

# ANNUAL ACCOUNTS OF EESTI PANK

For the Financial Year Ended on 31 December 2003




## APPROVAL OF THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2003 BY THE EXECUTIVE MANAGEMENT OF THE BANK

The Executive Management of Eesti Pank has prepared the Annual Accounts of Eesti Pank, consisting of the Balance Sheet, Profit and Loss Account, Statement of Changes in Equity, and Notes to the Annual Accounts. The Executive Management has submitted the Annual Accounts with the Auditor's Report to the Board of Eesti Pank for approval.

The Annual Accounts have been prepared in compliance with the Eesti Pank Act, the Statute of Eesti Pank, and internal guidelines for preparing the Annual Accounts, and they give a true and fair view of the assets, liabilities, equity, and performance of Eesti Pank.

On 25 March 2004, all members belonging to the Executive Management of Eesti Pank on that day signed the Annual Accounts.

Chairman of the Executive Management



Vahur Kraft

Members of the Executive Management



Rein Minka



Märten Ross



Andres Sutt

## BALANCE SHEET AT 31 DECEMBER 2003 AND 2002 (EEK THOUSAND)

	Item	31.12.2003	31.12.2002
<b>ASSETS</b>			
<b>Foreign assets</b>		<b>18,397,027</b>	<b>16,407,441</b>
Gold	1	42,739	42,267
Convertible foreign currency assets	2	17,139,726	15,028,681
Special Drawing Rights (SDRs)	3	969	1,013
Participation in the IMF	3	1,202,326	1,323,081
Other claims on the IMF	3	11,267	12,399
<b>Domestic assets</b>		<b>300,366</b>	<b>261,190</b>
Loans and other claims	4	56,973	69,220
Credit institutions		–	9,083
Other		56,973	60,137
Shares	5	73	73
Other assets	6	23,818	9,168
Fixed assets	7	219,502	182,729
<b>Total assets</b>		<b>18,697,393</b>	<b>16,668,631</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Foreign liabilities</b>		<b>1,687,372</b>	<b>1,516,277</b>
Foreign debt	2	480,827	189,095
IMF kroon accounts	3	1,202,237	1,322,983
Accounts of non-residents	8	4,308	4,199
<b>Domestic liabilities</b>		<b>13,505,761</b>	<b>11,778,845</b>
Notes and coins in circulation		8,324,146	8,112,958
Accounts of credit institutions and other current liabilities	9	5,126,210	3,619,172
Accounts of credit institutions		5,062,641	3,565,070
Other		63,569	54,102
Convertible foreign currency deposits	3	5,056	5,564
Other liabilities	10	50,349	41,151
<b>Equity</b>		<b>3,504,260</b>	<b>3,373,509</b>
Capital and reserves	11	3,228,509	2,772,130
Profit for the year		275,751	601,379
<b>Total liabilities and equity</b>		<b>18,697,393</b>	<b>16,668,631</b>

The following notes on pages 98 to 113 form an integral part of these Financial Statements.

## PROFIT AND LOSS ACCOUNT FOR THE YEARS 2003 AND 2002 (EEK THOUSAND)

	Item	2003	2002
<b>Foreign net interest income and similar items</b>	<b>12</b>	<b>440,374</b>	<b>815,018</b>
<b>Domestic net interest income and similar items</b>	<b>13</b>	<b>-42,064</b>	<b>-62,511</b>
Interest and other income		12,565	12,177
Interest and other expense		-54,629	-74,688
<b>Other operating income</b>	<b>14</b>	<b>8,062</b>	<b>8,548</b>
<b>Operating expenses</b>	<b>15</b>	<b>-178,601</b>	<b>-182,360</b>
Personnel expenses		-76,945	-68,403
Banknote and coin production costs		-10,018	-15,649
General administration expenses		-65,787	-71,245
Depreciation of fixed assets		-25,851	-27,063
<b>Profit before provisions and extraordinary items</b>		<b>227,771</b>	<b>578,695</b>
Extraordinary income		48,050	23,896
Provisions		-70	-1,212
<b>Extraordinary items and net change of provisions</b>	<b>16</b>	<b>47,980</b>	<b>22,684</b>
<b>Net profit for the year</b>	<b>17</b>	<b>275,751</b>	<b>601,379</b>

The following notes on pages 98 to 113 form an integral part of these Financial Statements.

