the cut-off of a public entity. The Communities established an exhaustive inventory of the applicable rules and considered the presentation in the financial statements.

The ultimate goal was to make sure the proposed methodology would reduce the risk that the financial statements do not reflect a true and fair view.

The Communities then translated this designed cut-off strategy into operational and practical instructions, including the recommended methodology and a description of possible techniques by topics.

- The main amounts of accrued charges are for EAGGF-Guarantee: EUR 26.3 billion cover incurred expenses between 16 October and 31 December 2004 which are declared by Member States beyond the time frame necessary for the preparation of the financial statements, EUR 21.2 billion cover market measures including direct aid (this consists of entitlements incurred in 2004 with financial consequences in 2005) and rural development (this consists of eligible expenditure incurred by operators or the payment authorities until the 31/12/2004, for which no payment request was yet received by the Communities). Another significant amount represents accrued charges for Structural Funds: at 31 December 2004 EUR 6.3 billion for the FEDER 2000-2006, ISPA, innovative actions, EUR 5.1 billion for FSE. The remaining amounts of EUR 5.3 billion cover accrued charges for other policies, the most significant of which is the research area with +/- EUR 1.5 billion - see note **3.18.4**.

2.3.10 Reserves and accumulated surplus/deficit

In accordance with new accounting rules, the adjustment to fair value of available-for-sale assets is now accounted for through the fair value reserve (EUR 88 million). The biggest effect on reserves was however the inclusion of the Guarantee Fund reserve (EUR 1,086 million), which corresponds to the 9% target amount and, of other reserves of the ECSC in liquidation (EUR 328 million). Previously these amounts had been recognised as a provision.

All changes, other than fair value adjustments, required to restate the opening balance sheet where made through the accumulated surplus/deficit account, thus the large impact on its balance.

3. NOTES TO THE BALANCE SHEET

I. NON CURRENT ASSETS

3.1 INTANGIBLE FIXED ASSETS

Intangible fixed assets are identifiable non-monetary assets without physical substance. To be entered on the assets side of the balance sheet, they must be controlled by the entity and generate future economic benefits for the European Communities.

Intangible Fixed Assets *EUR*

	Amount
Gross carrying amount at 31 December 2004 (restated)	43,147,504.22
Additions during the year	15,428,793.99
Disposals	(473,054.00)
Other changes	6,445,391.79
Gross carrying amount at 31 December 2005	**64,548,636.00**
Accumulated depreciation at 31 December 2004 (restated)	26,010,414.69
Depreciation charge for the year	6,842,720.30
Disposal	(200,762.00)
Other changes	5,219,638.51
Accumulated depreciation at 31 December 2005	**37,872,011.50**
NET CARRYING AMOUNT AT 31 DECEMBER 2005	**26,676,624.50**

3.2 TANGIBLE FIXED ASSETS

3.2.1 Land and buildings

In some countries the value of the land occupied by Delegations cannot be distinguished from the value of the building.

In December 2005, together with the Parliament, the Commission bought a building in Copenhagen with a value of EUR 9.9 million. Each party owns 50%, although the Parliament paid the full amount for the building and the Commission will repay its share to the Parliament during the life of the building. In the same month, the two Institutions also jointly signed an acquisition contract worth EUR 7.4 million for a building in The Hague, but since the building was not put into use until 2006, it does not appear in the balance sheet at 31 December 2005.

3.2.2 Plant and equipment
Furniture and vehicles
Computer hardware
Other tangible fixed assets

For approximately 20% of the Delegations, there is no information available about tangible fixed assets at 31 December 2005. An initiative is underway since January 2003 to improve the quality and exhaustiveness of the information provided by the Delegations and this, as well as a specific inventories project launched in 2004, should help to resolve this problem in the future. Furthermore, the integration of the delegations' transactions directly in the central accounting system in 2007 will also improve this situation.

Adjustments as a direct result of these projects total EUR 3.6 million and are shown under the heading "other changes" in the table below. The total net amount of tangible fixed assets included for the Delegations at 31 December 2005 is EUR 72.3 million.

3.2.3 Finance leases (and similar rights)

The main building occupied by the Publications Office is not included in the balance sheet since it is classified as an operating lease. Although the Office has two purchase options (in October 2006 and in 2010) with values based on the market value, it is not considered that the risks and rewards incident to ownership of the asset are substantially transferred to the Office. The classification will be reviewed later in 2006, when the first purchase option may be taken up.

On 21 September 2005 the **Commission** signed a 27 year finance lease contract for a building in Brussels valued to EUR 50 million.

The **Economic and Social Committee** (ESC) and the **Committee of the Regions** (CoR) have entered the finance leasing contracts for their Belliard building in Brussels on the assets side of the balance sheet. It is co-financed on the following scale: ESC : 50% - CoR : 50%. The 27 year financial lease these two Committees signed in May 2004 for another Brussels building has been included in the restated opening balance sheet for 2005. It is co-financed on the following scale: ESC : 40% - CoR : 60%.

3.2.4 Fixed assets under construction

On March 2003 the **Council** signed a contract for the construction and acquisition of the LEX building in Brussels. The estimated price upon completion is EUR 258 million as at 31 December 2005. EUR 64 million has been paid in 2005 as an advance for this construction and EUR 59 million in previous years - in total EUR 123 million.

In October 2004 the **Parliament** signed a financial lease with a purchase option for a building complex in Brussels and the construction began during 2004. In November 2004 an advance payment of EUR 40 million was paid. Until the signature of the provisional approval report the Parliament has the right to make additional advance payments and which so far have been done as following (in Euro millions):

Balance 31 December 2004	EUR 40.0 million
Payments 2005 for work done in 2004 (incl. in the restated opening balance sheet)	EUR 82.3 million
Expenses for work done 2005	EUR 73.7 million
Total at 31 December 2005	EUR 196.0 million

Tangible Fixed Assets

EUR

	Land and buildings	Plant and equipment	Furniture and vehicles	Computer hardware	Other tangible fixed assets	Finance leases and similar rights	Assets under construction	TOTAL
Gross carrying amount at 31 December 2004 (restated)	2,798,459,908.84	314,685,311.72	151,655,006.60	359,450,313.77	94,848,414.86	2,128,258,298.61	204,629,792.33	6,051,987,046.73
Additions during the year	22,183,255.17	28,503,264.15	13,886,120.31	58,804,654.05	13,083,916.15	60,966,303.61	142,094,984.67	339,522,498.11
Disposals	0.00	-18,802,716.65	-5,955,058.02	-48,288,305.99	-1,639,942.74	0.00	-99,843.00	-74,785,866.40
Transfers between headings	3,986,584.00	1,173,719.60	-322,248.13	281,086.13	-1,134,157.60	1.600.00	-3,986,584.00	0.00
Other changes	-1,971,063.00	-8,036,654.33	-23,723,883.65	-3,096,256.80	353,124.82	0.00	0.00	-36,474,732.96
Gross carrying amount at 31 December 2005	**2,822,658,685.01**	**317,522,924.49**	**135,539,937.11**	**367,151,491.16**	**105,511,355.49**	**2,189,226,202.22**	**342,638,350.00**	**6,280,248,945.48**
Accumulated depreciation at 31 December 2004 (restated)	1,033,480,507.23	258,891,143.45	110,533,143.17	254,904,329.06	57,922,871.90	251,829,129.22		1,967,561,124.03
Depreciation charge for the year	116,156,557.09	22,621,584.39	9,779,959.02	54,066,519.67	8,767,186.25	67,317,044.30		278,708,850.72
Write-back of depreciation	0.00	0.00	-229,829.46	-729,745.93	-15,737.40	0.00		-975,312.79
Disposals	0.00	-18,211,797.85	-5,493,049.90	-47,248,494.30	-1,591,914.10	0.00		-72,545,256.15
Impairment	0.00	0.00	0.00	0.00	0.00	0.00		0.00
Write-back of impairment	0.00	0.00	0.00	0.00	0.00	0.00		0.00
Transfers between headings	0.00	868,666.66	-28,854.37	262,731.22	-1,104,143.51	1,600.00		0.00
Other changes	72,548.64	-8,311,960.11	-22,789,122.90	-2,934,810.67	242,634.39	0.00		-33,720,710.65
Accumulated depreciation at 31 December 2005	**1,149,709,612.96**	**255,857,636.54**	**91,772,245.56**	**258,320,529.05**	**64,220,897.53**	**319,147,773.52**		**2,139,028,695.16**
NET CARRYING AMOUNT AT 31 DECEMBER 2005	**1,672,949,072.05**	**61,665,287.95**	**43,767,691.55**	**108,830,962.11**	**41,290,457.96**	**1,870,078,428.70**	**342,638,350.00**	**4,141,220,250.32**

Charges still to be paid in respect of finance leases and similar entitlements are shown in long-term and short-term liabilities in the balance sheet. They break down as follows:

Finance Leases & Similar Rights

EUR millions

Description	Cumulative charges (A)	Future amounts to be paid				Total Value	Acquisition value of works	Asset value	Depreciation	Net carrying amount =A+B+C+E
		< 1 year	> 1 year	> 5 years	Total Liability (B)	A+B	(C)	A+B+C	(E)	
Land and buildings	326.64	29.83	151.54	1,621.29	1,802.66	2,129.30	59.59	2,188.89	(318.85)	1,870.04
Furniture and vehicles	0.14	0.02	0.03	0.00	0.05	0.19	0.00	0.19	(0.15)	0.04
Other tangible fixed assets	0.13	0.02	0.00	0.00	0.02	0.15	0.00	0.15	(0.15)	0.00
Total at 31.12.2005	**326.91**	**29.87**	**151.57**	**1,621.29**	**1,802.73**	**2,129.64**	**59.59**	**2,189.23**	**(319.15)**	**1,870.08**

3.3 INVESTMENTS

This heading covers investments made with a view to establishing permanent links and/or seen as supporting the activities of the European Communities. It also includes the net assets of the Guarantee Fund.

Investments

EUR

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Investment in Associates: EIF	185,570,299.80	175,976,040.60
Interest in Joint ventures: Galileo	141,459,169.43	89,283,659.98
Guarantee Fund	1,309,361,111.18	1,649,202,571.55
Available-for-Sale assets	210,520,545.57	204,797,460.68
Held for trading assets	27,509,180.02	30,917,567.38
Amount at 31 December 2005	**1,874,420,306.00**	**2,150,177,300.19**

3.3.1 Investments in associates and interests in joint ventures

Associates and Joint-Ventures

EUR

	Investments in Associates: EIF	Interests in Joint Venture: Galileo
Amount at 31 December 2004 (restated)	**175,976,040.60**	**89,283,659.98**
Acquisitions	0.00	156,000,000.00
Disposals and withdrawals	0.00	0.00
Share of profit/(loss)	12,858,259.20	(103,824,490.55)
Other equity movements	(3,264,000.00)	0.00
Amount at 31 December 2005	**185,570,299.80**	**141,459,169.43**

European Investment Fund (EIF)

The EIF is the European Union's financial institution specialising in risk capital and guarantees to SMEs. Under the Council Decision of 6 June 1994 the European Communities, represented by the Commission, subscribed for a total of ECU 600 million of the EIF's capital, being 600 shares. This represents 30% of the EIF's capital. The Commission has paid all the called-up capital, which amounts to 20%. Payments outstanding on the non-called up capital (80%) total EUR 480 million.

Under an agreement between the Commission and the European Investment Bank (EIB) signed in 2000, on 30 June 2005, the Commission was entitled to sell its shares to the EIB at a fixed unit price of EUR 315,000. However, the Commission did not exercise its put option. On the same date, a new Share Purchase Undertaking Agreement entered into force. Under this new agreement, the Commission is entitled to sell its shares at any time to the EIB at the price corresponding to the EIF valuation divided by the total number of issued shares. The formula will be based on the elements contained in the annual report and annual accounts established for the financial year in which the sale notice is given and approved by the general meeting.

The value of the put option is close to nil since the formula used for determining the sale price of the shares is similar to the one used to determine the net equity of the EIF and since, in the absence of a full fair value exercise, the so-determined net equity of the EIF is deemed to be the best approximation of its fair value. It should also be noted that the Commission has no intention to sell its shareholding in the EIF as long as the Commission will continue to develop its venture capital funds and guarantee programs in co-operation with the Fund. The put option was granted to the Commission by the mother company, the EIB, for the sole purpose of giving equal rights to each shareholder of the EIF.

The equity method is used to value the Communities' share in the EIF, in accordance with the accounting rules. Under the equity method the shareholding is initially recorded at cost and is then adjusted to take into account changes subsequent to the investor's acquisition of a share of the net assets of the controlled entity. The result of adjustments reflects the investor's share of the results of the controlled entity.

Under the equity method, the shareholding is valued at 30% of the EIF's own capital. The EIF's balance sheet for 2005 shows a total of EUR 618.6 million of own capital, including profits of EUR 42.9 million for the year. The Communities' share is 30% of this amount (EUR 185.6 million), of which EUR 12.9 million concerns the result for 2005. A dividend of EUR 3.3 million relating to the financial year 2004 was received in 2005.

It should be noted that while the EIF is working towards the application of International Financial Reporting Standards (IFRS) for its annual accounts, its 2005 accounts do not yet fully comply with these rules, particularly with regard to the issue of fair value accounting.

Galileo Programme

For the implementation of the development phase of the Galileo programme, a joint undertaking, within the meaning of Article 171 of the Treaty, was set-up by the Council Regulation 876/2002 for a period of 4 years (2002 to 2006.) The aim of this legal entity is to ensure the unity of the administration and the financial control of the Galileo programme for its development, and to this end to mobilise the funds assigned to that programme. The founding members are the European Communities, represented by the Commission, and the European Space Agency (ESA). The Commission, through grants given under the trans-European networks (TEN) budget, makes available to the Galileo undertaking the requested funds to co-finance the related activities of the development phase.

The Communities have subscribed for EUR 520 million of the capital of this entity and at 31 December 2005 EUR 438 million had been paid, with the balance, EUR 82 million uncalled.

As with the EIF, it is accounted for using the equity method of consolidation. For 2005 the Communities' share of the loss of the joint undertaking was EUR 103.8 million. Thus the value of the investment at 31 December 2005 was EUR 141.5 million being the investment of EUR 438 million less the accumulated share of the losses, EUR 296.5 million.

3.3.2 Guarantee Fund

Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 set up a Guarantee Fund for external actions to repay the Communities' creditors in the event of default by beneficiaries of loans granted or guaranteed by the Communities. This facility covers loans guaranteed by the Communities as a result of a Council Decision, in particular European Investment Bank (EIB) lending operations outside the European Union and loans under macro-financial assistance (MFA loans) and Euratom loans outside the European Union.

In accordance with Article 6 of the Regulation the Commission entrusted financial management of the Fund to the EIB under an agreement signed between the Communities and the EIB on 23 November 1994 in Brussels and on 25 November 1994 in Luxembourg.

Regulation (EC, Euratom) No 2728/94 on the Guarantee Fund, as amended by Council Regulation (EC, Euratom) No 1149/1999 of 25 May states that with effect from 1 January 2000 the Fund is endowed by payments from the Communities' general budget equivalent to 9% of the capital value of the operations, the proceeds from interest on investments made from the Fund's assets, and sums recovered from defaulting debtors for whom the Fund has had to activate its guarantee. The same Regulation sets the target amount at 9%. In accordance with the Regulation, "if, at the end of a year, the target amount is exceeded, the surplus shall be paid back to a special heading in the statement of revenue in the general budget of the European Communities."

The Inter-institutional Agreement of 6 May 1999 on budgetary discipline and improvement of the budgetary procedure provided that the general budget of the European Communities should include a guarantee reserve to cover loans to third countries. This reserve is intended to cover the requirements of the Guarantee Fund and, where necessary, activated guarantees exceeding the amount available in the Fund, so that these amounts may be charged to the budget.

This reserve of EUR 1,231.2 million corresponds to the target amount[3] for the Guarantee Fund calculated on the basis of the amount outstanding at 31 December 2005. The entry on the assets side of the Commission's balance sheet of EUR 1,324.7 million before elimination of MFA debt certificates represents the Fund's net assets at 31 December 2005. The difference between the amount of the Fund shown on the assets side and the amount of the reserve corresponds to the surplus to be repaid to the budget, i.e. EUR 93.5 million.

Net assets of the Guarantee Fund *EUR*

	31.12.2005	31.12.2004 Restated
Current assets	1,324,663,957.25	1,670,814,232.53
After elimination	*1,310,086,228.65*	*1,649,968,069.48*
Short-term investments: Available-for-sale assets	1,008,639,934.02	1,080,917,586.27
After elimination	*994,062,205.42*	*1,060,071,423.22*
Cash and cash equivalents	316,024,023.23	589,896,646.26
Current liabilities	(725,117.47)	(765,497.93)
Net assets	1,323,938,839.78	1,670,048,734.60
After elimination	***1,309,361,111.18***	***1,649,202,571.55***

The Guarantee Fund holds three floating rate notes issued by the European Communities for an amount of EUR 14.6 million, including accrued interest, as at 31/12/05 (2004: EUR 20.8 million) these bonds were issued by the non budgetary instrument MFA. From an accounting point of view, both assets (GF) and liabilities (MFA) have to be eliminated at the Communities level.

The risk management policies of the Guarantee Fund are described in notes **E 7.6** to **E 7.9**.

3.3.3 Other investments

3.3.3.1 Available-for-sale assets

This heading includes investments and participations purchased to help beneficiaries develop their business activities.

European Bank for Reconstruction and Development (EBRD) investment

The EBRD was given initial capital of EUR 10 billion, of which 3% was subscribed by the Communities. The proportion of this capital called up is 30%. On 15 April 1996, at their annual meeting, the Bank's governors decided to double the amount of authorised capital. Under this decision, the Communities have subscribed for 30,000 additional shares with a face value of EUR 10,000 each. This operation involves called-in shares and callable shares in the following proportions: 22.5% of the subscribed shares represent the number of called-in shares and the remainder will be callable shares.

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3 The target amount corresponds to 9% of the amount outstanding.

At balance sheet date, the Communities' subscription to the EBRD's capital amount to EUR 157.5 million, of which EUR 147.5 million have been called up and partially paid. Payments outstanding on called up capital (EUR 9.5 million) are recorded under long-term liabilities and accounted for at amortised cost. As the long-term liability to be recorded can be compared to a long-term borrowing that carries no interest, the fair value of such liability on initial recognition has been estimated as the present value of all future cash payments discounted using the prevailing market rate of interest on that date for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.

Payments outstanding on non-called up capital amount to EUR 442.5 million and are included as contingent liabilities in the off-balance sheet.

As the EBRD is not quoted on any stock exchange and in view of the contractual restrictions included in the EBRD's articles of incorporation relating, amongst others, to the sale of participating interests, capped at acquisition cost and only authorised to existing shareholders, the 3% European Communities' shareholding in the EBRD is valued at cost less any write-down for impairment.

ECIP programme

This heading covers Communities' contributions to the provision of equity and subordinated loan capital for joint ventures set up under the European Community Investment Partners Programme (ECIP) in Asia, Latin America, the Mediterranean region and South Africa. The ECIP programme that has been in existence for many years, but which was halted early, the only extension being its winding-up. The programme cannot be definitively wound up until the last joint venture has been completed. Most of the operations have already been wound up, recovered or converted into definitive grants and work on the remaining open files is ongoing. A review of open files is currently ongoing to assess the recoverability and thus the value of the investments.

Eurotech Capital, Venture Consort and JOP

The purpose of the **Eurotech Capital** instrument is to encourage the private funding of trans-national high-technology projects developed by small and medium-sized undertakings through a network of risk-capital investors. It covers payments made since 1990 in the form of pre-financing repayable under certain circumstances when contracts run out. The Communities' contributions do not constitute equity stakes in the relevant venture capital companies. Rather they represent a fixed proportion of certain investments of these venture capital companies in third companies. These contributions are reimbursable according to conditions specified in the contracts between the Communities and these venture capital companies.

The purpose of the **Venture Consort** instrument is to promote the trans-national syndication of risk-capital operators in small and medium-sized enterprises. It covers contributions since 1985 for investments in small and medium-sized enterprises (SMEs) engaging in innovatory projects.

The purpose of the Phare-Tacis Joint Venture programme (**JOP**) is to foster the creation and development of joint ventures in the countries of Central/Eastern Europe and former Soviet states.

Since all three are risk capital operations, and even if some amounts may be reimbursed, it is very difficult to assess the real present value of the contributions. In accordance with the principle of prudence, a 100% write down has been made for the value of these contributions, which are therefore entered in the balance sheet at zero.

Other financial instruments

The "SME Finance Facility / SME financing mechanism" under the trusteeship of the EBRD is designed to encourage investment funds to grow and to retain over the long term the capital investments they make in SMEs in the Phare candidate countries. The programme is financed jointly by the Commission budget, the European Bank for Reconstruction and Development (EBRD), the Council of Europe Development Bank (CEB), in association with the Kreditanstalt für Wiederaufbau (KfW) and the European Investment Bank (EIB).

The "Growth & Employment - ETF Start up facility" (1998-2000 programme) and "MAP Equity - ETF Start up facility" (2001-2005 programme), under the trusteeship of the EIF support the creation and financing of start-up SMEs by investing in suitable specialised venture capital funds.

Shares were received in 1998 by the ECSC in liquidation as part of the restructuring plan of Eurotunnel. These shares were divested in 2005.

AVAILABLE FOR SALE INVESTMENTS

EUR

	EBRD	ECIP	Venture consort JOP, Eurotech	SME Finance Facility	ETF Start-up Growth & Employment	ETF Start-up MAP Equity	Eurotunnel	TOTAL
Amount at 31 December 2004 (restated)	157,500,000.00	1,269,739.36	0.00	1,453,155.69	35,100,523.63	2,381,756.00	7,092,286.00	204,797,460.68
Acquisitions				2,191,762.52	6,526,602.37	7,765,435.00		16,483,799.89
Disposals and withdrawals			(3,239,356.00)		(11,826,491.00)	(66,505.00)	(7,092,286.00)	(22,224,638.00)
Exchange differences					29,206.00	18,309.00		47,515.00
Revaluation surplus/(deficit) t/f to equity					7,978,667.00	200,293.00		8,178,960.00
Impairment loss			3,237,448.00					3,237,448.00
Amount at 31 December 2005	**157,500,000.00**	**1,269,739.36**	**(1,908.00)**	**3,644,918.21**	**37,808,508.00**	**10,299,288.00**	**0.00**	**210,520,545.57**

If the "fair value method" developed in 2005, as described in note **E 1.5.4**, *had been applied at 31 December 2005, then the investments of the "Growth & Employment - ETF Start up facility" (1998-2000 programme) and "MAP Equity - ETF Start up facility" (2001-2005 programme) would have amounted to EUR 60 million and EUR 9.8 million, respectively.*

3.3.3.2 Held for trading assets

The European Communities use derivative instruments in the form of currency and interest rate swaps or hedging purposes.

Currency and interest rate swaps are commitments to exchange one set of cash flow for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed-rate for floating-rate) or a combination of all those (i.e. cross-currency interest rate swaps). Swaps, as detailed below, are used to match the cash flows of loans with the cash flows of related borrowings.

These derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The extent to which instruments are favourable or unfavourable and thus the fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

The **ECSC in liquidation (ECSC)** entered into the following swap agreements:

- In 1994, an interest rate swap was acquired to match the cash flow of a 14 years loan granted at a fixed rate of 12,077% and designed with a 5 years grace period on interest payments and a final maturity on 26 March 2008, on one side and, the cash flow of the related borrowing obtained at a fixed rate of 6,375% and with a identical maturity date, on the other side;

- In 1990, a combination of both interest rate swap and cross-currency interest rate swap was acquired to match the cash flow of a 19 years French franc loan granted at a floating interest rate (reset every 3 months and based on pibor 3 months less 21 basis points) with a final maturity on 13 March 2009, on one side and, the cash flow of the related borrowing obtained in pound sterling at a fixed rate of 11,875% and with an identical maturity date, on the other side.

SWAPS						
Counterparty	Rating S&P		Nominal	CCY	Terms	Maturity
JP Morgan Chase Bank N.Y., London Branch	A+	to receive	100,000,000.00	USD	6.375% yearly	26.03.2008
N/A	N/A	to pay	100,000,000.00	USD	0% the first 5 years, 12.077% yearly the last following years	26.03.2008
BNP Paribas	AA	to receive	60,000,000.00	GBP	11.875% yearly	13.03.2009
N/A	N/A	to pay	60,000,000.00	GBP	3M LIBOR -0.31%	13.03.2009
BNP Paribas	AA	to receive	60,000,000.00	GBP	3M LIBOR -0.31%	13.03.2009
N/A	N/A	to pay	85,036,062.00	EUR	3M EURIBOR -0.21%	13.03.2009

The fair value of the interest rate swap was obtained by discounting the net fixed cash flows using zero-coupon swap rates on the balance sheet date.

The valuation of the combined instrument was performed in two steps: first, the interest rate swap component was valued by discounting the cash flows (fixed and floating) that would result from reversing the swap position on the balance sheet date (discounting is performed using zero-coupon swap rates on that date); then, the cross-currency interest rate swap was valued by discounting the cash flows (fixed and floating) that would come from returning the two floating branches of the swap with a standard interest rate swap, taking into account the final nominal exchange transaction at maturity of the swap.

The fair value (including accrued interests) of the swaps with final maturity of more than one year after the balance sheet date is detailed below:

Held for trading assets

EUR

Derivative	31.12.2005	31.12.2004 Restated
ECSC in liquidation swaps	27,509,180.02	30,917,567.38

3.4 LOANS

This heading covers loan amounts owed to the European Communities maturing in over one year.

3.4.1 Loans granted from the European Communities budget and the ECSC in liquidation

This item principally covers risk capital operations and loans with special conditions granted as part of co-operation with non-member countries as well as housing loans granted by the ECSC in liquidation from its own funds.

Risk Capital Operations

Risk capital operations are loans granted to financial intermediaries to finance equity investments. These finance contracts do not have the basic and constituent characteristics of a loan as there is no fixed reimbursement schedule nor interest rate agreed for the principal consideration and therefore, are assimilated to indirect equity investments for valuation purposes. They are held at historic cost less any provisions for impairment, as there are no quoted market prices available in an active market and their fair value cannot currently be reliably measured. The provisions for impairment as at the balance sheet date are based on the provisional or definitive write-offs communicated by the financial counterparts.

Loans with Special Conditions

Loans with special conditions are loans granted at preferential rates. They are initially recognised at fair value which, in the case of loans carrying interest below market conditions, corresponds to the net present value of expected cash flows discounted at the average prevailing EIB lending rate of interest for borrowers in the respective countries, then subsequently measured at amortised cost. The provisions for impairment, if any, are based on the provisional or definitive write-offs as provided for under the respective finance contracts.

Housing loans of the ECSC in liquidation (ECSC)

Housing loans are loans granted by the ECSC from its own funds in accordance with articles 54 and 54.2 of the ECSC Treaty. These loans are granted at a fixed rate of 1% and consequently, considered as loans at preferential rates. They are initially recognised at fair value which corresponds to the net present value of expected cash flows discounted at the market rate of interest prevailing for bonds with similar maturities issued by the member states where the borrowers are located, then subsequently measured at amortised cost. The provisions for impairment, if any, are based on the provisional or definitive write-offs as provided for under the respective finance contracts.

3.4.2 Loans granted from borrowed funds

Under the Communities' Treaties, the Council, acting unanimously, has the power to adopt guarantee or borrowing programmes if it considers this necessary to attain the objectives of the Communities. Communities borrowings are direct commitments by the Communities itself and not by any individual Member State. This item includes loans granted by Macro Financial Assistance (MFA) and Euratom and the ECSC in liquidation.

In accordance with the accounting policy described in note **E 1.5.4**, loans are initially recognised at fair value, then subsequently measured at amortised cost. The fair value of a financial instrument on initial recognition is normally the transaction price. However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on initial recognition in an arm's length exchange motivated by normal business considerations. In the specific case of Euratom and MFA loans, the borrower benefits from a AAA interest rate, when under normal conditions, a spread reflecting his creditworthiness or that of any party guaranteeing the loan would have been applied. The valuation technique here used by the Communities takes into account the historical risk-free yield curve and assumes that borrowers are allocated to credit classes. The historical credit spread for the relevant credit class and maturity is used to infer the average risk-neutral hazard rate, based on a recovery rate that is appropriate for bonds. The average risk-neutral hazard rate is then used with a recovery rate appropriate for Communities' loans, to value the loan cash flows. Based on this valuation technique, the lower bound value of a defaultable bullet loan with maturities of between 1 year and 20 years, for various values of spreads consistent with the grading of the borrowers and recovery rates consistent with actual expected recovery rates on Communities sovereign loans and, assuming a risk-free yield of 4%, is always close to par. Consequently, it was considered as reasonable to initially recognise the Communities loans at par.

Macro Financial Assistance (MFA) loans

MFA is a policy-based financial instrument of untied and undesignated balance-of-payment and/or budget support to partner third-countries. It takes the form of medium/long term loans or grants or an appropriate combination of both and generally complements financing provided in the context of an IMF-supported adjustment and reform program.

MFA is exceptional in nature and is mobilised on a case-by-case basis. It is in principle reserved for countries geographically close to the EU territory which respect democracy and human rights and with which the EU has important political, economic and commercial ties. The assistance is released on the basis of the fulfilment of economic and financial policy conditions.

Based on materiality considerations, the effective interest rate method is not applied separately to loans and borrowings. The transaction costs are directly expensed in the economic outturn account.

Euratom loans

Euratom is a separate legal entity of the European Union represented by the European Commission. The financial objective of this entity is to grant loans to Member States and non-Member States as follows:

- Euratom loans to Member States are granted for the purpose of financing investment projects in the Member States relating to the industrial production of electricity in nuclear power stations and to industrial fuel cycle installations.
- Euratom loans to non-Member States are granted to improving the level of safety and efficiency of nuclear power stations and installations in the nuclear fuel cycle which are in service or under construction. Projects may also relate to the decommissioning of installations for which modifications to upgrade its safety level to Western ones is not justified in technical or economic terms and which would pose a safety hazard if simply abandoned. The financing granted may relate to investment during the period between shut-down and the start of decommissioning and to the decommissioning measures themselves. The financing of the decommissioning measures is considered only where no provision to finance these measures has been made during the operating life of the installation.

Based on materiality considerations, the effective interest rate method is not applied separately to loans and borrowings. The transaction costs are directly expensed in the economic outturn account.

ECSC in liquidation loans

This item mainly includes loans granted by the ECSC in liquidation on borrowed funds in accordance with articles 54 and 56 of the ECSC Treaty as well as two unquoted debt securities issued by the European Investment Bank (EIB) as substitute of a defaulted debtor. These debt securities will be held till their final maturity (2017 and 2019) in order to cover the service of related borrowings.

The changes in carrying amount correspond to the change in accrued interests plus the amortisation of the year of premiums paid and transaction cost incurred at inception, calculated according to the effective interest rate method.

The effective interest rates (expressed as a range of interest rates) were as follows:

Effective interest rates on loans granted from borrowed funds

Borrowings	31.12.2005	31.12.2004
Macro Financial Assistance (MFA)	2.039% - 4.54%	2.075% - 4.54%
Euratom	2.224% - 5.76%	2.241% - 5.76%
ECSC in liquidation.	2.241%-12.077% (*)	2.276%-12.077%(*)

(*) higher bound value relates to the fixed rate loan covered by the interest rate swap (see point **3.3.3.2**).

LOANS GRANTED FROM THE EUROPEAN COMMUNITIES BUDGET & THE ECSC IN LIQUIDATION

EUR

Loan type	Balance at 31.12.2004 Restated	New loans	Repayments	Exchange differences	Changes in carrying amount	Impairment losses	Net value at 31.12.2005	Amount due < 1 year	Amount due > 1 year
Loans with special conditions	175,103,234.52	0.00	(17,122,923.18)	0.00	12,030,468.16	0.00	170,010,779.50	0.00	170,010,779.50
Risk capital operations	215,939,683.21	19,147,397.00	(14,893,518.33)	3,881,554.00	0.00	(181,986.77)	223,893,129.11	0.00	223,893,129.11
ECIP loans	1,634,336.59	0.00	(1,784,131.45)	0.00	0.00	313,528.22	163,733.36	119,080.24	44,653.12
Loans for migrant workers	11,008.86	0.00	(11,008.86)	0.00	0.00	0.00	0.00	0.00	0.00
ECSC in liquidation	48,545,467.75	0.00	(8,773,724.00)	147,654.25	3,744,415.00	0.00	43,663,813.00	157,003.00	43,506,810.00
Total	**441,233,730.93**	**19,147,397.00**	**(42,585,305.82)**	**4,029,208.25**	**15,774,883.16**	**131,541.45**	**437,731,454.97**	**276,083.24**	**437,455,371.73**

LOANS GRANTED FROM BORROWED FUNDS

EUR

Loan type	Balance at 31.12.2004 Restated	New loans	Repayments	Exchange differences	Changes in carrying amount	Impairment losses	Net value at 31.12.2005	Amount due < 1 year	Amount due > 1 year
Macro Financial assistance (MFA)	1,220,549,230.50	15,000,000.00	(149,000,000.00)	0.00	(289,993.38)	0.00	1,086,259,237,12	23,122,853.34	1,063,136,383.78
Euratom	172,468,638.77	215,000,000.00		0.00	1,365,031.88	0.00	388,833,670.65	0.00	388,833,670.65
ECSC in liquidation	492,509,315.00	0.00	(2,009,133.00)	19,075,678.00	(1,674,783.00)	0.00	507,901,077.00	0.00	507,901,077.00
Total	**1,885,527,184.27**	**230,000,000.00**	**(151,009,133.00)**	**19,075,678.00**	**(599,744.50)**	**0.00**	**1,982,993,984.77**	**23,122,853.34**	**1,959,871,131.43**

3.5 LONG-TERM PRE-FINANCING

Pre-financing is a payment intended to provide the beneficiary with a cash advance, i.e. a float. It may be split into a number of payments over a period defined in the particular pre-financing agreement. The float or advance is either used for the purpose for which it was provided during the period defined in the agreement or it is repaid - if the beneficiary does not incur eligible expenditures he has the obligation to return the pre-financing advance to the European Communities. Thus pre-financing paid is not a definitive expense until the relevant contractual conditions are met and so is recorded as an asset on the balance sheet when the initial payment is made. The amount of the pre-financing asset is reduced (wholly or partially) by the acceptance of eligible costs and amounts returned. When a pre-financing amount is fully or partially accepted by the Communities, following analysis of the eligibility of a cost claim received, then the accepted amount of eligible expenditure is removed from the balance sheet and taken as an expense in the economic outturn account. In this way, interim or final payments are intended to reimburse expenditure incurred by the beneficiary on the basis of a statement of expenditure. This may clear the pre-financing amount in whole or in part.

Pre-financing is valued at its estimated recoverable amount. The Communities reviews its pre-financing for "value reductions" whenever events, changes in circumstances or information indicate that the carrying amount of the asset might not be recoverable. This assessment takes into consideration the existence of a related guarantee attached to the pre-financing. The expected irrecoverable pre-financing, or the amount for which recovery has ceased to be probable, is recognised as a value reduction or charge in the economic outturn account. The corresponding amount is recognised as a decrease in the pre-financing carrying value in the balance sheet.

At year-end outstanding pre-financing amounts are valued at the original amount(s) paid less: amounts returned, eligible amounts cleared, estimated eligible amounts not yet cleared at year-end, and value reductions. Guarantees related to pre-financing amounts are disclosed in the off-balance sheet as contingent assets.

Interest is generally earned on all pre-financing paid out, except for amounts paid to Member States or as pre-accession aid. This interest is recognised as it is earned in accordance with the provisions of the relevant agreement. An estimate of the accrued interest revenue, based on the most reliable information, is made at the year-end and included in the balance sheet. The ownership of this interest designates the two categories of pre-financing existing - European Communities and Third Party. The difference between the two categories is that the interest generated by "European Communities" pre-financing amounts remains the property of the Communities and so must be returned to the Communities, while that earned on "Third Party" pre-financing is the property of the beneficiary.

Long-term Pre-financing amounts *EUR*

Management type	Outstanding at 31.12.2005
Pre-financing European Communities:	
Centralised direct management: Functioning grants	3,120,098.90
Pre-financing Third parties:	
Centralised direct management: Operational	144,832,316.07
Decentralised management	106,081,969.40
Shared management	22,477,696,941.48
Total long-term Pre-financing	**22,731,731,325.85**

As many of the projects funded by the European Communities Structural Fund actions are long-term in nature, it is necessary that the related advances are available for more than one year. Thus these pre-financing amounts are shown as long-term assets. The Commission makes a payment on account amounting to 7% of the total contribution from the Structural Funds once the programme is adopted. The payment on account will have to be reimbursed if no expenditure is declared within 18 months. The Commission then makes interim payments to reimburse actual expenditure certified by the

Member State. The balance of 5% is paid on the closure of the programme once all the documents required are submitted and approved by the Commission. Payments are posted to the earliest open commitment.

3.6 LONG-TERM RECEIVABLES

Long-term receivables *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Building contribution	42,325,657.00	62,004,976.00
Due from Member States	134,827,865.00	155,743,558.00
ECSC staff loans	20,101,723.12	21,004,999.12
EAR credit schemes	40,014,742.29	62,388,235.71
Guarantees and deposits	6,535,636.06	6,642,128.24
Total	**243,805,623.47**	**307,783,897.07**

The building contribution is primarily the financial contribution by the Belgian State to the purchase and fitting-out of the D3 building for the Parliament, which came to EUR 176 million and is to be paid over ten years ending in 2008. At year-end EUR 42.3 million is due greater than one year (2004: EUR 62 million), while a further EUR 21.4 million (2004: EUR 21.1 million) falls due within one year.

Amounts to be received from Member States refer to amounts due to the ECSC in liquidation from former accession countries. The total contribution amounts to EUR 170 million and is to be paid in four instalments on the first working day of each year, starting in 2006, in the following amounts: 15%, 20%, 30% and 35%. The net present value of these contributions was EUR 158.8 million at year-end (2004: EUR 155.7 million), being split up between long-term receivables, EUR 134.8 million (2004: EUR 155.7) and short-term receivables, EUR 24 million (2004: zero).