## STATEMENT OF CHANGES IN EQUITY (EEK THOUSAND)

	Statutory capital	Reserve capital	Special reserve	Revaluation reserves	Profit	Total
<b>Balance at the end of 2001</b>	<b>100,000</b>	<b>500,000</b>	<b>1,752,831</b>	<b>3,347</b>	<b>530,952</b>	<b>2,887,130</b>
Transfers	–	–	128	-128	–	–
Distribution of 2001 profit	–	–	415,952	–	-415,952	–
Transfers into the state budget	–	–	–	–	-115,000	-115,000
Net profit for the 2002	–	–	–	–	601,379	601,379
<b>Balance at the end of 2002</b>	<b>100,000</b>	<b>500,000</b>	<b>2,168,911</b>	<b>3,219</b>	<b>601,379</b>	<b>3,373,509</b>
Transfers	–	–	3,219	-3,219	–	–
Distribution of 2002 profit	–	–	456,379	–	-456,379	–
Transfers into the state budget	–	–	–	–	-145,000	-145,000
Net profit for the 2003	–	–	–	–	275,751	275,751
<b>Balance at the end of 2003</b>	<b>100,000</b>	<b>500,000</b>	<b>2,628,509</b>	<b>–</b>	<b>275,751</b>	<b>3,504,260</b>

The following notes on pages 98 to 113 form an integral part of these Financial Statements.

# NOTES TO THE ANNUAL ACCOUNTS OF EESTI PANK

## ACCOUNTING POLICIES

### General Principles

The Annual Accounts have been prepared in accordance with the Eesti Pank Act, the Statute of Eesti Pank, and internal guidelines for preparing the Annual Accounts. The Accounting Act and internationally accepted accounting principles have been applied where appropriate and applicable to the activities of a central bank.

Annual accounts have been prepared on a historical cost basis, except in cases explained under relevant items.

Pursuant to the Eesti Pank Act, Eesti Pank is not subject to paying income tax or other taxes related to economic activities into the state budget or local budgets, except for taxes related to individuals.

The Annual Accounts have been prepared in thousands of Estonian kroons (EEK thousand), unless indicated otherwise.

The main accounting principles applied in preparing the Annual Accounts of Eesti Pank are presented below.

### Foreign Currency Transactions

Foreign currency transactions are recorded at the official foreign exchange rates as quoted by Eesti Pank at the transaction date. Assets and liabilities denominated in foreign currencies are translated into Estonian kroons at the official foreign exchange rates effective on the balance sheet date. All foreign exchange gains and losses are recorded in the Profit and Loss Account as gains or losses for the period.

The official exchange rates applied on 31 December 2003 and 2002 were as follows:

	2003	2002
USD	12.40960	14.93642
SDR	18.44059	20.29266
EUR	15.64664	15.64664

### Financial Assets and Liabilities

The Balance Sheet of Eesti Pank has been structured so that assets and liabilities as well as related gains and losses are separated according to residency (domestic and foreign). Such Balance Sheet structure demonstrates the backing of the Estonian kroon by gold and convertible foreign currency assets. Foreign exchange transactions are mostly related to foreign exchange reserve management. Transactions in Estonian kroons are mainly related to currency circulation, market operations, and daily operations of Eesti Pank.

Fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction. If the fair value of financial assets and liabilities differs significantly from their book value, these differences have been shown separately in the Notes to the Annual Accounts.

There were no significant differences between the fair value and book value of the financial assets and liabilities of Eesti Pank as at 31 December 2003 and 31 December 2002.

## Gold

Gold reserves are valued at the market value at the end of the year, equal to Eesti Pank's daily quotation of the Estonian kroon and gold. Changes in the market value of gold at the end of the accounting period compared to the beginning of the period are recognised in the Profit and Loss Account under the item 'Foreign Net Interest Income and Similar Items'.

## Investments in Convertible Foreign Currency Assets

Foreign treasury bills and other quoted securities denominated in convertible foreign currencies are recorded at their year-end fair value. Gains and losses from changes in the fair value of securities are recognised in the Profit and Loss Account under the item 'Foreign Net Interest Income and Similar Items'.

Repurchase agreements are recorded as loans taken with collateral security at the fair value, i.e. securities are recorded on the Balance Sheet of the Bank as assets and the repurchase sum as a liability. The fair value has been estimated using the discounted cash flow method. The change in the fair value is recorded on an accrual basis in the Profit and Loss Account under the item 'Foreign Net Interest Income and Similar Items'.

Reverse repurchase agreements are recorded as loans issued with collateral security at the fair value. The fair value has been estimated using the discounted cash flow method. The change in the fair value is recorded on an accrual basis in the Profit and Loss Account under the item 'Foreign Net Interest Income and Similar Items'. Collateral securities under reverse repurchase agreements are not recorded on the Balance Sheet of the Bank.

## Derivative Financial Instruments

Derivative financial instruments are used to manage foreign exchange risks and interest rate risks and they include foreign exchange forwards, currency swaps, and futures. Derivative contracts are recorded on the Balance Sheet at their fair value on the trade date under 'Convertible Foreign Currency Deposits' (contracts with positive value) and 'Foreign Debt' (contracts with negative value). The change in the fair value is recorded on an accrual basis under the item 'Foreign Net Interest Income and Similar Items' in the Profit and Loss Account. Eesti Pank does not apply hedge accounting to derivative instruments.