Also included above is an amount of EUR 20.1 million relating to loans given by the ECSC in liquidation to officials of the European Communities. These loans are financed by the ECSC in liquidation from its own funds and are currently managed by the Commission. EAR (the European Agency for Reconstruction and Development) credit schemes refer primarily to Counterpart Funds and Credit Line Schemes advanced.

II. CURRENT ASSETS

3.7 STOCKS

STOCKS *EUR*

Description	Acquisition value	Value reduction	Net book value at 31.12.2005	Net book value at 31.12.2004 Restated
Scientific Equipment:				
Scientific material	11,109,187.38	0.00	11,109,187.38	664,820.59
Fissile material	32,195,147.92	0.00	32,195,147.92	13,989,565.81
Heavy water	14,923.00	0.00	14,923.00	14,923.00
Vaccinations	6,857,590.00	0.00	6,857,590.00	6,857,590.00
For re-sale	63,561,282.00	0.00	63,561,282.00	36,834,072.25
Production materials	6,895,280.89	0.00	6,895,280.89	0.00
Publications	9,598,355.07	(3,761,430.34)	5,836,924.73	4,894,077.03
TOTAL	**130,231,766.26**	**(3,761,430.34)**	**126,470,335.92**	**63,255,048.68**

The increase in the balance of scientific material is because 2005 includes raw material amounts of EUR 10 million for the first time. The large increase in fissile material stocks is because there is no value reduction made in 2005 as a result of a change in accounting estimates - previously an impairment was made if there had not been any movements in the stock during the year, where as now stocks are valued at the lower of cost and net realisable value. This is also a reason for the increase in the scientific material for re-sale. Another reason for the increase in these stocks is that EUR 20 million of stock in production is now included under stock for re-sale.

The Commission keeps a stock of production material, valued to EUR 6.9 million, mainly consisting of building maintenance material and spare parts used by the Joint Research Centres.

The stock of publications held and/or managed by the Publications Office for which a charge is made (paying stock) is valued at zero following an analysis made in 2001. Publications not destined for resale are valued on the base of average cost of stocks for re-sale. Stocks with low turnover have been written down by 33% per year.

3.8 SHORT-TERM INVESTMENTS

Short-term investments consist of available-for-sale securities, which are purchased for their investment return or yield, or held to establish a particular asset structure or a secondary source of liquidity and may therefore be sold in response to needs for liquidity or changes in interest rates. Also included are held for trading assets.

3.8.1 Short-term available-for-sale assets

Short-term available-for-sale assets *EUR*

	SME Guarantee Facility	ETF Start up - Growth& Empl	TEN Risk Capital EIB	ECSC in Liquidation	Total
Amounts 31.12.2004 (restated)	22,027,144.89	15,993,581.81	0,00	1,403,111,917.00	1,441,132,643.70
Acquisitions	11,995,800.00	0,00	3,000,000.00	336,634,706.48	351,630,506.48
Disposals and withdrawals	(12,000,000.00)	(12,000,000.00)		(321,119,440.06)	(345,119,440.06)
Adjustment to amortised cost	7,320.00				7,320.00
Change in carrying amount	49,867.11	1,104.19	0.00	(8,067,709.01)	(8,016,737.71)
Revaluation surplus/(deficit) t/f to equity	8,040.00	9,979.00	0.00	0.00	18,019.00
Amounts 31.12.2005	**22,088,172.00**	**4,004,665.00**	**3,000,000.00**	**1,410,559,474.41**	**1,439,652,311.41**

SME Guarantee Facility - ETF start-up Growth & Employment

All investments are AAA floating rate bonds denominated in EUR and quoted in active markets. At 31 December 2005 the nominal value of debt securities with a remaining duration to maturity of less than one year amounts to EUR 4 million (2004: EUR 24 million.) A new bond was purchased in 2005.

Ten Risk Capital EIB

Investments made under the TEN Risk Capital Facility (to date only one totalling EUR 3 million) are undertaken by the establishment of a joint special purpose entity (jointly held by the EIB and the Galaxy Fund, the TEN RCF partner), under the name of GALAXY - A28 for Trans-European Network projects involving private sector investments. These investments represent an equity holding in the special purpose entity, and therefore should be recorded appropriately as an equity investment in the Communities' balance sheet.

ECSC in liquidation

As stipulated in the internal prudential rules of the ECSC in liquidation, the investments are to be confined to securities issued by first-ranking entities. All investments are debt securities denominated in EUR and quoted in an active market. Details of the investment portfolio by issuer type and by rating are described in note **E.7.13**. At 31 December 2005 debt securities (expressed at their fair value) reaching final maturity in the course of 2006 amount to EUR 237.4 million (2004: EUR 200.1 million).

3.8.2 Short-term held for trading assets

Short-term held for trading assets *EUR*

Derivative	31.12.2005	31.12.2004 Restated
MFA interest rate swaps	0.00	1,689,247.14

The **Macro Financial Assistance (MFA)** swap agreement, as detailed below, was entered into to match the cash flow of a loan with a floating interest rate and a final maturity on 22 December 2008, on one side and, the cash flow of the corresponding borrowing with a fixed interest rate and a final maturity on 22 December 2005, on the other side. The swap agreement was structured in two "tranches": the "swap tranche", where both floating and fixed rate legs were active, ended on 22 December 2005, the second "tranche" with only the floating rate leg being a forward floating borrowing starting on the same date.

SWAPS						
Counterparty	Rating S&P		Nominal	CCY	Terms	Maturity
BNP Paribas	AA	to receive	125,000,000.00	EUR	fix € 4,531,250 yearly	22.12.2005
N/A	N/A	to pay	125,000,000.00	EUR	EUR-6M LIBOR -0.147%	22.12.2005

The fair value of the "swap tranche" was obtained by discounting the cash flows (fixed and floating) that would result from reversing the swap position on the balance sheet date (discounting is performed using zero-coupon swap rates on that date).

3.9 SHORT-TERM PRE-FINANCING

The split of amounts outstanding between management types reflects the pre-financing payments made during the year 2005 (comparative figures are not available for 2004.) The historic pre-financing amounts are those first included in the opening balance sheet and are shown separately on a single line.

Accrued charges represent the amount of eligible costs that were estimated to have been incurred by the beneficiaries of the outstanding pre-financing amounts at year-end, but not yet reported to the Communities. These amounts are taken as expenses in the Economic Outturn Account. See also note **3.5** for further explanations concerning long-term pre-financing.

Short-term Pre-financing amounts

EUR

Management type		Outstanding at 31.12.2005
Pre-financing European Communities gross amounts:		
Direct centralised management	*Action grants*	4,790,792,434.87
	Functioning grants	111,387,513.26
Indirect centralised management	*National agencies*	620,077,642.63
	Financial activities	63,518,496.96
	Other	3,583,333.00
Decentralised management		195,456,099.10
Other		473,882,469.99
Pre-financing implemented by other Institutions and Agencies		6,482,306.56
Historic pre-financing balances*		5,254,181,771.25
Total gross pre-financing amounts		**11,519,362,067.62**
Less accrued charges:		
Direct centralised management		(5,891,600,089.98)
Indirect centralised management		(1,376,200,198.71)
Decentralised management		(122,922,410.00)
Other		(169,505,546.79)
Total Pre-financing European Communities		**3,959,133,822.14**
Pre-financing Third parties:		
Direct centralised management	*Procurement*	260,024,355.90
	Operational	356,060,584.56
Decentralised management		361,009,093.23
Shared management		390,843,176.32
Joint management		317,053,334.83
Pre-financing implemented by other Institutions and Agencies		143,664,170.02
Historic pre-financing balances*		2,774,751,315.50
Total gross pre-financing amounts		**4,603,406,030.36**
Less accrued charges:		
Direct centralised management		(1,199,787,477.00)
Decentralised management		(382,891,261.00)
Shared management		(201,212,486.00)
Joint management		(143,223,312.00)
Other		(1,943,330.98)
Total Pre-financing European Third parties:		**2,674,348,163.38**
Total short-term pre-financing		**6,633,481,985.52**

* No information on the split by budget management type was available at 31/12/2004

3.10. SHORT-TERM RECEIVABLES

Short-term receivables

EUR

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Long-term receivables due in less than one year	45,918,358.03	50,826,727.14
Current receivables	4,243,426,047.08	4,435,308,351.36
Sundry receivables	21,591,738.74	44,898,157.64
Accruals and deferrals	2,926,918,379.47	2,608,028,778.50
Total	**7,237,854,523.32**	**7,139,062,014.64**

3.10.1 Long-term receivables falling due in less than one year

These amounts totalling EUR 45.9 million (2004: EUR 50.8 million) represent primarily the loans with remaining final maturities less than 12 months after the balance sheet date (see note **3.4** above for more details) and the financial contribution by the Belgian State to the purchase and fitting-out of the D3 building for the Parliament (see note **3.6** above.) Also included are the short-term contributions owed by former accession countries to the ECSC in liquidation (see note **E.3.6** above.)

3.10.2 Current receivables

Current receivables *EUR*

Account Group	At 31.12.2005			At 31.12.2004 Restated		
	Gross amount	Written down	Net Value	Gross amount	Written down	Net Value
Customers	2,371,840,418.60	(149,841,788.65)	2,221,998,629.95	1,435,132,856.81	(177,742,051.83)	1,257,390,804.98
Members States	3,252,041,919.04	(1,603,860,946.87)	1,648,180,972.17	3,976,072,649.01	(1,586,639,391.71)	2,389,433,257.30
EFTA	29,607,404.80	0.00	29,607,404.80	36,797,915.81	0	36,797,915.81
Third States	126,449,842.51	(627,693.54)	125,822,148.97	77,282,595.98	0	77,282,595.98
Others	229,666,086.81	(11,849,195.62)	217,816,891.19	675,014,983.85	(611,206.56)	674,403,777.29
Total	**(6,009,605,671.76)**	**(1,766,179,624.68)**	**4,243,426,047.08**	**6,200,301,001.46**	**(1,764,992,650.10)**	**4,435,308,351.36**

3.10.2.1 Customers

These are *recovery orders* entered in the accounts at 31 December 2005 as established entitlements to be recovered and not already included under other headings on the assets side of the balance sheet.

In respect of imposed *fines* of EUR 4,274.7 million at 31/12/2005 a total of EUR 2,103.3 million was collected provisionally. The balance of EUR 2,171.4 million is included under this heading, of which EUR 1,465.7 million was covered by bank guarantees. The provisional payments (and related interest) are applied against the related receivable and included as restricted cash under the cash heading. The bank guarantees are entered as contingent assets in the off-balance-sheet. The amount shown in the off-balance-sheet as contingent liabilities totals EUR 4,427.4million, being the total outstanding claims pending judgement plus interest earned on payments received pending final judgement.

3.10.2.2 Receivables from Member States

Advances to Member States

In 2004 this amount concerned advances paid by the Commission to various Member States from the Emergency Veterinary Fund for certain animal disease eradication costs incurred.

EAGGF Guarantee receivables

This item covers the amounts owed by beneficiaries of EAGGF Guarantee as declared and certified by the Member States and entered in the debtors ledger at the end of the year (15 October 2005) in accordance with Regulation (EC) No 2761/99 less 20% of the amount, which the Member States are allowed to retain to cover administrative costs. The Member States are not required to make the amounts available to the Commission unless they are recovered.

Additionally, and in accordance with the principle of prudence, the European Commission must estimate and record the part of the EAGGF Guarantee that is unlikely to be recovered. The declared estimate of the write-down is EUR 873.9 million (as estimated by the Member States), which accounts for 59.3% of the total amount to be recovered at 31 December 2005 (57.4% at 31 December 2004.) The Commission relies on the estimates of the Member States based on the assumption that the paying agencies are in a better position to assess the amounts likely to be recovered. The findings of the certifying bodies concerning management of amounts owed are handled under the 2005 clearance procedure, including any proposal for the application of financial corrections. The fact that this adjustment is entered in the accounts does not mean that the EC is waiving future recovery of the amounts covered by the write-down.

Receivables from Member States *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Advances to Member States	0.00	500,000.00
EAGGF Guarantee receivables		
EAGGF Guarantee receivables	1,473,622,922.19	1,560,899,301.12
Value correction	(873,943,547.28)	(895,401,413.57)
Subtotal	599,679,374.91	665,497,887.55
VAT paid and recoverable from Member States		
VAT to be recovered	21,039,461.52	22,506,889.98
Value correction	(1,628,334.45)	(1,791,277.23)
Subtotal	19,411,127.07	20,715,612.75
Own resources		
Own resources established in the A account, as laid down in Article 6(3) of Council regulation 1150/2000, and pending recovery	44,984,573.61	114,832,792.31
Own resources established in the separate account, as laid down in Article 6(3) of Council regulation 1150/2000, and pending recovery	1,410,925,222.84	1,428,849,871.51
Value correction	(728,277,014.62)	(689,442,098.87)
Other	201,639,674.07	497,629,295.47
Subtotal	929,272,455.90	1,351,869,860.42
Other receivables from Member States		
Late interest	1,289,335.32	46,650,783.13
Other	98,528,678.97	304,199,113.45
Subtotal	99,818,014.29	350,849,896.58
Total	**1,648,180,972.17**	**2,389,433,257.30**

VAT

This item covers the amounts of VAT paid by the Communities and recoverable from Member States.

Own resources

The separate account contains traditional own resources which, under Article 6(3)(b) of Regulation No 1150/2000, have been established by the Member States but not made available to the Communities as they have not yet been recovered or guaranteed or because they have been challenged. Council Decision No 2000/597/EC, Euratom of 29 September 2000 on the system of the European Communities' own resources allows Member States to withhold 25% of traditional own resources as collection costs.

Each Member State sends the Commission a quarterly statement of these accounts, with the following particulars for each type of resource:

- the previous quarter's outstanding balance,
- the amounts recovered during the quarter in question,
- rectifications of the base (corrections/cancellations) during the quarter in question,
- amounts written off,
- the balance to be recovered at the end of the quarter in question.

When the traditional own resources from the separate account are recovered, they must be made available to the Commission at the latest on the first working day following the 19th day of the second month following the month during which the entitlement was recovered.

This figure overestimates the Communities' actual entitlements since the separate account for traditional own resources largely consists of amounts where actual recovery is unlikely. For previous years the Commission calculated a write-down of the entitlements in the separate account by using a statistical method. From 2004 onwards this write-down is based on estimations made by Member States themselves. In order to ensure that the separate account provides a better picture of the actual budgetary situation Article 6(4)(b) of Council Regulation (EC, Euratom) No 1150/2000 was amended by Council Regulation (EC, Euratom) No 2028/2004 of 16 November 2004. This Article states now: "Together with the final quarterly statement for a given year, Member States shall forward an estimate of the total amount of entitlements contained in the separate account at 31 December of that year for which recovery has become unlikely."

Based on the estimations sent by Member States, a write-down of EUR 728.3 million has been deducted from the item for receivables from Member States on the asset side of the balance sheet. However, this does not mean that the Commission is waiving recovery of the amounts covered by this value adjustment. Even where recovery looks very unlikely, if not virtually impossible, this does not necessarily mean that the amounts in question are lost to the Community budget as traditional own resources. This is because non-recovered entitlements are lost only if the Member State has exhausted all the avenues it is required to pursue in order to secure recovery. Where the Member State fails to do this, it is held financially liable and required to pay the amount into the Community budget in accordance with Article 17(2) of Regulation No 1150/2000.

Other own resource amounts at 31 December 2005 concerned amounts due from Portugal that had not been paid when due in December 2005.

Other receivables from Member States

Other receivables from Member States include EUR 74 million of recovery of expenses from the regions. Included under "other" in 2004 was an amount of EUR 170 million relating to contributions due from the new Member States to the Research Fund for Coal & Steel (see note **3.6.**)

3.10.3 Sundry receivables

The main amount included here relates to advances granted under the MEDIA programme, EUR 36.5 million (2004: EUR 41.7 million). Using the prudence principle and based on the risks and uncertainty involved, a value reduction of EUR 24.5 million (2004: EUR 28.1 million) has been applied.

Amounts due from personnel are EUR 4.2 million (2004: EUR 12.6 million.)

3.10.4 Accrued income and deferred charges

The most significant accrued income amounts represent accrued income relating to traditional own resources (agricultural duties, sugar levies and custom duties). At 31 December 2005 these amounted to EUR 2.3 billion compared to EUR 2 billion the previous year. Also included here is late interest income, accrued bank interest and accrued interest on pre-financing amounts.

The main amounts under deferred charges at 31 December 2005 are anticipated payments of EUR 89.5 million (EUR 108 million in 2004) for budgetary compensation to new Member States, pre-paid office rental of EUR 29.7 million (EUR 49 million in 2004), EUR 62.3 million paid for bilateral fisheries agreements with third countries (EUR 61.7 million in 2004) and EUR 62.8 million pre-paid expenses concerning the European schools.

3.11 CASH AND CASH EQUIVALENTS

Cash & cash equivalents *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Unrestricted cash:	**9,602,870,098.36**	**5,947,447,712.18**
Accounts with Treasuries & Central Banks	8,092,743,965.78	3,221,396,622.84
Current accounts	705,792,850.51	2,102,099,904.24
Imprest accounts	61,021,076.87	71,433,147.76
Cash in hand	290,635.82	252,979.35
Transfers (cash in transit)	0.00	76,479,847.20
Short-term deposits and other cash equivalents	743,021,569.38	475,785,210.79
Restricted cash	**2,251,065,838.56**	**2,129,991,326.83**
Total	**11,853,935,936.92**	**8,077,439,039.01**

Unrestricted cash covers all the funds which the Communities' keeps in its accounts in each Member State and EFTA country (treasury or central bank), as well as in current accounts, imprest accounts, short-term bank deposits and petty cash.

Restricted cash refers to amounts received in connection with fines issued by the Commission for which the case is still open. These total EUR 2.25 billion and are kept in specific current accounts that are not used for any other activities.

Cash & cash equivalents include the following for the purposes of the cash flow statement:

EUR

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Cash and cash equivalents	11,853,935,936.92	8,077,439,039.01
Cash and cash equivalents - Guarantee Fund (see note 3.3.2)	316,024,023.23	589,896,646.26
Total	12,169,959,960.15	8,667,335,685.27

III. NON CURRENT LIABILITIES

3.12 EMPLOYEE BENEFITS

Employee benefits *EUR*

	Amount at 31.12.2004 Restated	Additional provisions	Amounts used	Amount at 31.12.2005
Pension Scheme	**26,012,130,886.00**	**8,044,529,533.33**	**(900,775,481.33)**	**33,155,884,938.00**

Pensions

At 31 December 2005, the rules concerning the Pension Scheme of European Officials (PSEO) were defined by the latest version of the Staff Regulations of Officials of the European Communities (in force since 1st May 2004). The rules regarding the staff pensions are directly applicable in all Member States. The arrangement covers various types of pensions and allowances (seniority, invalidity, survival).