## Investments in Shares

Investments in shares are recorded at their fair value if their value can be reliably estimated. The estimation of the fair value of shares is not reliable if they are not actively traded and there are no alternative methods to estimate their value in a reliable way. In this case investments in shares are accounted for at their adjusted acquisition cost (initial acquisition cost less provisions for any impairment in value other than temporary below balance sheet value). Profits and losses on the disposal of shares are recorded in the Profit and Loss Account when the sale becomes unconditional. Dividend income is recorded as income for the period.

## Fixed Assets

Fixed assets are assets with useful life over a year and acquisition cost in excess of 5,000 kroons. Fixed assets are recorded at their acquisition cost, including purchase price and other directly associated expenditure related to putting the asset to use. Land, buildings, IT hardware, software, and other assets with long-term

useful lives are recorded as fixed assets on the Balance Sheet. Prepayments for fixed assets are also recorded as fixed assets.

Land and objects of art and culture are not depreciated. Other fixed assets are depreciated on a straight-line basis over the estimated useful lives of the assets at the following rates:

	2003	2002
Buildings	3%	3%
Hardware	33%	33%
Software	20-50%	20-50%
Other	20%	20%

In 2002 software depreciation rates were structured. The need arose due to the introduction of applications software with high acquisition cost and long-term useful life in 2002.

Renovation costs are added to the acquisition cost of renovated fixed assets if external floor areas of the buildings or structures have increased, or the purpose of the existing buildings or structures has changed. Current repair costs are recognised as periodic expenditure. Write-down allowance is made if it is known or probable that the value of the fixed assets is persistently less than the value recorded in the accounts.

Development costs are recognised as expenses in the Profit and Loss Account in the period when they are incurred.

## Estimates

Preparing the Annual Accounts pursuant to the generally accepted accounting principles requires the Executive Management to provide estimates regarding the aspects affecting the assets and liabilities of Eesti Pank and income and expenses during the accounting period as at the balance sheet date. These estimates are based on the available information about Eesti Pank, its intentions and risks as at the date of compilation of the Annual Accounts.

## Provision for Loans and Other Claims

Allowance is made for doubtful loans and other claims. A provision is set up to cover doubtful loans and other claims, which is recorded as an expense of the reporting period in the Profit and Loss Account while assets on the Balance Sheet are reduced respectively.

A general provision is set up to cover loan losses of the loan portfolio. The loan-loss provision is established to cover anticipated unidentified losses in the loan portfolio. The general provision is applied only to low-risk loans. It reflects the estimates of the Executive Management of Eesti Pank on the loan loss, based on the risk group of the loans and previous experience. The general provision is calculated by multiplying the debt by the risk-group-based provision rate.

Loans and other claims are maintained on the Balance Sheet until they are recovered or written off. Loans and other claims are written off only after all legal means to recover them have been exhausted, or if such recovery is not feasible. Loans previously written off but collected during the reporting period are recorded as an offsetting entry under expenses.

## Liabilities

All known liabilities and provisions are recorded on the Balance Sheet, if reliable estimates can be made of the amount and they are likely to be realised. Contingent liabilities, sureties, and guarantees are recognised as off-balance sheet items. If the possibility of an outflow of resources is remote, associated details are not disclosed in the Notes to the Annual Accounts.



## Notes and Coins in Circulation

Notes and coins in circulation are notes and coins issued by Eesti Pank at their nominal value reflected on the Balance Sheet as a liability in favour of the holder of the notes and coins. The cost of producing notes and coins is recorded in the Profit and Loss Account as the Bank's payment obligation to the supplier arises.

## Post-Balance-Sheet Events

Annual Accounts of Eesti Pank reflect significant circumstances affecting the valuation of assets and liabilities between the balance sheet date and the date the Annual Accounts are signed by the Executive Management of Eesti Pank.

## Income and Expenses

Income and expenses are recorded in the Profit and Loss Account during the accounting period on an accrual basis regardless of when cash was received or paid.

## ITEM 1 – GOLD

Movements in Eesti Pank's gold reserves are as follows:

	Amount (troy ounce)	Market price (EEK per ounce)	Market value (EEK thousand)
Balance as at 31.12.2002	8,250.171	5,123.1910	42,267
Revaluation	–	–	472
<b>Balance as at 31.12.2003</b>	<b>8,250.171</b>	<b>5,180.3880</b>	<b>42,739</b>

## ITEM 2 – CONVERTIBLE FOREIGN CURRENCY ASSETS, FOREIGN CURRENCY LIABILITIES

These comprise Eesti Pank's foreign exchange reserves and liabilities related to reserve management, denominated in convertible foreign currency. The following financial instruments are used to manage the foreign exchange reserves: demand and time deposits, bonds, spot transaction, derivatives (futures, forwards, and swaps), repurchase and reverse repurchase agreements.

*EEK thousand*

	Balance as at 31.12.2002	Remaining maturity structure				
		Up to 3 months	3-12 months	1-3 years	3-5 years	Over 5 years
<b>Convertible foreign currency</b>	<b>15,028,681</b>	<b>10,877,322</b>	<b>–</b>	<b>1,859,760</b>	<b>945,115</b>	<b>1,346,484</b>
Cash and current accounts	126,485	126,485	–	–	–	–
Time deposits	135,898	135,898	–	–	–	–
Securities	7,820,646	3,669,287	–	1,859,760	945,115	1,346,484
Reverse repurchase agreements	6,859,784	6,859,784	–	–	–	–
Fair value of derivatives	85,868	85,868	–	–	–	–
	<b>Balance as at 31.12.2003</b>	<b>Up to 3 months</b>	<b>3-12 months</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>Over 5 years</b>
<b>Convertible foreign currency</b>	<b>17,139,726</b>	<b>4,307,985</b>	<b>7,952,153</b>	<b>3,241,949</b>	<b>658,722</b>	<b>978,917</b>
Cash and current accounts	348,506	348,506	–	–	–	–
Time deposits	2,117,811	2,117,811	–	–	–	–
Securities	12,831,741	–	7,952,153	3,241,949	658,722	978,917
Reverse repurchase agreements	1,742,145	1,742,145	–	–	–	–
Fair value of derivatives	99,523	99,523	–	–	–	–

EEK thousand

	Balance as at 31.12.2002	Remaining maturity structure				
		Up to 3 months	3-12 months	1-3 years	3-5 years	Over 5 years
<b>Foreign debts</b>	<b>189,095</b>	<b>189,095</b>	-	-	-	-
Repurchase agreements	176,663	176,663	-	-	-	-
Fair value of derivatives	12,432	12,432	-	-	-	-
	Balance as at 31.12.2003	Up to 3 months	3-12 months	1-3 years	3-5 years	Over 5 years
<b>Foreign debts</b>	<b>480,827</b>	<b>480,827</b>	-	-	-	-
Repurchase agreements	448,091	448,091	-	-	-	-
Fair value of derivatives	32,736	32,736	-	-	-	-

In 2003, Eesti Pank's net foreign exchange reserves increased by 1.8 billion kroons, totalling 16.7 billion kroons at the end of the year. During 2003 the amount of Estonian kroons purchased from Eesti Pank for foreign currency was 38.9 billion, while the amount of Estonian kroons sold to Eesti Pank for foreign currency totalled 37.5 billion. The net gain of 1.4 billion kroons on transactions in line with the principles of the currency board arrangement was additionally channelled into circulation. The foreign exchange reserves increased due to the growth in the volume of Estonian kroons in circulation and the fair value of the reserves.

Short-term repurchase agreements (short-term lending against collateral security) at the end of 2003 added 448.1 million kroons to the foreign exchange reserves. Lending against collateral securities is recorded under the item 'Foreign Debts'.

Eesti Pank's foreign currency reserves are required to back up notes and coins in circulation, the funds in the accounts of credit institutions with Eesti Pank, and other Balance Sheet liabilities of Eesti Pank. Therefore, conservative risk constraints established to protect the asset base of the Estonian kroon are followed, which prioritise maintaining the assets and their liquidity while earning investment returns.

At the end of 2003, financial instruments denominated in euros accounted for 91% of the total foreign currency assets. Considering also the foreign currency positions from foreign exchange swap transactions, the share of the euro in Eesti Pank's foreign currency reserves was nearly 100%.

EEK thousand

	Balance as at 31.12.2003		Balance as at 31.12.2002	
	Convertible foreign currency (EEK thousand)	Structure	Convertible foreign currency (EEK thousand)	Structure
<b>Total</b>	<b>17,139,726</b>	<b>100%</b>	<b>15,028,681</b>	<b>100%</b>
EUR	15,665,203	91%	13,408,338	89%
USD	1,437,889	8%	1,609,638	11%
Other foreign currencies	36,634	0%	10,705	0%

	Balance as at 31.12.2003		Balance as at 31.12.2002	
	Foreign debts (EEK thousand)	Structure	Foreign debts (EEK thousand)	Structure
<b>Total</b>	<b>-480,827</b>	<b>100%</b>	<b>-189,095</b>	<b>100%</b>
EUR	-333	0%	-1	0%
USD	-449,654	94%	-185,061	98%
Other foreign currencies	-30,840	6%	-4,033	2%

Off-balance sheet net position

<b>Total</b>	<b>-850,661</b>	<b>100%</b>	<b>-1,324,552</b>	<b>100%</b>
USD	-1,172,786	138%	-1,324,552	100%
Other foreign currencies	322,125	-38%	-	-

The guidelines for managing Eesti Pank's foreign currency reserves allow only transactions with highly rated international banks and financial institutions and limit any credit risk the Bank can take in managing its foreign assets. The issuer risk is permissible for the following minimum credit ratings assigned by international rating agencies (S&P/Moody's): A-1 or P-1 for bonds with up to one-year maturity and AA- or Aa3 for bonds with maturity of more than a year. In 2003, Eesti Pank's foreign currency reserves were mainly placed in the markets of low-risk government bonds of leading euro-area industrial countries and the United States of America with an average maturity of slightly above one year.