In accordance with article 83 of the Staff Regulations, the payment of the benefits provided for in the pension scheme constitutes a charge to the Communities' budget. Member States guarantee the payment of these benefits collectively according to the scale fixed for the financing of this expenditure. In addition, officials contribute one third to the long-term financing of this scheme via a compulsory contribution.

The liabilities of the PSEO were the subject of an actuarial valuation by independent experts on 31 December 2005 on the basis of the applicable rules of the statute. This evaluation covered the benefits connected with retirement, invalidity and survival, as well as invalidity allowance. It was carried out in accordance with the methodology of International Accounting Standard 19 (IAS 19). This accounting standard requires the employer to determine his actuarial commitment on an ongoing basis, taking into account both the promised benefits during the active lifetime of employees, and foreseeable increases in salaries.

The actuarial valuation method used to calculate this liability is known as the projected unit credit method. The main actuarial assumptions used in the valuation were as follows:

1. The nominal discount rate was based on the government bonds in the Euro zone in December 2005 for a duration close to that of the scheme (19 years), as an estimation of the zero coupon Euro yield curve in December 2005 for the same duration, being 3.6%. According to IAS 19, the inflation rate must be an expected inflation rate over the duration of the scheme - it was thus based on prospective values as expressed by index-linked bonds on the European financial markets. The expected long-term inflation rate was 2.1% and so the used real discount rate was 1.5%.
2. The "EU-2004 Life table" was made on the basis of the national tables of the officials' countries of origin, and was corrected to take account of actual observed mortality rates among staff.
3. The "EU-2004 Invalidity table" was based on the one used by the Co-ordinated Organisations (OECD, NATO, ESA, etc) and corrected with the observation of the population of EC officials.
4. The general salary growth (GSG), being equal to the general pension revaluation, was based on revaluation statistics of salaries and pensions of the period 1993-2005, being equal to 0.3%. The individual salary progression (ISP) beyond the rate of the GSG was estimated on the basis of the new career structure (promotion rates specified in annex I of the Staff Regulations) and its transitional measures (section 1 of annex XIII of the Staff Regulations) - it varies with the status, the age and the grade and step of the person.
5. The matrimonially coefficients for active officials at the time of their departure on retirement were based on statistics of the population of officials. The actual marriage situation was taken for former officials (pensioners and invalids).
6. The departure on retirement is supposed to occur at the time when the official benefits from his full rights, taking into account the reduction for early retirement and the Barcelona Incentive for late retirement, at the latest at 65 years.

Liabilities cover the rights previously defined for the following persons:

1. Staff in active employment at 31 December 2005 in all the Institutions and agencies included in the PSEO.
2. Staff in a deferred situation, i.e. who temporarily or definitively left the Institutions leaving his/her pension rights in the PSEO.
3. Former officials and other servants benefiting from a retirement pension.
4. Former officials and other servants benefiting from an invalidity pension.
5. Former officials and other servants benefiting from an invalidity allowance.
6. The recipients of a survivor pension (widows or widowers, orphans, dependants).

The population of the PSEO at 31 December 2005 was extracted from the Eurostat database. The results obtained within the framework of this study were compared with the estimates based on the previous actuarial valuation on 31 December 2004.

The principal facts are:

- The actuarial liability was valued at EUR 33.2 billion on 31 December 2005, while the previous valuation carried out for the situation on 31 December 2004 gave an amount of EUR 26 billion.
- The 2005 service cost was valued at EUR 1.2 billion and the 2005 interest cost at EUR 1.2 billion
- **The estimated actuarial loss for the year was EUR 5.5 billion**
- The real discount rate changed from 1.9% to 1.5%, so if we consider furthermore the general salary growth effect (0.2% in 2004 and 0.3% in 2005), the net discount rate decreased from 1.7% to 1.2%.
- The population of members of the pension scheme increased by 7,094 to 54,876 individuals since 31 December 2004, and it contains new categories of persons (beneficiaries of an invalidity allowance and contractual agents as well as deferred pensioners), the new agents having a lower yearly accrual rate for pension (1.9% instead of 2%).

The calculations of gross pensions and family allowances are based on the provisions of the Staff Regulations.

Also included in the above amount is the liability relating to the pension obligations towards members and former members of the Commission and Court of Auditors, as well as the judges and former judges of the Court of Justice and the Court of First Instance. The amounts used in 2005 represent the pension amounts paid, from the 2005 budget, to retired staff (widows, orphans, etc.) during the year.

3.13 LONG-TERM PROVISIONS FOR RISKS AND CHARGES

Long-term provisions for risks and charges *EUR*

	Amount at 31.12.2004 Restated	Additional provisions	Transfer to short-term	Present value discounting	Amount at 31.12.2005
Legal cases	81,205,000.00	18,350,223.47	0.00	0.00	99,555,223.47
Nuclear site dismantlement	831,401,306.00	0.00	(34,565,000.00)	87,010,574.00	883,846,880.00
Financial provisions	100,358,155.85	46,601,400.50	(36,517,733.21)	2,605,078.86	113,046,902.00
Other	55,649.18	338,280.06	0.00	0.00	393,929.24
Total	**1,013,020,111.03**	**65,289,904.03**	**(71,082,733.21)**	**89,615,652.86**	**1,096,842,934.71**

Legal cases

This is the estimate of amounts that are likely to be paid after 2006 in relation to a number of ongoing legal cases. The largest (EUR 60 million) concerns the estimate of amounts that will probably have to be paid out for 18 court cases pending at 31 December 2005 in relation to the financial corrections for EAGGF Guarantee expenditure. A further EUR 37.2 million is provided for 5 other court cases concerning agricultural expenditure

Decommissioning of JRC nuclear facilities

In 2002 a consortium of independent experts conducted a study into the estimated costs of the decommissioning of the JRC nuclear facilities and waste management programme. Their estimate of EUR 1,145 million (including EUR 76 million as an estimate of the cost required for the "green field" option, i.e. total destruction of all the buildings) is taken as the basis for the provision to be included in the accounts. To fully apply the Communities' accounting rules, this provision is indexed for inflation (at a rate of 2.5%) and then discounted to its net present value (using the Euro zero-coupon swap curve). At 31 December 2005, this resulted in an amount for the provision of EUR 1,016.4 million, less the costs incurred to date of EUR 81.5 million, giving EUR 934.9 million split between amounts expected to be used in 2006 (EUR 51 million) and afterwards (EUR 883.9 million.)

In view of the estimated duration of this programme (around 30 years), it should be pointed out that there is some uncertainty about this estimate, and the final cost could be different from the amounts currently entered.

Financial provisions

Under the SME Guarantee Facility 1998 implemented as part of the European Union's Growth and Employment Initiative and the SME Guarantee Facility 2001 implemented under the Multi-annual Programme for enterprise and entrepreneurship (MAP), the European Investment Fund (EIF) is empowered to issue guarantees in its own name but on behalf of and at the risk of the Communities.

The financial risk linked to the drawn and undrawn guarantees is capped as follows:

- Under the SME Guarantee Facility 1998, the guarantee cap amount is a Euro fixed amount calculated by the EIF and approved by the Commission for each guarantee portfolio. However, as the inclusion period for this facility is over, the financial risk provision is not based on the guarantee cap amount but rather on the contracted percentage of actual utilisation of guarantees issued to financial intermediaries, subsequently reduced by the payment demands made by these intermediaries, net of any loss recoveries. The net amount then obtained represents the payment obligation of the facility.
- Under the SME Guarantee Facility 2001, the guarantee cap amount is the pre-agreed payment obligation to financial intermediaries recorded upon the signature of a new guarantee agreement and subsequently reduced by the payment demands made by financial intermediaries, net of any loss recoveries. The pre-agreed payment obligation covers a small part of the total guarantee volume, technical support for the Micro-credit window (capped to a maximum of EUR 100,000 per intermediary) and marketing costs and collection of information costs (respectively capped to EUR 2,500 and EUR 5,000 per intermediary).

As at the balance sheet date, financial provisions correspond therefore for both facilities to the payment obligations towards to financial intermediaries minus the net payment demands made up that date. Due to the time value of money, long-term financial provisions are discounted to their net present value (using the Euro zero-coupon swap curve).

The financial provisions are annually adjusted in view of any variation of the utilisation of guarantees or any change in the net payment demands made by the financial intermediaries. The total increase in financial provisions (long-term and short-term) in 2005 is EUR 27.4 million, divided into the effective additional provision of EUR 51.7 million less the payments made for the guarantee calls amounting to EUR 27.9 million, and an increase of provision due to the effect of time of EUR 3.6 million.

3.14 FINANCIAL LIABILITIES

3.14.1 Borrowings

This heading includes borrowings due by the European Communities maturing in over one year.

The detailed movements in borrowings during 2005 are as follows:

Borrowings

EUR

Name	Balance at 31.12.2004 Restated	New borrowings	Repayments	Exchange differences	Change in carrying amount	Balance at 31.12.2005
MFA	1,220,589,960.38	108,750,000.00	(242,750,000.00)	0.00	(331,548.81)	1,086,258,411.57
After elimination	*1,199,743,797.33*	*108,750,000.00*	*(236,525,000.00)*	*0.00*	*(288,114.36)*	*1,071,680,682.97*
EURATOM	172,412,848.97	215,000,000.00	0,00	0.00	1,317,018.07	388,729,867.04
ECSC in liquidation	448,826,114.00	0.00	(2,223,144.00)	21,085,001.00	(85,520.00)	467,602,451.00
Total	1,841,828,923.35	323,750,000.00	(244,973,144.00)	21,085,001.00	899,949.26	1,942,590,729.61
After elimination	***1,820,982,760.30***	***323,750,000.00***	***(238,748,144.00)***	***21,085,001.00***	***943,383.71***	***1,928,013,001.01***

Split of borrowings between long-term & short-term

EUR

	Maturity< 1 year	Maturity > 1 year	Total at 31.12.2005
Borrowings			
MFA	23,122,422.79	1,063,135,988.78	1,086,258,411.57
After elimination	*22,018,193.71*	*1,049,662,489.26*	*1,071,680,682.97*
EURATOM	0.00	388,729,867.04	388,729,867.04
ECSC in liquidation	0.00	467,602,451.00	467,602,451.00
Total before elimination	23,122,422.79	1,919,468,306.82	1,942,590,729.61
Total after elimination	***22,018,193.71***	***1,905,994,807.30***	***1,928,013,001.01***

Borrowings include debts evidenced by certificates amounting (after elimination) to EUR 1,281.4 million (2004: EUR 1,223.8 million). The changes in carrying amount correspond to the change in accrued interests plus, in the case of ECSC in liquidation's borrowings, the amortisation of the year of any material transaction costs incurred at inception, calculated according to the effective interest rate method.

The effective interest rates (expressed as a range of interest rates) were as follows:

Effective interest rates on borrowings

Borrowings	31.12.2005	31.12.2004
Macro Financial Assistance (MFA)	2.039% - 4.54%	2.075% - 4.54%
Euratom	2.144% - 5.6775%	2.161% - 5.6775%
ECSC in liquidation	1.625%-11.875% (*)	1.6875%- 11.875% (*)

(*) higher bound value relates to the fixed rate borrowing covered by the interest rate swap (see note **3.3.3.2**)

3.14.2 Held for trading liabilities

See held for trading assets, note **3.3.3.2** above, for more details.

Held for trading liabilities

EUR

Derivative	31.12.2005	31.12.2004 Restated
ECSC in liquidation swaps	14,497,707.04	19,204,008.62

3.15 OTHER LONG-TERM LIABILITIES

This item covers leasing liabilities due in greater than one year (see note **3.2** above) and payments still to be made on the part of the EBRD capital subscribed by the Commission which has been called in.

Included under "Other" are amounts of EUR 19.9 million and EUR 7 million relating to the pension fund for local agents working in the delegations and the unemployment fund for temporary agents respectively. An amount of EUR 42.3 million (2004: EUR 62 million) is also included here relating to reimbursements of investment costs to be made by the Parliament concerning its building in Brussels.

Other long-term liabilities *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Finance Leasing debts	1,772,858,660.07	1,736,441,055.04
EBRD subscriptions	9,464,084.64	17,286,307.05
Other	70,327,191.85	89,824,834.69
Total	**1,852,649,936.56**	**1,843,552,196.78**

IV. CURRENT LIABILITIES

3.16 SHORT-TERM PROVISIONS FOR RISKS AND CHARGES

This heading includes the portion of provisions which fall due for payment in less than one year's time.

Short-term provisions for risks and charges *EUR*

	Amount at 31.12.2004 Restated	Additional provisions*	Unused amounts	Amounts used	Present value discounting	Amount at 31.12.2005
Legal cases	34,300.00	16,132,973.27	(20,798.39)	(13,501.61)	0.00	16,132,973.27
Nuclear site dismantlement	38,294,093.00	34,565,000.00	0.00	(21,811,237.00)	0.00	51,047,856.00
Emergency Veterinary Fund	41,923,055.00	15,417,743.00	(3,444,839.76)	(18,604,903.26)	0.00	35,291,054.98
Financial provisions	138,553,202.62	41,604,725.38	0.00	(27,899,063.00)	1,031,992.00	153,290,857.00
Other	21,435,602.98	8,652,113.80	(3,839,873.04)	(6,569,587.36)	0.00	19,678,256.38
Total	**240,240,253.60**	**116,372,555.45**	**(7,305,511.19)**	**(74,898,292.23)**	**1,031,992.00**	**275,440,997.63**

* Includes amounts transferred from long-term provisions (see note 3.13 above)

Legal cases

This is the estimate of amounts that are likely to be paid in 2006 in relation to a number of ongoing legal cases, as well as the associated legal costs.

Decommissioning of JRC nuclear facilities - see note **3.13**

Emergency Veterinary Fund provision

This provision concerns the estimates of the Communities' contributions to various Member States under the Emergency Veterinary Fund for certain animal disease outbreaks, totalling EUR 35.3 million (2004: EUR 41.9 million). Amounts of EUR 5.5 million already agreed to be paid are included as a debt due to Member States.

Financial provisions - see note **3.13**

Other provisions

These relate to provisions for untaken holidays of staff in various agencies.

3.17 SHORT-TERM FINANCIAL LIABILITIES

This heading includes borrowings and other financial liabilities with remaining final maturities less than 12 months after the balance sheet date (see text and tables above, note **3.14**).

3.18 ACCOUNTS PAYABLE

Accounts payable *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Long-term liabilities due in less than one year	51,333,980.13	58,576,673.54
Current payables	15,220,283,490.91	9,411,614,657.02
Sundry payables	108,665,542.69	224,816,354.27
Accrued charges and deferred income	67,147,704,569.99	64,546,197,089.81
Total	**82,527,987,583.72**	**74,241,204,774.64**

3.18.1 Long-term liabilities falling due in less than one year

This heading includes amounts which fall due for payment in less than one year's time, primarily long-term leasing debts falling due within the year (EUR 29.9 million). It also includes EUR 21.4 million (2004: EUR 21 million) relating to reimbursements of investment cost to be made by the Parliament concerning its building in Brussels.

Long-term liabilities falling due in less than one year *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Finance Leasing debts	29,866,390.13	36,764,256.76
Other	21,467,590.00	21,812,416.78
Total	**51,333,980.13**	**58,576,673.54**

3.18.2 Current payables

Current payables *EUR*

Type	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Member States	15,335,166,489.79	9,051,856,661.89
EFTA	8,990,813.33	21,938,674.64
Staff	820,194.62	164,540.84
Third States	174,963,659.84	171,147,130.45
Suppliers and other	1,350,211,214.82	1,534,230,533.57
Eligibility to be checked	(1,649,868,881.49)	(1,367,722,884.37)
Total	**15,220,283,490.91**	**9,411,614,657.02**

Current payables concern mainly cost statements received by the Communities under the framework of the grant activities. They are credited for the amount being claimed from the moment the demand is received. If the counterpart is a Member State, they are classified as such. It is the same procedure for invoices and credit notes received under procurement activities.

Giving out grants under the different policy areas is the core activity of the European Communities. The normal lifecycle of grant implementation can be summarised as follows: a financing decision is made, followed by a budgetary commitment (reservation of funds in the budget), followed by the signature of the contract between the Communities and the beneficiary (although the sequence may vary for example in the case of the structural funds.) A pre-financing payment can then be made, intended to provide the beneficiary with a float.

The next (interim or final) payments may be repeated and are intended to reimburse expenditure incurred by the beneficiary on the basis of a statement of expenditure when the action is in progress. It may clear the outstanding pre-financing amount in whole or in part.

Cost statements are sent by the beneficiaries, which the Communities have to analyse, looking at the eligibility of the expenses, together with a possible clearing of the pre-financing amount. The rhythm of these cost claims sent during the year is variable depending on the type of action being funded and the contractual conditions, and they are not necessarily received at year end. Cost statements received are registered immediately as a current payable with "Eligibility to be checked" the counterpart entry.

Eligibility criteria are defined in the basic act, in the calls for proposal, in other information documents for grant beneficiaries and/or in the contractual clauses of the grant agreements. After analysis, the eligible expenses are taken into charges and the beneficiary is informed about any non eligible amounts. "Eligibility to be checked" amounts thus represent received cost claims for which the eligibility has not yet been checked and therefore where the event giving rise to the expense being realised has not yet been reached.

The cost claims concerned have been taken into account for the year-end cut off procedures (see note **3.18.4** below). Following these cut off entries, estimated eligible amounts have therefore been recorded as accrued charges, while the non-eligible parts remain open on the "eligibility to be checked" accounts. In order not to overestimate assets and liabilities, it has been decided to present the net amount to be paid under the current liabilities.

Member States

The primary amounts here related to unpaid cost claims for structural fund actions and also EUR 3.8 billion due back to Member States following the rectifying budget (8) made at the end of 2005.

EFTA countries

Amounts owed to EFTA countries include the budget outturn figures of the current year and the previous years but primarily the balance on the EFTA current account.

Staff

This heading covers the unemployment fund for temporary staff at the Commission and the welfare fund for Commission local staff in non-member countries.

Suppliers and other

As well as amounts relating to grant activities, also included under this heading are amounts owed following procurement activities. This heading also covers amounts payable to several public bodies (universities, institutes, chambers of commerce, United Nations, EIB, etc.) and non-consolidated entities, including the EDF.

Eligibility to be checked

Following the year-end accruals, EUR 1,650 million remains open as "eligibility to be checked" on cost claims in the framework of the grant activity. The most important amounts concern DG REGIO (EUR 801 million), DG EMPL (EUR 465 million), DG AGRI (EUR 252 million) and DG EAC (EUR 51 million).

The remaining balance of "eligibility to be checked" (EUR 81 million) concerns invoices received and requests for reimbursement, mainly from procurement activities, for which the invoice has still to be checked with the delivered goods and services and requests for pre-financing.

3.18.3 Sundry payables

An amount of EUR 5.5 million (2004: EUR 126.4 million) to be paid to various Member States included under this heading relates to claims made for reimbursement of certain costs in connection with certain disease eradication costs and is also included under this heading.

Also included are co-financing amounts of EUR 30.2 million (2004: EUR 24.6 million) received from Member States for their participation in some development projects. Corresponding amounts are also included under cash and cash equivalents.