## ITEM 3 – RELATIONS WITH THE INTERNATIONAL MONETARY FUND (IMF)

### Special Drawing Rights (SDR)

Each IMF member state has an SDR account with the IMF, used to conduct borrowing and other similar operations between the member state and the IMF. The following table reflects movements in the account the Republic of Estonia holds with the IMF.

*EEK thousand*

<b>Special Drawing Rights (SDRs)</b>	<b>2003</b>	<b>2002</b>
Balance at the beginning of the year	1,013	610
Interests and other income accrued	68	763
Purchases of SDRs	–	224,218
Loan repaid to the IMF (STF)	–	-219,660
Interest and other expenses paid	–	-4,855
Currency translation differences	-112	-63
<b>Balance at the end of the year</b>	<b>969</b>	<b>1,013</b>

### Participation in the IMF

Eesti Pank acts as a fiscal agent between the Republic of Estonia and the IMF and as a depository of IMF's kroon deposits and treasury notes. Each IMF member state has a quota determining its subscription and voting power in the IMF. Participation in the IMF is recorded under assets on the Balance Sheet and equals to the country's quota in the IMF. At the end of 2003 the quota of the Republic of Estonia was 65,200,000 SDRs.

The Republic of Estonia has paid its subscription in treasury notes deposited with Eesti Pank, which are recorded under the item 'IMF Kroon Accounts'. These treasury notes do not pay interest.

*EEK thousand*

<b>Participation in IMF (assets)</b>	<b>2003</b>	<b>2002</b>
Balance at the beginning of the year	1,323,081	1,440,277
Currency translation differences	-120,755	-117,196
<b>Balance at the end of the year</b>	<b>1,202,326</b>	<b>1,323,081</b>
<b>IMF kroon accounts (liabilities)</b>		
Balance at the beginning of the year	1,322,983	1,441,279
Interests accrued	–	3,013
Currency translation differences	-120,746	-117,195
Interest paid	–	-4,114
<b>Balance at the end of the year</b>	<b>1,202,237</b>	<b>1,322,983</b>

## Other Claims on the IMF

Since March 1997 this item has reflected the amounts that the IMF has reserved to consolidate its financial situation and the source of which is the surcharge (ca 0.1%) added to the interest rate of the Stand-by Arrangement (SBA) and the Systemic Transformation Facility (STF).

These sums were partially reserved to finance the IMF's Poverty Reduction and Growth Facility (PRGF) on behalf of the Republic of Estonia and Eesti Pank. In 2002, the Government of the Republic of Estonia and Eesti Pank supported the programme for Heavily Indebted Poor Countries (HIPC) launched by the World Bank and the IMF, allocating the funds deposited in a special account with the IMF since 1997 as grants of 0.7 million kroons and 2.4 million kroons respectively, and the interest of 0.3 million kroons earned on these funds.

*EEK thousand*

<b>Other claims on IMF</b>	<b>2003</b>	<b>2002</b>
Balance at the beginning of the year	12,399	16,971
Additions (disposals)	–	-3,468
Currency translation differences	-1,132	-1,104
<b>Balance at the end of the year</b>	<b>11,267</b>	<b>12,399</b>
Eesti Pank, SBA (loan related receivable)	6,211	6,835
Government, STF (loan related receivable)	5,056	5,564
<b>Total</b>	<b>11,267</b>	<b>12,399</b>

## Liabilities in Foreign Currency

The item reflects the Republic of Estonia's claim on the IMF, which is recorded on the Balance Sheet of Eesti Pank as the Bank's liability to the Government of the Republic of Estonia. The claim is related to the participation of the Republic of Estonia in consolidating the financial situation of the IMF through premium calculated on the Systemic Transformation Facility (STF).

In previous periods the item included also demand deposits of the Republic of Estonia with Eesti Pank. In 2002, Eesti Pank fully returned the Republic of Estonia its demand deposits with Eesti Pank.

*EEK thousand*

<b>Convertible foreign currency deposits</b>	<b>2003</b>	<b>2002</b>
Balance at the beginning of the year	5,564	7,801
Increase(+)/decrease(-)	–	-1,097
Debited the account in Eesti Pank	–	223,617
Loan repaid to the Government	–	-603
Interests accrued	–	606
Currency translation differences	-508	-830
Loan repaid to the IMF (STF)	–	-219,660
Interests and other expenses paid	–	-4,270
<b>Balance at the end of the year</b>	<b>5,056</b>	<b>5,564</b>

Between 1993 and 1995 the IMF granted the Government of the Republic of Estonia 429.2 million kroons under the Systemic Transformation Facility (STF) in order to promote economic development, which the Government of the Republic re-lent through commercial banks. Eesti Pank acted as an agent for the Government in intermediating the loan and carried out necessary transactions upon servicing the loan. The loan was purchased with treasury notes of the Government of the Republic deposited with Eesti Pank. The STF was

not recorded on the Balance Sheet of Eesti Pank. In 2002, the item included transactions related to servicing the STF loan granted by the IMF to the Republic of Estonia. The final maturity date of the STF was January 2005. The loan balance at the end of 2001 was 235.4 million kroons. The Government of the Republic of Estonia fully repaid the loan in 2002.