3.18.4 Accrued charges and deferred income

Accrued charges & deferred income *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Accrued charges	66,685,287,593.12	64,205,034,324.37
Deferred income	79,167,972.98	74,393,506.91
Other	383,249,003.89	266,769,258.53
Total	**67,147,704,569.99**	**64,546,197,089.81**

The most significant accrued charges amounts represent accrued charges relating to EAGGF-Guarantee expenditure. At 31 December 2005 these amounted to EUR 49.1 billion compared to EUR 47.6 billion the previous year: EUR 25.1 billion (EUR 26.3 billion in 2004) cover incurred expenses between 16 October and 31 December 2005 which are declared by Member States beyond the time frame necessary for the preparation of the financial statements, EUR 23.5 billion (EUR 21.2 billion in 2004) cover market measures including direct aid (this consist of entitlements incurred in 2005 with financial consequences in 2006) and rural development (this consist of eligible expenditure incurred by operators or the payment authorities until the 31 December 2005, for which no payment request was yet sent to the Commission), EUR 0.5 billion (EUR 0.1 billion in 2004) represents stock intervention.

Another significant amount represents accrued charges for structural funds: at 31 December 2005 EUR 7.9 billion for the FEDER 2000-2006, ISPA, innovative actions (EUR 6.3 billion in 2004), EUR 5.1 billion for FSE (EUR 5.1 billion in 2004). The remaining amounts of EUR 4.5 billion (EUR 5.2 in 2004) covers accrued charges for other politics, the most significant of which is the Research area with +/- EUR 1.5 billion in 2005 and 2004.

More details on the year-end cut-off process are given in note **E 2.3.9**.

V. NET ASSETS

3.19 RESERVES

Reserves *EUR*

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Fair value reserve	**81,362,536.78**	**88,457,197.90**
Other reserves:	**2,727,247,043.21**	**2,479,074,943.38**
Guarantee fund	1,231,211,256.30	1,086,129,313.44
Revaluation reserve	57,124,663.00	57,124,663.00
Borrowing and lending activities	1,438,911,123.91	1,335,820,966.94
Total	**2,808,609,579.99**	**2,567,532,141.28**

3.19.1 Fair value reserve

In accordance with the new accounting rules, the adjustment to fair value of available-for-sale assets is accounted for through the fair value reserve.

3.19.2 Other reserves

Guarantee fund

See also note 3.3.2 concerning the operation of the Guarantee Fund. This reserve reflects the 9% target amount of the outstanding amounts guaranteed by the Fund that is required to be kept as assets. As stated earlier, any surplus of the assets of the Fund above this 9% reserve amount is repaid to the budget.

Revaluation reserve

The revaluation reserve comprises the revaluations of tangible and intangible fixed assets. The balance at the year-end of EUR 57.1 million relates to a revaluation of Commission land and buildings, which had already occurred before the transition to the new accounting rules.

Borrowing and lending activities reserve

These amounts comprise the reserves relating to the Communities' borrowing and lending activities. The main amount relates to the ECSC in liquidation reserves (EUR 1.43 billion, 2004: EUR 1.34 billion.)

3.20 AMOUNTS TO BE CALLED FROM MEMBER STATES

This amount represents the excess expenses already incurred by the Communities up to 31 December 2005 that must be funded by future budgets. It arises through the application of accrual accounting methods, done for the first time in 2005, which are different to the rules of cash accounting used to prepare the budgetary accounts. Accrual accounting recognises expenses in the period to which they relate regardless of when the payment is actually made, whereas cash accounting records a transaction only when a payment is made. Based on these new rules, the Communities must evaluate and recognise in its financial statements the expenditure to be financed by the general budget but which has not yet been declared by the year-end. Thus very many expenses are recognised under accrual accounting rules in the year N although they may be actually paid in year N+1 using the budget of year N+1. Nevertheless, the Communities only call up resources from the Member States when it needs money to pay an amount due, so as to give Member States maximum flexibility in managing their public finances. This inclusion in the accounts of the Communities liabilities coupled with the fact that the corresponding amounts are only recognised in future budgets results in liabilities greatly exceeding assets at the year-end.

The existence of negative net assets simply highlights the difference between cash-based accounting and accrual accounting for an entity which is financed according to its cash-flow needs. It does not take into account the obligation of Member States to provide the necessary resources in the future to pay for the expenditure incurred when it falls due. It should be remembered that the Communities cannot make a payment unless it was foreseen in the budget and all budgeted expenditure is covered by budgeted revenue from the Member States.

The most significant amounts to be highlighted are the EAGGF Guarantee activities. The amount of payments due to the Member States for the period 16 October to 31 December 2004 was EUR 26.3 billion. This is an expense under accrual accounting rules in the year 2004 and so is recognised under accrued charges as such. However, this amount is covered by the 2005 budget and was actually paid out in January and February 2005, being recorded in the budgetary accounts as a payment for 2005 (no entry in the budgetary accounts had been made for these amounts in the 2004 year.)

Also impacting this figure is the amount of the pension obligation of the Communities towards its staff - at 31 December 2004 this amount was estimated to be EUR 26.0 billion. This amount will not all be paid out in one year, rather the pension payments are continuously paid to staff when they become eligible every month. These payments are thus covered by the (future) budget of the year in which they are paid.

The majority of the amounts are in fact paid by the Member States in less than 12 months after the end of the financial year in question as part of the budget of the following year. Thus looking at the opening amounts to be called from Members States at 31 December 2004 of EUR 54.2, the following amounts were received during 2005:

- EUR 30 billion of the amounts received from Member States in the period January 2005 to March 2005 were used to pay the EAGGF Guarantee amounts that were accrued for as liabilities at year-end.
- A further EUR 18.5 billion was received during 2005 and paid out under the EAGGF Guarantee, of which all but EUR 1 billion had also been accrued at 31 December 2004.
- EUR 900 million was paid out by the Communities as pension costs during 2005, and thus funded by the Member States under the 2005 budget. The balance of the pension liability recognised at 31 December 2004 (EUR 25.1 billion) will be funded by Member States as part of the budgets of 2006 and later.

The split of the amounts to be called from Members States in the future is as follows:

EUR millions

	Balance at 31.12.2005	Balance at 31.12.2004 Restated
Amounts to be called in future years from Member States:		
Accumulated from previous years	57,140,886,586.80	58,358,647,440.20
Economic outturn for the year*	7,812,464,365.47	(4,194,018,305.10)
Total amounts to be called from Members States	**64,953,350,952.27**	**54,164,629,135.10**

* The economic outturn for 2004 was based on the accounting rules then in place.

This year due to the change in accounting policies following the move to accrual accounting, all the necessary changes to the opening balance sheet of 2005 were made to the (then) accumulated surplus carried forward from 2004.

It should also be noted that the above has no effect on the budget outturn - budget revenue should always equal budget expenditure since any excess of revenue is returned to the Member States.

4. NOTES TO THE ECONOMIC OUTTURN ACCOUNT

It should be noted that since 2005 is the first year of preparing the annual accounts under the new accrual accounting rules, and thus the first year that an Economic Outturn Account is prepared, it was decided that the comparative figures for 2004 would not be presented. This is because such figures were not required for the 2004 annual accounts since they were prepared under different accounting rules. Comparative figures for the economic outturn account will be given from 2006 onwards.

4.1 OPERATING REVENUES

Operating revenue of the European Communities can be divided into two main categories: own resources and other revenue. The main bulk of expenditure is financed by own resources, other revenue represents only a minor part of total financing.

OPERATING REVENUES

EUR

	Note	2005
OWN RESOURCE REVENUE:	*4.1.1*	**101,143,885,139.05**
GNI resources		70,861,050,698.58
VAT resources		16,018,121,497.86
Traditional own resources:		
Agricultural duties		1,310,659,214.95
Custom duties		12,252,130,814.06
Sugar levies		701,922,913.60
BUDGETARY ADJUSTMENTS	*4.1.2*	**2,606,103,308.82**
CONTRIBUTIONS OF THIRD COUNTRIES (INCLUDING EFTA COUNTRIES)		**214,140,937.98**
FINES		**719,616,062.54**
RECOVERY OF EXPENSES	*4.1.3*	**1,385,693,507.89**
Direct centralised management		59,430,895.71
Indirect centralised management		40,947,197.39
Decentralised management		(4,251,306.90)
Shared management		1,289,744,473.46
Joint management		(177,751.77)
REVENUE FROM ADMINISTRATIVE OPERATIONS	*4.1.4*	**895,083,199.67**
Staff		779,205,112.48
Fixed assets related revenues		42,427,876.97
Other administrative revenues		73,450,210.22
OTHER OPERATING REVENUES	*4.1.5*	**925,576,809.61**
Adjustments/provisions		3,507,474.00
Exchange gains		413,875,369.41
Other		508,193,966.20
TOTAL		**107,890,098,965.56**

4.1.1 Own resource revenue

There are three categories of own resources: traditional own resources, the VAT resource and the GNI resource. Traditional own resources, in turn, comprise agricultural duties, sugar levies and customs duties. A correction mechanism in respect of budgetary imbalances (UK Rebate) is also part of the own resources system. Member States retain, by way of collection costs, 25% of traditional own resources.

VAT own resources derive from the application of a uniform rate, for all countries, to the harmonised VAT base, a base which is capped at 50% of GNI for all Member States. The GNI resource is a variable resource intended to supply the revenue required, in any given year, to cover expenditure exceeding the amount collected from traditional own resources, VAT resources and miscellaneous revenue. The revenue derives from the application of a uniform rate to the aggregate GNI of all the Member States.

It should be noted that corrections made in 2005 relating to the period 1995-2004 for GNI resources were EUR 2,049 million. Similarly, corrections relating to the period 1991-2004 for VAT Resources were EUR 399 million. These corrections have the same impact in the budgetary accounts.

4.1.2 Budgetary adjustments

The budgetary adjustments include the budget surplus from 2004 (EUR 2.7 billion) which is refunded to Member States by deduction of the amounts they have to pay in the following year - thus it is a revenue for 2005. The UK rebate (EUR 130.6 million) is also deducted here.

4.1.3 Recovery of expenses

Future corrections can and are made to amounts paid out by the European Communities. Thes e corrections are entered in the accounts if the amount of eligible expenditure, as defined by ex-post controls or audits, is lower than the amount of cumulated eligible expenditure initially recognised by the Communities.

For normal grant activity, a recovery order has in this case to be addressed to the beneficiary of the grant. If this is done before final payment of the grant, it results in the entering of a receivable from the recipient with counterpart a reduction in the charge of the year. However, if the recovery order is only issued after the final payment, it results in a receivable on the recipient with the counterpart being income in the economic outturn account of the year under the heading "recovery of expenses".

In the framework of the Common Agricultural Policy, amounts accounted for as income of the year under this heading concern negative expenditures, like receipts from frauds and irregularities, milk levies in order to guarantee the equilibrium in the markets, and conformity clearances following audits that adjust the eligible charges. In 2005, an amount of EUR 46.6 million concerning EAGGF was accounted for as a correction under the 2004 clearance of accounts process. Three further conformity decisions were also taken during 2005, with a financial impact of EUR 520.5 million. In 2005 also, EUR 447.0 million concern milk levies and EUR 107.3 million fraud and irregularities.

At 31 December 2005 the amount of EAGGF Guarantee amounts subject to future corrections total EUR 1.15 billion. This amount is treated as a contingent asset in the off-balance sheet.

Other formal corrections were made during 2005 for amounts paid out previously, which are now being recovered (these corrections have the same impact in the budgetary accounts):

- Under the European Social Fund, financial corrections were made in 2005 relating to the period 1994-1999 totalling EUR 5.3 million and for the period 2000-2006 totalling EUR 6.3 million.
- Under the European Regional Development Fund, corrections were made in 2005 relating to the period 1994-1999 totalling EUR 0.5 million and for the period 2000-2006 totalling EUR 100 million (another EUR 400 million is to be issued in 2006-2008).
- Concerning the Cohesion Fund the amount of financial corrections made in 2005 was EUR 119.4 million.

There are other types of corrections which are not recorded for example, because of the possibility given to the Member States to offset the ineligible expenditure by other expenditure.

Accrued income because of ineligibility of expenses is estimated at year end and accounted for under this heading. The negative amounts (under decentralised and joint management) concern reversal of opening balance sheet cut off entries. Ineligible amounts had been considered as accrued income, but the amount had been overestimated by two DGs.

4.1.4 Revenue from administrative operations

Revenue from staff is made up primarily of two amounts - pension contributions and taxes on income.

4.1.5 Other operating revenues

The largest amount (EUR 276.2 million) relates to amounts received from accession countries. Other amounts include the write back of amounts previously written off receivables.

Exchange gains, except on financial activities dealt with in note **4.5** below, are also included under this heading. These arise on the everyday activities and related transactions made in currencies other than the Euro, as well as the year-end revaluation required to prepare the accounts - they are both realised and unrealised.

4.2 ADMINISTRATIVE EXPENSES

These are administrative expenses incurred as part of the activities of the Communities. Costs incurred here include: staff costs, costs relating to fixed assets (such as depreciation).

Land and building costs (EUR 349 million) which include rental charges and operating lease expenses are included under "other administrative expenses", as well as publication costs and internal procurement of goods.

4.3 OPERATING EXPENSES

The European Communities' operating expenditure covers the various headings of the financial perspective and takes different forms, depending on how the money is paid out and managed. In accordance with the Financial Regulation, the Communities implement the general budget using the following methods:

Direct centralised management: this is where the implementation of the budget is done directly by the responsible Communities' Institution or body.

Indirect centralised management: this refers to cases where the Communities entrust the task of managing a portion of the budget to a Communities or Member State body.

Decentralised management: these are the cases where the Communities delegate certain tasks for implementation of the budget to third countries.

Shared management: similarly under this method of management the Communities delegate certain tasks for implementation of the budget to Member States.

Joint management: under this method, the Communities entrust certain implementation tasks to an international organisation.

The majority of the expenditure (EUR 86.9 billion) falls under the heading "Shared Management" involving the delegation of tasks to Member States, covering such areas as EAGGF spending and Structural Actions.

4.4 OTHER OPERATING EXPENSES

Movements on provisions for risks and charges are shown under this heading. In accordance with the Communities' accounting rules, provisions recognised on the balance sheet need to be re-examined at least at each year-end and adjusted where necessary so as to reflect their current underlying situation. Also included are write-downs made on amounts receivable.

Exchange losses, except on financial activities dealt with in note **4.6** below, occur on the everyday activities and related transactions made in currencies other than the Euro, as well as the year-end revaluation required to prepare the accounts - they are both realised and unrealised.

OTHER OPERATING EXPENSES

EUR

	2005
Adjustments/provisions	138,579,083.80
Exchange losses	375,983,460.65
Other	417,090,475.73
TOTAL	**931,653,020.18**

4.5 FINANCIAL OPERATIONS REVENUE

The Communities' financial income consists mainly of interest income derived from loans, either granted from the general budget or from borrowed funds, as well as from debt securities and derivative instruments. Interest is also earned on amounts held in bank accounts and short-term bank deposits.

FINANCIAL OPERATIONS REVENUE

EUR

	2005
DIVIDEND INCOME	**7,319,379.77**
From Venture Capital Funds	7,319,379.77
INTEREST INCOME	**343,282,568.96**
On loans	92,060,982.27
On cash & cash equivalents	78,350,741.02
Other	172,870,845.67
OTHER FINANCIAL INCOME	**38,655,069.39**
Realised gain on sale of financial assets	5,127,264.81
Reversal of impairment losses on financial assets	3,550,976.22
Other	29,976,828.36
PRESENT VALUE ADJUSTMENT	**4,573,808.00**
EXCHANGE GAINS	**5,257,702.60**
TOTAL	**399,088,528.72**

4.6 FINANCIAL OPERATIONS EXPENSES

The main financial expense incurred by the European Communities consists of interest on financial lease contracts, as well as on borrowings taken out to fund lending activities and derivative instruments. In addition to losses on the sale and the write down in the value of financial assets, other financial expenses also include the adjustments made to financial provisions and the management fees paid to the fiduciaries.

FINANCIAL OPERATIONS EXPENSES

EUR

	2005
INTEREST EXPENSES	**215,368,551.00**
On borrowings	72,644,656.26
Other	142,723,894.74
OTHER FINANCIAL EXPENSES	**151,709,601.37**
Realised loss on sale of financial assets	2,246,264.94
Impairment losses on financial assets	1,575,224.77
Other	147,888,111.66
EXCHANGE LOSSES	**1,571,986.82**
TOTAL	**368,650,139.19**

4.7 SHARE OF NET SURPLUS/(DEFICIT) ASSOCIATES & JOINT VENTURES

In accordance with the equity method of accounting, the Communities includes in its economic outturn account its share of the net surplus of its associate, EIF, and its share of the net deficit of its joint venture, Galileo (see also note E 3.3.1).

5. NOTES TO THE CASHFLOW TABLE

It should be noted that since 2005 is the first year of preparing the annual accounts under the new accrual accounting rules, and thus the first year that a cashflow table is prepared, it was decided that the comparative figures for 2004 would not be presented. This is because such figures were not required for the 2004 annual accounts since they were prepared under different accounting rules. Comparative figures for the cashflow table will be given from 2006 onwards.

5.1 PURPOSE AND PREPARATION OF THE CASHFLOW TABLE

Cash flow information is used to provide a basis for assessing the ability of the Communities to generate cash and cash equivalents, and its needs to utilise those cash flows.

The cash flow table is prepared using the indirect method. This means that the net surplus or deficit for the financial year is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operat ing cash receipts or payments, and items of revenue or expense associated with investing cash flows.

Cash flows arising from transactions in a foreign currency are recorded in the European Communities' reporting currency (euro), by applying to the foreign currency amount the exchange rate between the euro and the foreign currency at the date of the cash flow.

The cash flow table shown above reports cash flows during the period classified by operating, investing and financing activities. The cash flows associated with extraordinary items, if any, are classified as arising from operating, investing or financing activities as appropriate, and separately disclosed.

5.2 OPERATING ACTIVITIES

Operating activities are the activities of the Communities that are not investing activities. These are the majority of the activities performed. Loans granted to beneficiaries (and the related borrowings, when applicable) are not considered as investing (or financing) activities as they are part of the general objectives and thus daily operations of the Communities. Operating activities also include investments such as EIF, Galileo, EBRD and venture capital funds. Indeed, the objective of these activities is to participate in the achievement of policy targeted outcomes.

5.3 INVESTING ACTIVITIES

Investing activities are the acquisition and disposal of intangible and tangible fixed assets and of other non-operating investments which are not included in cash equivalents. Investing activities do not include loans granted to beneficiaries. The objective is to show the real investments made by the Communities.

It should be noted that EUR 2.25 billion of cash and cash equivalent balances held by the Communities are not available for use by the Communities. This is the cash received as payment of fines levied, where the other party is appealing the imposition of the fine. These amounts are clearly disclosed as "restricted cash" under note **3.11** above.

6. OFF-BALANCE SHEET & NOTES

CONTINGENT ASSETS

EUR

	Note	31.12.2005	31.12.2004 Restated
Guarantees received	**6.1**	***3,352,097,595.13***	***2,867,545,633.50***
Guarantees received in respect of pre-financing	6.1.1	1,138,136,716.33	1,261,653,669.13
Guarantees received in respect of fines' cases pending	6.1.2	1,465,706,342.00	1,165,874,001.00
Other guarantees received	6.1.3	748,254,536.80	440,017,963.37
Borrowing agreements signed	**6.2**	***0.00***	***0.00***
Contingent assets relating to cases of fraud & irregularities concerning structural actions	**6.3**	***1,244,918,719.00***	***1,102,621,000.00***
Other contingent assets	**6.4**	***1,234,642,838.97***	***905,824.00***
Total Contingent Assets		**5,831,659,153.10**	**3,971,072,457.50**

CONTINGENT LIABILITIES & COMMITMENTS FOR FUTURE FUNDING

EUR

Contingent Liabilities	Note	31.12.2005	31.12.2004 Restated
Guarantees given	**6.5**	***15,788,387,107.69***	***14,557,201,106.61***
Guarantees given for EIB loans	6.5.1	15,055,116,636.77	13,899,797,966.00
Guarantees signed by the EIF	6.5.2	732,272,742.00	656,517,527.00
Other guarantees given		997,728.92	885,613.61
EAGGF Guarantee	**6.6**	***465,360,931.04***	***562,604,294.00***
Contingent liabilities connected with the clearance of the EAGGF Guarantee accounts pending judgement by the Court of Justice	6.6.1	465,360,931.04	554,096,294.00
Contingent liabilities relating to the judgements by the Court of Justice pending enforcement	6.6.2	0.00	8,508,000.00
Fines - Appeals to the Court of Justice	**6.7**	***4,427,429,022.00***	***3,837,913,801.00***
Amounts relating to legal cases and other disputes	**6.8**	***2,490,921,822.28***	***2,430,473,105.00***
Other contingent liabilities	**6.9**	***709,055,454.83***	***558,822,340.00***
Total Contingent Liabilities		**23,881,154,337.84**	**21,947,014,646.61**

Commitments for future funding	Note	31.12.2005	31.12.2004 Restated
Undrawn commitments	**6.10**	***331,766,142.56***	***485,693,578.78***
Commitments against appropriations not yet consumed	**6.11**	***88,824,110,196.66***	***83,945,009,118.97***
Legal Commitments for which budget commitments have not yet been made	**6.12**	***48,183,934,608.94***	***89,485,289,562.47***
Structural operations (aid planned but not committed for the period 2000-2006)	6.12.1	39,014,608,434.94	75,999,232,173.47
Cohesion fund	6.12.2	6,000,664,296.00	8,193,874,771.00
ISPA	6.12.3	514,617,181.00	630,464,832.00
TRDI	6.12.4	2,096,000,000.00	4,027,000,000.00
Protocols with Mediterranean Countries	6.12.5	259,258,239.00	253,739,892.00
External relations	6.12.6		
KEDO		57,236,958.00	58,025,519.00
UNWRA		0.00	63,669,375.00
Fisheries agreements	6.12.7	241,549,500.00	259,283,000.00
Contributions to related organisations	**6.13**	***946,500,000.00***	***1,022,500,000.00***
Uncalled Share capital EBRD	6.13.1	442,500,000.00	442,500,000.00
Uncalled Share capital EIF	6.13.2	480,000,000.00	480,000,000.00
Uncalled Share capital Galileo programme (adjusted)	6.13.3	24,000,000.00	100,000,000.00
Operating lease commitments	**6.14**	***1,415,393,523.34***	***1,182,189,017.45***
Total Commitments for future funding		**139,701,704,471.50**	**176,120,681,277.67**

All contingent liabilities and commitments would be financed, should they fall due, by the Communities' budget in the years to come. The Communities' budget is financed by the Member States.

CONTINGENT ASSETS

6.1 GUARANTEES RECEIVED

6.1.1 Guarantees received in respect of pre-financing

These are guarantees that the European Communities request from beneficiaries when paying out advance payments (pre-financing). In some cases as required by the Financial Regulation, guarantees can be required in order for beneficiaries to receive pre-financing. The object of the guarantee is therefore to secure the pre-financing. The generating event is linked to the existence of the pre-financing. Here the guarantee's generating event is the pre-financing payment. At 31 December 2005 the full (or facial) amount of those guarantees amounts EUR 1.14 billion.

In some cases, the associated pre-financing has been partially cleared via an interim payment. The estimated value of the related open pre-financing amounts at 31 December 2005 is about EUR 0.73 billion.

6.1.2 Guarantees received in respect of fines' cases pending

These are guarantees received from the recipient of a Communities' fine who wishes to appeal this fine. A bank guarantee can be given for the amount (and interest) in question instead of making a provisional payment.

6.1.3 Other guarantees received

The types of guarantees included under this heading are:

Other guarantees received *EUR*

	31.12.2005	31.12.2004 Restated
Euratom loans: guarantees by third countries	385,000,000.00	170,000,000.00
Performance guarantees	253,793,322.70	166,209,567.12
Guarantees received as part of tenders	4,690,212.61	1,597,083.84
Guarantees for payment delays	3,759,388.45	6,348,343.37
Other	101,011,613.04	95,862,969.04
Total	**748,254,536.80**	**440,017,963.37**

The Commission has received guarantees from third-party guarantors in respect of loans granted through Euratom. The Commission has not received third-party guarantees for loans granted under the financial assistance (MFA) scheme. However, these loans are guaranteed by the Guarantee Fund.

Performance guarantees are sometimes requested to ensure that beneficiaries of Communities funding meet the obligations of their contracts with the Communities. Included here is a bank guarantee of EUR 127.8 million (2004: EUR 60.8 million) received by the Council relating to the advance payments given for the construction of the LEX building.

Other guarantees include EUR 93.4 million at 31 December 2005 (2004: EUR 84.3 million) concerning guarantees received by the ECSC in liquidation for loans granted (as specified in the related contracts.)

6.2 BORROWING AGREEMENTS SIGNED

These are borrowing agreements entered into by the Communities but not yet drawn down before the year-end - there were none at 31 December 2005 or 2004.

6.3 FRAUD AND IRREGULARITIES - STRUCTURAL ACTIONS

The table below is based on the formal reports submitted by the Member States in accordance with Commission Regulation No 1681/94, with amounts broken down by Member State. The tables show the difference between amounts identified by the Member States as still to be recovered (calculated on the basis of established entitlements or estimates) and amounts already recovered or declared irrecoverable.

Contingent assets: fraud & irregularities cases *EUR'000*

Member State	31.12.2005	31.12.2004
Belgium	14,045	14,574
Denmark	9,920	9,032
Germany	568,213	500,481
Greece	96,237	67,425
Spain	51,665	45,389
France	13,801	17,722
Ireland	2,396	2,824
Italy	344,455	294,349
Luxembourg	12	119
Netherlands	7,876	7,272
Austria	9,226	5,723
Poland	324	23
Portugal	47,509	58,233
Finland	2,171	2,076
Sweden	1,035	944
United Kingdom	75,959	76,435
Czech Republic	34	0
Estonia	33	0
Hungary	8	0
TOTAL	**1,244,919**	**1,102,621**

The figures given in this table represent a theoretical maximum rather than the amounts that will actually be made available to the Communities' budget, for the following reasons:

- The Member States do not always report the results of their recovery operations (and certainly not promptly).

- Although Member States must inform the Commission of the likelihood of recovery, it is impossible to determine exactly what proportion of the amounts still to be recovered will actually be recovered. National laws sometimes provide for a 30-year limitation period, which may well make the national authorities delay formally writing off the debt even if the chances of recovery are only theoretical. For structural operations, Member States must now send the Commission once a year a statement of the amounts awaiting recovery (Article 8 of Regulation No 438/2001) to give a better picture of the actual situation.

- Even if the Member State concerned launches recovery proceedings in time, a positive outcome is not guaranteed. This is particularly true where recovery orders are contested in the courts.

- Individual projects are co-financed as part of multi-annual programmes. As long as a multi-annual programme has not been closed, it is impossible to put an exact figure on the amounts to be recovered because the sums involved in irregularities may, in certain circumstances, be reallocated to other, legitimate projects and because payment by instalments, in particular final payments, can sometimes be used as a means of adjusting expenditure. The figures in these tables are provisional figures based on the reports received and processed up to the end of March 2006. These figures may therefore be changed in line with further reports arriving late.

The prospects of recovery in individual cases cannot be assessed with sufficient accuracy from the information forwarded by the Member States.

On the date when the consolidated annual accounts were drawn up, the annual report on the fight against fraud for 2005 had not yet been adopted.

6.4 OTHER CONTINGENT ASSETS

Quantified amounts:
The most significant item included here concerns estimated amounts of EUR 1.15 billion to be received under the agricultural conformity clearance decisions framework for the period 2001-2005. As the amounts are not yet definitive, they are not recognised on the balance sheet.

Also included under this heading is a probable receivable of EUR 52.9 million related to a penalty payment following a judgement of the European Court of Justice during 2005 relating to the non-respect of certain Communities fisheries regulations by France. A first fine of EUR 20 million had been paid in September 2005. A second part of the Judgement was that an additional penalty needed to be paid covering the period 15/07/2005 - 15/01/2007 if no improvements to the control system were effectively implemented. This part is currently being evaluated, thus the receivable is not yet certain, so not recognised on the balance sheet.

Additionally an amount of EUR 26.6 million is included here, which relates to a potential receivable from a Member State following audits made.

Non-quantified amounts:
In the Annual Activity Report (AAR) each authorising officer reports on policy results and on the reasonable assurance he/she may have that the resources assigned to the activities described in his/her report have been used for their intended purpose and in accordance with the principles of sound financial management, and that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions.

For 2005, and taking an overall view, the Commission considers in the synthesis report that internal control system put in place, with the limitations described in the 2005 AAR, provides reasonable assurance on the legality and regularity of operations, for which the Commission is responsible under article 274 EC. Some Directors-General made reservations and quantified when possible the global impact of these reservations.

DG Education and Culture raised a reserve concerning accounting: i.e. an insufficient assurance regarding the reliability of recorded amounts due to the impossibility of checking all the transactions figuring in the accounting system before the deadline for finalising the accounts.

Detailed explanations are included in the Annual Activity Report of each DG and in the 2005 annual synthesis report.

CONTINGENT LIABILITIES

6.5 GUARANTEES GIVEN

6.5.1 On loans granted by the European Investment Bank (EIB) to third countries from its own resources

As formulated, the guarantee legally covers the loans signed by the EIB at 31 December 2005 (including loans granted to Member States before accession). However, the Communities' guarantee is limited to a percentage of the ceiling of the credit lines authorised: 65%, 70%, 75% or 100%. Where the ceiling is not reached, the Communities' guarantee covers the full amount.

At 31 December 2005 the amount outstanding totalled EUR 15,055 million (2004: EUR 13,900 million) and this, therefore, is the maximum risk faced by the Communities.

For loans covered by the Communities' budget guarantee, the EIB also obtains guarantees from third parties (States, public or private financial institutions); in these cases the Commission is a secondary guarantor. The Communities' budget guarantee covers only the political risk of guarantees provided under the title of "risk-sharing". The other risks are covered by the EIB should the primary guarantor not honour the undertakings given.

For guarantees provided under the title of "non-risk sharing", all the risks are covered by the Communities' budget should the primary guarantor not honour its undertakings given. If the primary guarantor is a public authority these risks are confined as a rule to the political risk, but when the guarantees are provided by an institution or a private company, the Communities' budget might also have to cover the commercial risk.

The loans granted by the EIB from its own resources to third countries and covered by the Communities' budget guarantee are as follows:

EIB loans guaranteed by the Communities *EUR millions*

	"Risk Sharing" 31.12.2005	"Non-risk Sharing" 31.12.2005		Outstanding 31.12.2005 Total	Outstanding 31.12.2004
		Public authority	Private company		
65% guarantee	1,624	4,427	1,047	7,098	4,980
70% guarantee	502	3,262	416	4,180	4,384
75% guarantee	-	1,738	211	1,949	2,442
100% guarantee	-	1,366	462	1,828	2,094
Total	**2,126**	**10,793**	**2,136**	**15,055**	**13,900**

6.5.2 Guarantees signed by the European Investment Fund (EIF)

At 31 December 2005 the EIF had signed guarantees and commitments in venture capital operations totalling EUR 3,160.1 million, however of this amount EUR 719.2 million relates to the portfolio of guarantee operations for projects related to the development of Trans-European Networks (TEN) that has been transferred to the EIB (the relevant Agreement was signed with the EIB on December 7, 2000.) The EIB bears the risk of the transactions (with the EIF remaining the guaranteeing party under the relevant Guarantee Agreements) and in return is entitled to receive the related fees (utilisation fee + commitment fee) from the intermediaries. Excluding these amounts since the EIF bears no risk, the total guarantees given and commitments in venture capital operations by the EIF at 31 December 2005 is thus EUR 2,440.9 million; this represents a maximum potential risk of EUR 732.3 million for the European Communities, as the Communities contribute 30% of the capital of the EIF. The total capital subscribed by the Communities is EUR 600 million, of which 20% has been called up.

The proportion of the capital subscribed by the European Communities which has not been called up (80%) is also included in the off-balance-sheet commitments as a contingent liability (note **6.13.2**).

6.6 EAGGF GUARANTEE

6.6.1 Clearance of accounts

These are contingent liabilities towards the Member States connected with the EAGGF clearance of accounts procedures. The determination of the final amount of the liability and the year in which it will be charged to the budget will depend on the length of the procedure before the Court of Justice. An estimate of the probable amounts to be paid (EUR 60 million) has also been included as a long-term provision on the balance sheet (see note E **3.13**).

6.6.2 Contingent liabilities in respect of judgements pending execution

At the end of 2004, this amount represented contingent liabilities for which the Commission decision had not been taken by the date on which the accounts were closed and for which the compensation arrangements needed to be agreed on between the parties concerned. At end 2005, the relevant amounts (now amounting to EUR 17.1 million) have been included as accrued charges in the balance sheet since the amounts are now deemed certain.

6.7 FINES

For fines imposed by the Commission for infringement of competition rules where the amount has been provisionally paid (and thus included in the Commission balance sheet), it has been decided that both fines for which an appeal has been lodged[4] and those where it is unknown if an appeal will be made should be included as a contingent liability in the off-balance-sheet commitments pending a decision by the Court of Justice. This contingent liability will be maintained until a decision is final.

Once notified, debtors who do not accept the Commission decision fining them are entitled to lodge an appeal with the Court of Justice. However, the principal of the fine has to be paid within the prescribed time limit, since under Article 242 of the EC Treaty appeals do not have suspensory effect. Thus, debtors have two options: they can either provide a bank guarantee (shown under contingent assets) or make a provisional payment (shown under cash and cash equivalents in the balance sheet.)

Only once the final judgment is delivered, does the Accounting Officer either refund fully or partly the amount of the provisional payment plus the interest or irrevocably collect the full (or part) amount of the fine, as fixed by the final judicial decision.

Interest earned on provisional payments (EUR 154.4 million) is included in the economic result for the year and also as a contingent liability to reflect the uncertainty of the amounts.

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4 Even if the appeal against fines imposed in 2005 was made in 2006 before the closure of accounts.

6.8 AMOUNTS RELATED TO LEGAL CASES AND OTHER DISPUTES

This heading relates to actions for damages currently being brought against the Communities, other legal disputes and the estimated legal costs. The most significant amounts are summarised below:

- Action brought against it in June 2003 in relation to a ruling made by the Commission. The claim is for EUR 735 million. The Commission submitted its rejoinder in February 2005. Unlikely to be decided before 2007.
- Action for damages brought in October 2003, also in relation to a ruling made by the Commission. The claim is for an amount of EUR 1,664 million. The Commission submitted its rejoinder in November 2004. Unlikely to be decided before 2007.
- In May 2004 the owner of a building in Brussels initiated a legal process in the Court of First Instance against the Commission in order to be compensated for a non-signature of a lease contract. The Commission currently estimates the possible obligation to be EUR 20 million, which is thus treated as contingent liability.
- EUR 22 million concerns cases for damages brought against the Commission in the area of health.
- Other amounts are related to disputes involving suppliers, contractors and former staff.

It should be noted that in an action for damages under Article 288 EC the applicant must demonstrate a sufficiently serious breach by the institution of a rule of law intended to confer rights on individuals, real harm suffered by the applicant, and a direct causal link between the unlawful act and the harm.

6.9 OTHER CONTINGENT LIABILITIES

Included under this heading at the end of 2004, was the maximum possible liability, estimated at EUR 23.4 million (being net of the amounts already entered as either provisions or debts) concerning certain disease eradication costs that may have to have been borne by the Communities' budget. At end 2005 there was no outstanding contingent liability for this matter.

Also included here is the outstanding contractual obligation of EUR 130.2 million relating to the construction of the Council's LEX-building, as well as EUR 239 million relating to building contracts of the Parliament. The other significant amount included is EUR 330 million that concerns the extension of a Court of Justice building in Luxembourg.

COMMITMENTS FOR FUTURE FUNDING

6.10 UNDRAWN COMMITMENTS

These are lending and equity investment agreements entered into by the Commission and ECSC in liquidation (not covered by the RAL) but not yet drawn down by the other party before the year-end.

6.11 COMMITMENTS AGAINST APPROPRIATIONS NOT YET CONSUMED

This amount represents the amount of the open commitments for which payments have not yet been made. At 31 December 2005 the RAL totalled EUR 119.1 billion. The amount disclosed as a future commitment to be funded is this budgetary RAL less related amounts that have been included as expenses in the Economic Outturn Account giving a total of EUR 88.8 billion.

The RAL is the normal consequence of the existence of multi-annual programmes. In order to have a more precise view of the composition of this amount, it was decided to identify separately the oldest commitments or those for which no movements were noted. Thus the concept "Potentially Abnormal

RAL" (PAR) was defined. It is composed of the com mitments which answer the one of the two following conditions:

- A commitment of more than five years old
- Commitments for which no accounting transaction (payment or de-commitment) was noted during the last two years.

As a result of the joint statements of November 2002 and 2003, the Commission, the European Parliament and the Council stressed the need to eliminate gradually this potentially abnormal RAL. Thus at the beginning of each financial year the commitments meeting this definition are identified and are the subject of an individual examination. The remaining commitments are classified in 8 separate categories according to the identified hypothetical case. This regular analysis leads to a continuous reduction of this part of the RAL and avoids keeping in the accounts amounts that no longer correspond to any legal commitment.

Thus during the financial year 2005, the potentially abnormal RAL was reduced by 48%. The following table gives the situation by heading of the financial perspective:

Potentially Abnormal RAL (PAR) *EUR*

	PAR at 31/12/2004	Payments during 2005	Other movements during 2005	PAR at 31/12/2005
Agriculture	2,074,137	-	(2,060,350)	13,787
Structural actions	6,296,247,277	(2,416,431,008)	(1,073,475,677)	2,806,340,592
Internal policies	1,196,515,414	(358,981,904)	(198,920,639)	638,612,871
External policies	2,074,138,692	(554,000,167)	(281,897,691)	1,238,240,834
Administration	8,265,615	-	(3,917,209)	4,348,406
Pre-adhesion	1,198,127,481	(256,623,707)	(34,755,523)	906,748,251
Other	99,743	-	(99,743)	-
Total	**10,775,468,359**	**(3,586,036,786)**	**(1,595,126,832)**	**5,594,304,741**

6.12 LEGAL COMMITMENTS FOR WHICH BUDGET COMMITMENTS HAVE NOT YET BEEN MADE

These commitments originated because the Commission decided to enter into legal commitments in respect of amounts that were not covered by commitment appropriations in the budget.