## ITEM 4 – LOANS AND OTHER CLAIMS

The following is a more detailed overview of the movement of loans and other claims in 2003 followed by additional explanations:

*EEK thousand*

	Balance as at 31.12.2003	Extended	Repaid	Contractual claim	Change in provision	Contract termi- nation	Balance as at 31.12.2002
<b>Total</b>	<b>56,973</b>	<b>11,988</b>	<b>-13,765</b>	<b>874</b>	<b>214</b>	<b>-11,558</b>	<b>69,220</b>
<b>Loans to Estonian credit institutions</b>	<b>-</b>	<b>1,601</b>	<b>-</b>	<b>874</b>	<b>-</b>	<b>-11,558</b>	<b>9,083</b>
Eesti Ühispank	-	945	-	874	-	-8,372	6,553
Accrued interests	-	656	-	-	-	-3,186	2,530
<b>Guarantee Fund</b>	<b>124</b>	<b>124</b>	<b>-101</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>101</b>
<b>Loans</b>	<b>56,849</b>	<b>10,263</b>	<b>-13,664</b>	<b>-</b>	<b>214</b>	<b>-</b>	<b>60,036</b>
Staff loans	56,679	8,149	-11,490	-	214	-	59,806
Accrued interests	170	2,114	-2,174	-	-	-	230

### Eesti Ühispank

According to Eesti Pank's agreement concluded with AS Põhja-Eesti Pank on claims over assets and a deposit agreement with AS Eesti Ühispank, 95% of the sums accrued from the recovery of these assets, of which legal costs related to the recovery had been deducted, were transferred into Eesti Pank's deposit account with AS Eesti Ühispank. The deposit earned 9% interest per year. In 2003, 3.2 million kroons of interest were transferred into the deposit account, which was recorded as income. At the end of 2003 the agreement on claims and the deposit agreement were bilaterally terminated and AS Eesti Ühispank returned the deposit totalling 7.5 million kroons and a contract termination fee of 0.9 million kroons to Eesti Pank.

### Guarantee Fund

In 2002, Eesti Pank entered into an asset management contract with the Guarantee Fund under which the Guarantee Fund pays a service fee to Eesti Pank for the Fund's asset placement. The item records the service charge for the fourth quarter of 2003, which the Guarantee Fund paid in 2004.

### Loans to the Employees of Eesti Pank

Housing loans secured by real estate have been provided to the staff of Eesti Pank for a maximum of 25 years and consumption loans for up to two years. The Board of Eesti Pank establishes the interest rates on housing and consumption loans by its decision. The interest rate on housing loans is based on the reserves' interest rate Eesti Pank pays to credit institutions, plus a risk margin. The interest rate on consumption loans is comparable to the interest rate charged by Estonian credit institutions under similar conditions. In addition, study loans were granted for a maximum of ten years. Pursuant to the Eesti Pank Act, employees of Eesti Pank and Members of the Board were not allowed to borrow from any other credit institution apart from Eesti Pank before the year 2002.

## ITEM 5 – SHARES

Shares held by Eesti Pank:

	Balance as at 31.12.2003		Balance as at 31.12.2002	
	Holding percentage	EEK thousand	Holding percentage	EEK thousand
<b>Total</b>		<b>73</b>		<b>73</b>
<b>Bank for International Settlements</b>				
200 voting shares	N/A	2	N/A	2
<b>Tallinna Börs (Tallinn Stock Exchange)</b>				
8 shares nominal value à 10,000 EEK	1.1	71	1.1	71

N/A - not available

### Tallinn Stock Exchange (TSE)

Eesti Pank holds eight shares in TSE, amounting to an 1.1% holding.

### Bank for International Settlements (BIS)

Eesti Pank holds 200 voting shares in BIS.

## ITEM 6 – OTHER ASSETS

This item includes various prepayments for services and goods to be provided in 2004, liabilities of the Financial Supervision Authority to Eesti Pank for services provided as well as stocks and other current assets.

## ITEM 7 – FIXED ASSETS

Details of movement in fixed assets during 2003:

EEK thousand

	Buildings	Hardware	Furniture and fixtures	Software	Vehicles	Total
<b>Cost</b>						
Balance as at 31.12.2002	144,303	57,730	73,624	38,764	1,074	315,495
Additions	52,717	6,936	7,027	5,060	–	71,740
Disposals	–	-1,151	-862	–	-521	-2,534
<b>Balance as at 31.12.2003</b>	<b>197,020</b>	<b>63,515</b>	<b>79,789</b>	<b>43,824</b>	<b>553</b>	<b>384,701</b>
<b>Depreciation</b>						
Balance as at 31.12.2002	21,430	39,832	59,504	19,662	841	141,269
Charge for the year	5,290	9,243	6,164	7,007	137	27,841
Disposals	–	-1,151	-797	–	-435	-2,382
<b>Balance as at 31.12.2003</b>	<b>26,720</b>	<b>47,925</b>	<b>64,871</b>	<b>26,669</b>	<b>543</b>	<b>166,728</b>
<b>Net book value</b>						
Balance as at 31.12.2002	122,873	17,898	14,120	19,102	233	174,226
<b>Balance as at 31.12.2003</b>	<b>170,300</b>	<b>15,590</b>	<b>14,918</b>	<b>17,155</b>	<b>10</b>	<b>217,973</b>
<b>Prepayments for fixed assets</b>						
Balance as at 31.12.2002	6,382	–	–	2,121	–	8,503
<b>Balance as at 31.12.2003</b>	<b>372</b>	<b>–</b>	<b>262</b>	<b>895</b>	<b>–</b>	<b>1,529</b>
<b>Total fixed assets</b>						
Balance as at 31.12.2002	129,255	17,898	14,120	21,223	233	182,729
<b>Balance as at 31.12.2003</b>	<b>170,672</b>	<b>15,590</b>	<b>15,180</b>	<b>18,050</b>	<b>10</b>	<b>219,502</b>

The cost of fixed assets acquired in 2003 amounted to 71.7 million kroons. The main item acquired was the extension at Sakala 4/6 taken into use in December. The total cost of the new office building stood at 47.7 million kroons, of which 13.3 million kroons accounted for the costs serving the security requirements of the Bank. The security systems and devices installed provide a guarantee that the Bank is compliant with the requirements established for central banks by the European System of Central Banks. Hardware procurement includes computers, servers, printers, and various accessories. Purchases of furniture and fittings were comprised mostly of office machinery, security devices, and furniture. Software purchases included mainly system software and additional user licences for existing software.

As at the end of 2003, prepayments for fixed assets had been made primarily for the cash accounting system software, security devices, and the design of the gallery joining the buildings of Eesti Pank.

## ITEM 8 – ACCOUNTS OF NON-RESIDENTS

This item includes non-interest-bearing demand deposit accounts held with Eesti Pank by the World Bank and the Nordic Investment Bank and used for facilitating external loans from the above organisations to the Republic of Estonia.

## ITEM 9 – ACCOUNTS OF CREDIT INSTITUTIONS AND OTHER CURRENT LIABILITIES

This item includes the clearing accounts of credit institutions with Eesti Pank. Eesti Pank pays interest on the monthly average balance of credit institutions' deposits held with the central bank. The deposit interest rate of the European Central Bank effective on the last banking day of the accounting month has been imposed by Eesti Pank as the interest rate applied to credit institutions' deposits with the central bank, which in 2003 dropped from 1.75% to 1.0% (see Item 13).

Since the end of 2001 this item reflects also the funds in the account of the Financial Supervision Authority with Eesti Pank, which are made up of supervision fees paid by subjects of financial supervision. No interest was paid on the funds in the Financial Supervision Authority's account in 2003.

## ITEM 10 – OTHER LIABILITIES

This item includes accruals for miscellaneous 2003 expenses for settlements related to economic activities with payment dates in 2004.

This item also includes one-kroon coins issued in 1992, 1993, or 1995, which were withdrawn from circulation on 1 June 1998.

## ITEM 11 – CAPITAL AND RESERVES

Movements in capital and reserves in 2003:

*EEK thousand*

	Balance as at 31.12.2003	Transfers	Appropriation of 2002 profit	Balance as at 31.12.2002
<b>Total</b>	<b>3,228,509</b>	–	<b>456,379</b>	<b>2,772,130</b>
Statutory capital	100,000	–	–	100,000
Reserve capital	500,000	–	–	500,000
Special reserve	2,628,509	3,219	456,379	2,168,911
Revaluation reserve	–	-3,219	–	3,219

According to Section 30 of the Eesti Pank Act, at least 25% of the annual profit must be allocated for increasing both the statutory and reserve capital. After these allocations, part of the profit can be allocated for forming and supplementing endowments and trust funds, based on the decision of the Board of Eesti Pank. The remaining profit is transferred into the state budget.

The revaluation reserve reflects the balance of the revaluation of fixed assets in 1994. In each reporting period the reserve has been decreased by the depreciation of the revaluation that has been transferred to the special reserve. The reserve was also adjusted upon disposal or write-off of revalued assets. In 2003, the revaluation reserve was liquidated and its balance amounting to 3.2 million kroons was transferred into the special reserve.

## ITEM 12 – FOREIGN NET INTEREST INCOME AND SIMILAR ITEMS

This item reflects mainly net income from transactions with government bonds gained in managing Eesti Pank's foreign exchange reserves, including reverse repurchase transactions, gains arising from fluctuations in foreign exchange rates and gold price, interest income from time deposits, income from currency exchange transactions, and dividends.