Under the Inter-institutional Agreement and, more generally, the rules relating to the budget, the following expenditure must be recorded as off-balance-sheet commitments in view of the volume of financial commitments which arises:

- **6.12.1 & 6.12.2**: The Structural Funds and the Cohesion Fund represent expenditure targets and the whole allocation shown in the financial perspective is meant to be matched by decisions. As a result, contingent commitments are evaluated at a maximum.

Legal Commitments without budgetary commitments - Structural Operations

EUR billions

	31.12.2005	31.12.2004
Objective 1	28.46	55.83
Objective 2	3.44	6.97
Objective 3	4.29	8.15
FIFG (outside objective 1)	0.25	0.37
Communities initiatives	2.58	4.67
Total	39.02	75.99

- **6.12.3:** ISPA: In itself, the ISPA Regulation does not lead to off-balance-sheet commitments as it does not provide for an annual allocation or even a total allocation. This is determined each year by the budgetary authority in line with the financial perspective. The ceilings in heading 7 (pre-accession) are not expenditure targets and the Inter-institutional Agreement allows a degree of flexibility between the various pre-accession instruments. On the other hand, ISPA generates contingent liabilities in connection with the individual projects as they involve a number of annual tranches of which only the first is covered by a budget commitment when the decision is adopted.

- **6.12.4:** The Temporary Rural Development Instrument (TRDI) for the new Member States is funded under the EAGGF-Guarantee and covers the period 2004 to 2006. It is financed under differentiated appropriations and annual commitments are automatically made each year on the basis of the Commission decision approving the programme. No additional annual decision is required. The Commission decision represents an expenditure target and the whole allocation is meant to be matched by decisions.

- **6.12.5:** The commitments made under financial protocols with Mediterranean non-member countries: the amount included here is the difference between the total amount of the protocols signed and the amount of the budget commitments entered in the accounts. These Protocols are international treaties that cannot be wound up without the agreement of both parties, although the process (of winding them up) is on-going.

- **6.12.6 & 6.12.7:** Commitments entered into with specified third parties for other operations under external and fisheries actions, relating to specific amounts over a fixed period.

The other multi-annual programmes do not contain any commitments to be included under contingent liabilities: expenditure in future years is conditional on the annual decisions by the budgetary authority or changes in the rules concerned.

6.13 CONTRIBUTIONS TO RELATED ORGANISATIONS

This sum represents payments outstanding on non-called-up capital subscribed by the Commission.

6.13.1 Uncalled share capital: EBRD

EUR millions

EBRD	Total EBRD capital	Commission subscription
Capital	19,790	600
Paid-in	-5,197	-157.5
Uncalled	14,593	**442.5**

6.13.2 Uncalled share capital: EIF

EUR millions

EIF	Total EIF capital	Commission subscription
Capital	2,000	600
Paid-in	-400	-120
Uncalled	1,600	**480**

6.13.3 Uncalled share capital: Galileo joint venture

EUR millions

Galileo	Total Galileo capital	Commission subscription
Capital	580	520
Paid-in	-488	-438
Uncalled	92	82
Incl. in RAL	N/A	-58
Contingent Liability	N/A	24

Pursuant to Council Regulation (EC) No 876/2002 of 21 May 2002 the Commission's contribution to the Galileo joint venture is EUR 520 million. This commitment is for a period of four years ending in 2006. Commitments of EUR 58 million not yet paid are included in the RAL (above) and so deducted from the above uncalled amounts.

6.14 OPERATING LEASE COMMITMENTS

This heading covers buildings and other equipment rented under operating leasing contracts that do not meet the conditions for entry on the assets side of the balance sheet. The amounts indicated correspond to commitments still to be paid during the term of the contracts, except for the Court of Justice's Palais building, which is occupied under an indefinite lease; here, the amount of EUR 2.3 million corresponds to the annual rent.

OPERATING LEASE COMMITMENTS

EUR millions

Description	Charged during year	Future amounts to be paid			
		< 1 year	1- 5 years	> 5 years	Total
Buildings	172.6	176.7	546.6	675.3	1,398.6
IT materials and other equipment	11.4	9.0	7.8	0.0	16.8
Total	**184.0**	**185.7**	**554.4**	**675.3**	**1,415.4**

7. FINANCIAL RISK MANAGEMENT

MACRO FINANCIAL ASSISTANCE (MFA) AND EURATOM

The following disclosures relate to lending and borrowing activities carried out by the European Communities through **Macro Financial Assistance (MFA)** and **Euratom.**

7.1 RISK MANAGEMENT POLICIES AND HEDGING ACTIVITIES

The lending and borrowing transactions, as well as related treasury management, are carried out by the Communities according to the respective Euratom Council Decisions[5], if applicable, and internal guidelines.

Written procedure manuals covering specific areas such as borrowings, loans and treasury management have been developed and are used by the relevant operating units. Financial and operational risks are identified and evaluated and compliance to internal guidelines and procedures is checked regularly.

As a general rule, there are no hedging activities carried-out as lending operations are financed by "back-to-back" operations and as there are no open currency positions existing. However, derivative financial instruments can be used to hedge certain risk exposures when no perfect matching between lending and borrowing activities can be reached. A detailed description of such financial instruments can be found under section E **3.3.3.2.**

7.2 CURRENCY RISK

Since all financial assets and liabilities are denominated in euros, the Communities do not take on exposure to effects of fluctuations in foreign currency exchange rates on its financial position and cash flows.

7.3 INTEREST RATE RISK

Due to the nature of its lending and borrowing activities, the Communities have significant interest-bearing assets and liabilities.

Borrowings issued at variable rates expose the Communities to cash flow interest rate risk. They represent approximately 94% of the total volume of borrowings. However, the interest rate risks that arise from borrowings are offset by equivalent loans in terms and conditions ("back-to-back" operations). At the balance sheet date, the Communities have loans (expressed in nominal amounts) with variable rates of EUR 1.38 billion (2004: EUR 1.31 billion), with a re-pricing taking place every 6 months. The Communities also have loans (expressed in nominal amounts) with fixed rates for EUR 85 million in 2005 (2004: EUR 70 million), they have a final maturity date of more than five years.

The MFA swap agreement, as detailed in section **E 3.8.2**, was entered into to match the cash flow of a loan with a floating interest rate and a final maturity on 22 December 2008, on one side and, the cash

[5] 90/212/Euratom: Council Decision of 23 April 1990 amending Decision 77/271/Euratom on the implementation of Decision 77/270/Euratom empowering the Commission to issue Euratom loans for the purpose of contributing to the financing of nuclear power stations, *Official Journal L 112 , 03/05/1990 P. 26;*
77/271/Euratom: Council Decision of 29 March 1977 on the implementation of Decision 77/270/Euratom empowering the Commission to issue Euratom loans for the purpose of contributing to the financing of nuclear power stations, *Official Journal L 088 , 06/04/1977 P. 11;*
94/179/Euratom: Council Decision of 21 March 1994 amending Decision 77/270/Euratom, to authorize the Commission to contract Euratom borrowings in order to contribute to the financing required for improving the degree of safety and efficiency of nuclear power stations in certain non- member countries, *Official Journal L 084 , 29/03/1994 P. 41 - 43*

flow of the corresponding borrowing with a fixed interest rate and a final maturity on 22 December 2005, on the other side. The swap agreement was structured in two "tranches": the "swap tranche", where both floating and fixed rate legs were active, ended on 22 December 2005, the second "tranche" with only the floating rate leg being a forward floating borrowing starting on the same date.

7.4 CREDIT RISK

The Communities take on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Exposure to credit risk is managed, firstly by obtaining country guarantees in the case of Euratom, then through the Guarantee Fund. The Guarantee Fund for external actions[6] was set up in 1994 to cover default risks related to borrowings which finance loans to countries outside the European Union. In order to avoid any delays in payments due by the Entity, such borrowings are serviced by means of cash advances from the EC budget. If, three months after a payment is due, it is confirmed that a recipient country has defaulted, the cash advances are repaid to the budget by the Guarantee Fund for external actions.

The largest concentrations of credit risk that the Communities have are towards Bulgaria, Serbia-Montenegro and Romania. These countries represent approximately 33%, 15% and 13% respectively of the total volume of loans.

As far as treasury operations are concerned, guidelines on the choice of counterparties must be applied. Accordingly, the operating unit will be able to enter into deals only with eligible banks being part of a "trading list of authorized banks" and having sufficient counterparty limits.

7.5 FAIR VALUE

The estimated fair value of loans and borrowings is determined using a discounted cash flow model. According to this model, expected future cash flows are discounted by applying AAA yield curves appropriate for the remaining term to maturity.

The estimated fair value of floating rates loans are assumed to approximate their carrying amount since re-pricing at market interest rates takes place every 6 months.

At the balance sheet date, the estimated fair value of fixed interest bearing loans (including fixed rate leg of interest rate swap) and borrowings amount to EUR 99.4 million (2004: EUR 206.3 million) and EUR 99.1 million (2004: EUR 208.1 million), respectively, compared to corresponding book value of EUR 87.3 million (2004: EUR 197 million) and EUR 87.3 million (2004: EUR 197 million), respectively.

The negative difference between the estimated fair value of fixed interest bearing loans and borrowings as at 31 December 2004 is to be considered together with the positive fair value of the "swap tranche" (see note **E.3.8.2**).

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[6] Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions, *Official Journal L 293, 12/11/1994 P. 1 - 4*

GUARANTEE FUND

The following disclosures relate to the asset management of the **Guarantee Fund** carried out by the European investment Bank on behalf of the European Communities.

7.6 RISK MANAGEMENT POLICIES

The rules and principles for the asset management of the Guarantee Fund are laid out in the Convention between the European Commission and the European Investment Bank (EIB) dated 25 November 1994 and the subsequent amendments dated 17/23 September 1996 and 8 May 2002.

The main principles, as extracted directly from the Convention, are as follows:

- The Guarantee Fund will operate in one single currency: EURO. It will exclusively invest in this currency in order to avoid any exchange rate risk.
- Management of the assets will be based upon the traditional rules of prudence adhered to for financial activities. It will have to pay particular attention to reducing the risks and to ensuring that the managed assets have a sufficient degree of liquidity and transferability, taking into account the commitments to which the Guarantee Fund will be confronted.
- The Guarantee Fund will be able to use all the hedging instruments against the market and interest risks, already used by the Portfolio Division of the EIB.
- The portfolio management will be based on the optimal duration and on the best possible allocation between short term and long term, in order to draw a real advantage from the rates curve. In order to be able to quickly modify the duration of the portfolio according to the forecast of the future conditions of the market, the promoter will use, with the exclusive aim of hedging, the instruments available on the market for which the EIB already has the necessary experience.

7.7 INTEREST RATE POSITION

Theoretically, hedging instruments could be used to manage the interest rate (market) risk. However as agreed between the Commission and the EIB, no significant risk is currently taken and therefore hedging is not performed. As the transactions and operations are only denominated in Euro, no other hedging is required. The distribution of the Guarantee Fund's holdings at 31 December 2005 (market value excluding accrued interest) is detailed in the table below:

Segments	Fixed rate investments			Variable rate securities EUR	TOTAL EUR
	Less than 3 months EUR	3 months to 1 year EUR	1 to 10 years EUR		
Current accounts	1,582,090	0	0	0	1,582,090
Short term deposits - nominal	313,500,000	0	0	0	313,500,000
Available-for-sale assets	25,564,200	83,102,060	791,230,957	84,470,004	984,367,221
TOTAL	**340,646,290**	**83,102,060**	**791,230,957**	**84,470,004**	**1,299,449,311**
Percentage	*26.2%*	*6.4%*	*60.9%*	*6.5%*	*100.00%*

For the cash and cash equivalents (fixed term deposits), the effective interest rate range is between 2.13% and 2.41%. For the Available-for-Sale (AFS) securities portfolio, the effective interest rate range is between 2.61% and 5.92%.

For the short-term deposits, the interest rate (IR) exposure for 1 basis point (bp) is EUR 2,569 and for the bond portfolio, the IR exposure for 1bp is EUR 317,900. For the short-term deposits, the interest rate (IR) exposure range for +1% /-1% is EUR 256,656 to EUR (257,213) and the bond portfolio, the IR exposure range for +1% /-1% is EUR 30,868,578 to EUR (32,760,122).

7.8 LIQUIDITY POSITION

The table below provides an analysis of assets and liabilities into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date.
Those assets and liabilities that do not have a contractual maturity date are grouped together in the "Maturity undefined" category.

EUR

Maturity	Less than 3 months	3 months to 1 year	1 to 10 years	Maturity undefined	TOTAL
Assets in EUR :					
Current accounts	1,582,090	0	0	0	1,582,090
Short term deposits	314,441,933	0	0	0	314,441,933
Of which accrued interests	*941,933*	*0*	*0*	*0*	*941,933*
Available-for-sale assets	32,011,865	100,927,108	791,230,957	84,470,004	1,008,639,934
Of which accrued interests	*6,447,665*	*17,825,048*	*0*	*0*	*24,272,713*
TOTAL	**348,035,888**	**100,927,108**	**791,230,957**	**84,470,004**	**1,324,663,957**
Liabilities in EUR:					
Account payables	725,117	0	0	0	725,117
TOTAL	**725,117**	**0**	**0**	**0**	**725,117**
Net liquidity position at 31.12.2005	**347,310,771**	**100,927,108**	**791,230,957**	**84,470,004**	**1,323,938,840**

7.9 CREDIT RISK

Fixed Term Deposits - Profile of counterparties
In accordance with the agreement between the Community and the EIB on the management of the Guarantee Fund, all the inter-bank investments should have a minimum credit rating of A1. The Commission was informed in April 2005 that one counterparty has a long term rating of A2. Short-term inter-bank investments, including accrued interest, by type of counterparty at 31 December 2005 are as follows:

EUR

Rating	31.12.2005		31.12.2004 (restated)	
A1	74,203,179	23%	0	0%
A2	30,104,816	10%	0	0%
Aa1	28,093,133	9%	178,760,865	33%
Aa2	37,110,996	12%	162,189,715	29%
Aa3	144,929,809	46%	210,287,489	38%
Total	**314,441,933**	**100%**	**551,238,069**	**100%**

Available-for-sale assets - Profile of issuers

All the securities held meet the following criteria:

- Either they are issued by states in, or by institutions guaranteed by, the European Union, the G10 or supranational bodies;
- Or they are issued by another sovereign state with a rating of at least AA3;
- Or they are issued by another issuer with a rating of AAA.

The profile of issuers, market value excluding accrued interest, at 31 December 2005 is as follows:

EUR

Issuer	31.12.2005		31.12.2004 (restated)	
Other issuers AAA	322,068,453	32%	364,552,225	35%
Supra	16,279,008	2%	31,419,327	3%
Govt./Agencies AAA	248,536,575	25%	268,604,096	25%
Govt./Agencies AA2	100,525,980	10%	129,078,334	12%
Govt./Agencies AA1	133,813,520	14%	136,098,435	13%
Govt./Agencies A1	137,672,642	14%	104,032,885	10%
Govt./Agencies A2	15,014,543	2%	10,008,500	1%
Govt./Agencies NR	10,456,500	1%	10,890,000	1%
Total	**984,367,221**	**100%**	**1,054,683,802**	**100%**

EUROPEAN COAL & STEEL COMMUNITIES (in liquidation)

The following disclosures relate to lending and borrowing, as well as treasury activities carried out by the European Communities through the **European Coal & Steel Communities (in Liquidation).**

7.10 RISK MANAGEMENT POLICIES AND HEDGING ACTIVITIES

Following the expiry of the ECSC Treaty on 23 July 2002, the Member States decided[7] that the assets and liabilities of the ECSC be passed to the European Communities, and that the liquidation of the liabilities of the Community be managed by the Commission. Thus, no new loans and no corresponding funding are allowed for the ECSC in liquidation. New ECSC borrowings are restricted to refinancing with the aim to reduce the cost of funds.

The asset and liability management is carried out by the Commission in accordance with internal guidelines. Written procedures manuals covering specific areas such as borrowings, loans and treasury management have been developed and are used by the relevant operating units. Financial and operational risks are identified and evaluated and compliance to internal guidelines and procedures is checked regularly.

As far as treasury operations are concerned, the principles of prudent management with a view to minimize operational risk, counterparty risk and market risk are to be applied.

Investments are restricted in principle to the following categories: term deposits with banks, money market instruments, fixed and floating rate bonds.

The main investment limits per category are as follows:

[7] Regulation (EC) 1840/2002 of the European Parliament and the Council

- For term deposits, a bank is authorised to receive funds if the respective short-term rating is at least A-1 (S&P) or equivalent. The maximum limit per counterparty is the lower of either EUR 100 million per bank or 5% of the bank's own funds.
- Bonds issued or guaranteed by Member States or institutions of the Union up to EUR 250 million per Member State or institution depending on its rating.
- Bonds of other sovereign or supranational issuers with a long-term credit rating of not less than AA (S&P) or equivalent, EUR 100 million per issuer or guarantor.
- Bonds of other issuers having a minimum rating of AA (S&P) or equivalent, up to EUR 50 million, depending on the rating and issuer status.

The ECSC in liquidation uses derivative financial instruments to hedge certain risk exposures. A detailed description of such financial instruments can be found under note **E 3.3.3.2**.

7.11 MARKET RISK

7.11.1. Foreign exchange risk

The ECSC in liquidation is exposed to foreign exchange risk arising from currency exposures with respect to the US dollar and the UK pound.

The table below summarises the ECSC in liquidation's exposure to foreign currency exchange rate risk at 31 December 2005. Included in the table are the ECSC in liquidation's assets and liabilities at their Euro equivalent nominal values, categorised by currency.

EUR millions

	GBP	USD
Assets	223.01	84.99
Liabilities	305.68	84.77
Net balance sheet position	**(82.67)**	**0.22**
Effect of cross currency interest rate swaps	*87.56*	-
Net exposure	***4.89***	***0.22***

The GBP assets and liabilities position is mainly composed of euro equivalent 149.5 million unquoted debt securities issued by the European Investment Bank as substitute of a defaulted debtor (see note **E3.4.2**). The effect of cross currency interest rate swap corresponds to the euro equivalent notional amount of the swap, which is used to reduce the ECSC in liquidation's exposure to currency movements (see note **E 3.3.3.2**). Remaining net exposure results of euro equivalent 4.12 million housing loans and euro equivalent 0.77 million current account balances. The US dollar position principally consists of euro equivalent 84.8 million loan granted from borrowed funds. Net exposure results of € equivalent 0.22 million current account balances.

According to the Procedures Manual, buying euro is the only foreign exchange operation authorised for EC business. All exceptions to this rule must be duly motivated.

7.11.2. Price risk

The ECSC in liquidation is exposed to debt securities price risk because of investments classified on the balance sheet as available for sale.

7.12 INTEREST RATE RISK

Cash flow interest rate risk is the risk that the future cash flows of a financial instruments will fluctuate because of changes in market interest rates. Fair value interest risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. Due to the nature of its activities, the ECSC in liquidation takes on exposure to the effects of fluctuations in the prevailing levels of market interest rate on both its fair value and cash flow risks.

(a) Loans granted from borrowed funds

The interest rate risks that arise from borrowings are generally offset by equivalent loans in terms and conditions (back-to-back operations). In case that no perfect matching can be reached, derivative financial instruments are used to reduce the exposure to interest rate movements (see note E 3.3.3.2)

(b) Debt securities

Debt securities issued at variable rates expose the ECSC in liquidation to cash flow interest rate risk whereas debt securities at fixed rates expose the Community to fair value interest rate risk. Fixed rate bonds represent approximately 85% of the investment portfolio at the balance sheet date.

Interest rate sensitivity analysis

The market price of a debt security depends on the time to maturity, its coupon and the actual yield to maturity. For the shock analysis all debt securities of the portfolio (incl. Floating Rate Notes) are once priced at actual yields, then re-priced at yields shifted upwards by 100 bps. The change in market price is the reported hypothetical loss for the shock analysis. The 100 bps parallel shift is assumed to happen instantaneously, no time horizon is considered. At 31 December 2005 this hypothetical loss was about EUR 43.9 million.

7.13 CREDIT RISK

The ECSC in liquidation takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due.

Guidelines on the choice of counterparties must be applied. Accordingly, the operating unit will be able to enter into deals only with eligible banks being part of a "trading list of authorized banks" and having sufficient counterparty limits.

Exposure to credit risk is managed through regular analysis of the ability of borrowers to meet interest and capital repayment obligations.

Exposure to credit risk is also managed by obtaining collateral as well as country, corporate and personal guarantees.

At 31 December 2005, the total outstanding nominal amount of loans granted by the ECSC in Liquidation was EUR 374.96 million, broken down as follows (in EUR millions):

	Nominal Amount
Loans granted to credit institutions	55.89
Loans granted to customers	319.07
Total	374.96

59.41% of the total amount outstanding is covered by guarantees from a Member State or equivalent bodies (public institutions or public-sector industrial groupings in the Member States). 16.80% of loans outstanding have been granted to banks or have been guaranteed by banks.

5.35% of the outstanding debt (EUR 20.1 million) is made up of loans granted to European institutions officials from the former ECSC pension fund (in the summary table above, loans to officials are included in loans to customers), which are covered by life-and disability insurances and the respective salaries.

The outstanding loan balance, i.e. 18.44% (18.55% as of 31 December 2004), should be considered as presenting a higher degree of risk. It means that the guarantees received (guarantee bonds put up by private industrial groupings and other special guarantees) do not generally provide the same level of security in the event of problems.

From a liquidity perspective, the loans granted on borrowed funds were fully covered by a provision for risks and charges called "Guarantee Fund". By applying the new accounting rules, this provision has been replaced as at 1 January 2005 by a dedicated reserve. This reserve amounts to EUR 207 million at 31 December 2005.

The loans granted on own funds were covered by another reserve, formerly called "ECSC Special Reserve". This special reserve amounts to EUR 64 million at 31 December 2005.

(a) Cash and deposits with credit institutions – profile of counterparties

At the balance sheet date, 15% and 85% of deposits and current account balances are placed with banks rated (Fitch) F1+ (or equivalent) and F1 (or equivalent), respectively.

All deposits and current account balances are held with banks within the OECD.

(b) Loans and advances – profile of borrowers

Geographical concentrations of the **loans granted from borrowed funds** (expressed at their outstanding nominal amount) at the balance sheet date are as follows:

EUR millions

	31 December 2005	Number of loans
Greece	84.77	1
France	133.82	2
Italy	3.86	12
United Kingdom	68.58	1
Total	**291.03**	**16**

These loans were backed by guarantees as follows:

EUR millions

	Guarantee from public body	Bank guarantee	Industrial grouping (public)	No guarantee	Total
Greece	84.77	-	-	-	**84.77**
France	-	-	133.82	-	**133.82**
Italy	-	3.86	-	-	**3.86**
United Kingdom	-	-	-	68.58	**68.58**
Total EC	**84.77**	**3.86**	**133.82**	**68.58**	**291.03**

Following a restructuring of debts of a defaulting debtor in 1998, the Commission acquired EUR 149.54 million promissory notes from European Investment Bank (rated AAA) in order to re-establish the back-to back character of the lending/borrowing transaction and thus cover interest rate and currency risk. These promissory notes are not included in the tables above.

Geographical concentrations of the **loans granted on own funds** -without loans to European Institutions officials -(expressed at their outstanding nominal amount) at the balance sheet date are as follows:

EUR millions

	31 December 2005	Number of loans
Belgium	3.46	20
Denmark	0.01	1
Germany	31.75	36
Greece	0.35	9
Spain	7.46	21
France	6.31	22
Ireland	0.22	9
Italy	4.44	21
Luxembourg	0.66	6
Netherlands	0.55	7
Austria	3.39	2
Portugal	0.46	6
Finland	0.65	2
United Kingdom	4.12	21
Total	**63.83**	**183**

NB: These are loans for financing the construction of subsidised housing at an interest rate of 1% p.a.

These loans were backed by guarantees as follows:

EUR millions

	Guarantee from Public body	Bank guarantee (1)	Industrial grouping		No guarantee	Total
			Public	Private		
Belgium	-	3.46	-	-	-	3.46
Denmark	-	0.01	-	-	-	0.01
Germany	-	31.75	-	-	-	31.75
Greece	-	0.35	-	-	-	0.35
Spain	-	7.46	-	-	-	7.46
France	-	6.10	-	-	0.21	6.31
Ireland	0.22	-	-	-	-	0.22
Italy	-	4.44	-	-	-	4.44
Luxembourg	-	0.66	-	-	-	0.66
Netherlands	-	-	-	0.55	-	0.55
Austria	-	3.39	-	-	-	3.39
Portugal	-	0.46	-	-	-	0.46
Finland	-	0.65	-	-	-	0.65
UK	-	4.12	-	-	-	4.12
Total	**0.22**	**62.85**	**-**	**0.55**	**0.21**	**63.83**

(1) Mainly loans granted to financial institutions for on-lending to final recipient

(c) Derivative financial instruments – profile of counterparties: See note **E 3.3.3.2**

(d) Available-for-sale securities – profile of issuers

Details of the debt securities (expressed at their fair value) by issuer type and by rating (Standard & Poor's) at the balance sheet date are as follows:

EUR

	31 December 2005	%
Sovereign	444,410,188	31.5
Multinational Organisations	82,761,522	5.9
Banks & Financial Institutions	697,072,995	49.4
Other Public Issuer	186,314,769	13.2
Total	**1,410,559,474**	**100**

EUR

	31 December 2005	%
AAA	873,805.754	61.9
AA+	114,409,488	8.2
AA	122,419,397	8.7
AA-	71,922,828	5.1
A+	50,027,842	3.5
A-	142,200,568	10.1
BBB+	35,773,597	2.5
Total	**1,410,559,474**	**100**

Geographical concentrations of the debt securities (expressed at their fair value) at the balance sheet date are as follows:

EUR millions

Country	31 December 2005	%
Austria	57.51	4.1
Belgium	10.90	0.8
Canada	10.42	0.7
Cyprus	34.28	2.4
Czech Republic	11.10	0.8
Denmark	10.15	0.7
Finland	10.17	0.7
France	187.62	13.3
Germany	377.86	26.8
United Kingdom	47.15	3.3
Greece	15.75	1.1
Hungary	92.48	6.6
Ireland	73.42	5.2
Italy	62.10	4.4
Lithuania	22.14	1.6
Luxemburg	30.84	2.3
Latvia	10.92	0.8
Netherlands	95.16	6.7
Poland	35.78	2.5
Slovak Rep	5.55	0.4
Spain	120.06	8.5
Switzerland	42.30	3.0
United States	46.90	3.3
	1410.56	**100,0**

7.14 LIQUIDITY RISK

The liquidity risk that arises from borrowings is generally offset by equivalent loans in terms and conditions (back-to-back operations). In case that no perfect matching can be reached, derivative financial instruments are used to match cash flows.

For the asset management of ECSC in liquidation, the Commission manages liquidity requirements based on disbursement forecast with a 11 years horizon obtained through consultations with the responsible Commission services. Investments are carried out accordingly to meet respective annual requirements.

7.11 FAIR VALUE

Loans and borrowings

The estimated fair value of loan and borrowings is determined using a discounted cash flow model. According to this model, expected future cash flows are discounted by applying AAA yield curves appropriate for the remaining term of maturity.

The estimated fair value of floating rate loans are assumed to approximate their carrying amount since re-pricing at market interest rates takes place every 3 or 6 months.

The estimated fair value of fixed interest bearing loans and borrowings could not be obtained as the necessary data for calculating these values was not available.

Available-for-sale securities

The available-for-sale securities are presented at fair value which is the market price plus accrued interests.

Financial instruments measured at fair value

The total amount of the change in fair value estimated using a valuation technique that was recognized in the economic outturn account during the year is EUR 1.57 million (net profit). There are no financial instruments measured at fair value using a valuation technique that is not supported by observable market prices or rates.

Receivables and payables

The nominal value less impairment provision of trade receivables and the nominal value of trade payables are assumed to approximate their fair values.

Cash and cash equivalents

The fair value of cash and cash equivalents including currents accounts and short-term deposits (of less than three months) is their carrying amount.

8. RELATED PARTY DISCLOSURES

For the purposes of presenting information on related party transactions concerning the key management of the European Communities, such persons are shown here under five categories:

Category 1: the President of the Commission, the President of the Court of Justice and the President of the Court of First Instance
Category 2: the Vice-presidents of the Commission
Category 3: the Members of the Commission, the Judges and Advocates General of the Court of Justice, the Members of the Court of First Instance, the Ombudsman and the European Data Protection Supervisor
Category 4: the President and Members of the Court of Auditors
Category 5: the highest ranking civil servants of the Institutions and Agencies (grades A14 to A16)

KEY MANAGEMENT FINANCIAL ENTITLEMENTS

EUR

Entitlement	Category 1	Category 2	Category 3	Category 4	Category 5
Basic salary (per month)	22,858.33	20,705.01	18,634.51	17,889.13	12,417.36 - 16,234.51
Residential allowance (% salary)	15%	15%	15%	15%	N/A
Expatriation allowance (% salary)	N/A	N/A	N/A	N/A	16%
Family allowances:					
Household (% salary)	2% + 153.75	2% + 153.75	2% + 153.75	2% + 153.75	2% + 153.75
Dependent child	275.97	275.97	275.97	275.97	275.97
Pre-school	32.83	32.83	32.83	32.83	32.83
Education, or	227.96	227.96	227.96	227.96	227.96
Education outside place of work	455.92	455.92	455.92	455.92	455.92
Presiding judges allowance	N/A	N/A	810.74	N/A	N/A
Representation allowance	1,418.07	911.38	607.71	N/A	N/A
Annual travel costs	N/A	N/A	N/A	N/A	Yes
Transfers to Member State:					
Education allowance*	Yes	Yes	Yes	Yes	Yes
% of salary*	5%	5%	5%	5%	5%
% of salary with no cc	max 25%	max 25%	max 25%	max 25%	max 25%
Representation expenses	reimbursed	reimbursed	reimbursed	N/A	N/A
Taking up duty:					
Installation expenses	45,716.66	41,410.02	37,269.02	35,778.26	N/A
Family travel expenses	reimbursed	reimbursed	reimbursed	reimbursed	reimbursed
Moving expenses	reimbursed	reimbursed	reimbursed	reimbursed	reimbursed
Leaving office:					
Resettlement expenses	22,858.33	20,705.01	18,634.51	17,889.13	reimbursed
Family travel expenses	reimbursed	reimbursed	reimbursed	reimbursed	reimbursed
Moving expenses	reimbursed	reimbursed	reimbursed	reimbursed	reimbursed
Transition (% salary)**	40% - 65%	40% - 65%	40% - 65%	40% - 65%	N/A
Sickness insurance	covered	covered	covered	covered	optional
Pension (% salary, before tax)	Max 70%	Max 70%	Max 70%	Max 70%	Max 70%
Deductions:					
Community tax	8% - 45%	8% - 45%	8% - 45%	8% - 45%	8% - 45%
Sickness insurance (% salary)	1.8%	1.8%	1.8%	1.8%	1.8%
Special levy on salary	2.93%	2.93%	2.93%	2.93%	2.93%
Pension deduction	N/A	N/A	N/A	N/A	9.75%
Number of persons at 31/12/2005	**3**	**5**	**77**	**25**	**105**

* with correction coefficient ("cc") applied
** paid for the first 3 years following departure

9. EVENTS AFTER THE BALANCE SHEET DATE

At 31 March 2006, no material issues came to the attention of the accounting officer of the Commission or were reported to him that would require separate disclosure under this section. The annual accounts and related notes were prepared using the most recently available information and this is reflected in the information presented above.

10. CONSOLIDATED ENTITIES

The following entities are included in the European Communities consolidated accounts:

A. CONTROLLED ENTITIES
1. Institutions and consultative bodies
Committee of the Regions
Council of the European Union
Court of Justice of the European Union
European Commission
European Court of Auditors
European Data Protection Supervisor
European Economic and Social Committee
European Ombudsman
European Parliament
2. Community Agencies
European Agency for Reconstruction
European Agency for Safety and Health at Work
European Aviation Safety Agency
European Centre for Disease Prevention
European Centre for the Development of Vocational Training
European Environment Agency
European Food Safety Authority
European Foundation for Improvement of Living and Working Conditions
European Maritime Safety Agency
European Medicines Agency
European Monitoring Centre for Drugs and Drug Addiction
European Monitoring Centre on Racism and Xenophobia
European Network and Information Security
European Training Foundation
Translation Centre for the Bodies of the European Union
3. Other controlled entities
European body for the enhancement of judicial co-operation (Eurojust) [8]
European Coal and Steel Community (in liquidation)
B. JOINT VENTURES
Galileo Joint Undertaking [9]
C. ASSOCIATES
European Investment Fund [10]

[8] Decentralised body of the European Union falling under the pillar "Police and Judicial Cooperation in criminal matters"

[9] Proportion of interest 89.66 %, proportion of voting power 50.00 %

[10] Proportion of interest 30.00 %, proportion of voting power 30.00 %

11. NON-CONSOLIDATED ENTITIES

Although the Communities manage the assets of the below mentioned entities, they do not meet the requirements to be consolidated and so are not included in the European Communities accounts:

11.1 THE EUROPEAN DEVELOPMENT FUND (EDF)

The European Development Fund (EDF) is the main instrument for Community aid for development cooperation in the ACP countries and the Overseas Countries and Territories (OCT). Each Fund is concluded for a period of five years. Since the conclusion of the first partnership convention in 1964 (Yaoundé I Convention), the EDF cycles have generally followed that of the partnership conventions of Yaoundé and Lomé. The ninth EDF was concluded at the same time as the most recent partnership convention, the so-called Cotonou Agreement, on June 2000. The Cotonou Agreement was signed by 77 States: 48 countries of Sub-Sahara Africa; 15 countries of the Caribbean and 14 countries of the Pacific. The ninth EDF has been allocated EUR 13.5 billion over a period of five years. The Cotonou agreement makes provision for only 2 financial instruments under the EDF: an instrument for granting subsidies for long-term development support (non-reimbursable aid); and an investment facility to promote the private sector in ACP States.

The EDF is not funded from the Communities' Budget but from direct contributions from Member States, which are agreed in negotiations. The amount a Member State pays is, amongst other things, partly based on their GNP and partly based on their historical links (i.e. previous colonies) with the ACP States involved. The Commission and EIB manage the resources of the EDF.

The EDF is governed by its own Financial Regulation (OJ L 83/1 of 01/04/2003) which foresees the presentation of its own financial statements, separately from those of the Communities. The EDFs are subject to the external control of the Court of Auditors and the Parliament. For information purposes, the balance sheet and economic outturn account of the EDF are shown:

BALANCE SHEET - EDF

EUR millions

	31.12.2005	31.31.2004 Restated
CURRENT ASSETS:	**3,515.29**	**3,391.24**
Contributions to be received	13.72	42.38
Receivables	138.77	121.02
Pre-financing	2,304.20	1,885.06
Other current assets	3.31	6.89
Deferred charges	393.19	537.00
Security cash accounts	391.55	537.00
Cash & cash equivalents	270.55	261.89
TOTAL ASSETS	**3,515.29**	**3,391.24**
CURRENT LIABILITIES:	**1,878.94**	**1,578.49**
Accounts payable	1,878.94	1,578.49
TOTAL LIABILITIES	**1,878.94**	**1,578.49**
NET ASSETS	**1,636.35**	**1,812.75**
FUNDS & RESERVES		
Called-up fund capital	27,390.00	25,040.00
Result for the year	(2,526.40)	-
Results carried forward from previous years	(24,261.09)	(24,261.09)
Reserves	1,033.84	1,033.84
FUNDS & RESERVES	**1,636.35**	**1,812.75**

ECONOMIC OUTTURN ACCOUNT - EDF

EUR millions

	2005
TOTAL REVENUE	0.35
OPERATING EXPENSES	**2,544.15**
Operating Expenses:	2,515.78
Programme aid	949.13
Macro-economic support	383.01
Regional programs	33.32
Interest-rate subsidies	0.27
Emergency aid	134.92
Refugee aid	12.99
Risk capital	60.80
Stabex	66.40
Sysmin	13.99
Transfers from former EDFs	15.61
Structural adjustments	15.89
Debt relief	21.59
Payments World Bank	1.60
Sectorial policy	492.16
Compensation export receipts	(3.32)
Centre for the development of enterprise	16.51
Centre for the development of agriculture	11.09
General assembly	1.07
Technical assistance	0.04
Intra ACP projects	198.91
Congo Fund	89.80
Administrative expenses:	28.37
(DEFICIT) FROM OPERATING ACTIVITIES	**(2,543.80)**
NON-OPERATING ACTIVITIES	
Financial income	23.95
Financial charges	(0.19)
Provisions	(6.36)
SURPLUS FROM NON-OPERATING ACTIVITIES	17.40
RESULT FOR THE YEAR	**(2,526.40)**

11.2 THE SICKNESS INSURANCE SCHEME

The Sickness Insurance Scheme is the scheme that provides medical assurance to the staff of the various European Communities bodies. The funds of the Scheme are its own property and are not controlled by the European Communities, although its financial assets are managed by the Commission. The Scheme is funded by contributions from its members (staff) and from the employers (the Institutions/Agencies/bodies.) Any surplus remains within the Scheme.

The scheme has four separate entities - the main scheme covering staff of the Institutions, Agencies of the European Communities, and three smaller schemes covering staff in the European University of Florence, the European schools and staff working outside the EC such as staff in the EU delegations. The total assets of the Scheme at 31 December 2005 totalled EUR 260 million (2004: EUR 246 million.)