*EEK thousand*

	<b>2003</b>	<b>2002</b>
<b>Total</b>	<b>440,374</b>	<b>815,018</b>
<b>Income</b>		
Time deposits	8,491	3,872
Securities	302,311	661,096
Reverse repurchase agreements	91,389	121,363
Dividends (BIS shares)	807	809
Foreign currency derivatives	14,114	39,234
Foreign exchange gains	18,647	2,621
Other income	6,898	38
<b>Expenses</b>		
Repurchase agreements	-2,269	-11,867
Other expenses	-14	-2,148

In 2003 the rate of return on net foreign exchange reserves was 2.99%, which was quite precisely in line with the income forecast. Compared to 2002, the principal reason behind the nearly 50% decline in net interest and other net income lies in the considerably more modest fall in interest rates during 2003. In 2002 the rate of return on net foreign exchange reserves was extraordinarily high since the interest rates on two-year government bonds fell extraordinarily heavily in the euro zone – by about 1%. As a result, the prices of bonds in the investment portfolio of Eesti Pank rose on average by about 2% in 2002. Meanwhile the 2003 interest rates fell only by 0.2%, and the average term of the investment portfolio was shorter, which is why the average increase in the value of bonds was approximately 0.2%.

## ITEM 13 – DOMESTIC NET INTEREST INCOME AND SIMILAR ITEMS

This item includes mostly interest expense paid for resources in the clearing accounts of credit institutions and income arising from servicing credit institutions' clearing accounts. The item reflects also the interest earned on the loans to the employees of Eesti Pank.



	<i>EEK thousand</i>	
	<b>2003</b>	<b>2002</b>
<b>Total</b>	<b>-42,064</b>	<b>-62,511</b>
Interest income	2,831	3,325
Interest expense	-1	-
<b>Remuneration of credit institutions deposits and other fees</b>		
Interest expense	-54,303	-72,741
Fees from payment and settlement services	8,401	5,987
Other income	1,333	2,865
Other expense	-325	-1,947

In 2003, net interest expenses and other net expenses decreased by 20.4 million kroons compared to 2002. This resulted mainly from the decline in the interest paid on the clearing accounts of credit institutions after the European Central Bank lowered the interest rates in 2003 (see Item 9). The rise in income from settlement services comes from the increase in the volume of such services.

## ITEM 14 – OTHER OPERATING INCOME

Most other operating income comprises the income for services rendered to the Financial Supervision Authority in the amount of 4.5 million kroons. Based on the cooperation protocol between the Financial Supervision Authority and Eesti Pank, the Financial Supervision Authority reimbursed 50% of the cost of the support services rendered by Eesti Pank by way of monthly payments in 2003. In 2002 Eesti Pank fully covered the costs of support services rendered to the Financial Supervision Authority.

	<i>EEK thousand</i>	
	<b>2003</b>	<b>2002</b>
<b>Operating income</b>	<b>8,062</b>	<b>8,548</b>
Services sold to the Financial Supervision Authority	4,520	-
Income from the sale of commemorative coins and numismatic products	1,080	5,990
Rental income	620	499
Income from the sale of assets	368	717
Other income	1,474	1,342

Most other income in 2003 comprises the sales revenue of the canteen of Eesti Pank and of the publications of Eesti Pank.

Rent income from the training centres of Eesti Pank is recorded under 'Rent Income'. Income from the sale of assets reflects income from the sale of fixed assets and stocks which are not necessary for Eesti Pank.

## ITEM 15 – OPERATING EXPENSES

Compared to 2002, operating expenses increased by 2% in 2003. Compared to 2002, real estate renovation and administrative expenses, training and mission expenses, and administrative expenses of financial assets increased.

The Financial Supervision Authority, an agency with a separate budget, became operational on 1 January 2002. The Financial Supervision Authority and Eesti Pank have signed a cooperation protocol, which defines the

services provided by Eesti Pank to the Financial Supervision Authority and their pricing principles. Eesti Pank provides the Financial Supervision Authority with the following services: information technology, accounting, real estate, and administration services.

The estimated cost of the services provided by Eesti Pank to the Financial Supervision Authority in 2003 was about 9 million kroons in 2002. In 2003, Eesti Pank covered 50% of the costs of services and depreciation related to servicing the Financial Supervision Authority.

*EEK thousand*

	2003	2002
<b>Personnel expenses</b>	<b>-76,945</b>	<b>-68,403</b>
Salaries	-56,181	-49,320
Compensations and benefits	-1,723	-2,035
Social taxes	-18,771	-16,788
Unemployment insurance	-270	-260

In 2003, personnel expenses increased by 12.5% compared to 2002. Personnel expenses include mainly payroll costs together with taxes. One of the main factors behind rising personnel expenses is individual increase in the salaries of the staff in line with significant changes in the structure of positions as well as individual development of the employees. Another major contributor to rising payroll costs was the overall pay rise affecting all staff, which was carried out at the end of 2002 according to the remuneration policy of Eesti Pank.

Compensations and benefits include one-time benefits, pension scheme compensations, and the tax cost of fringe benefits calculated from housing loans. The expenditure on compensations and benefits was lower in 2003 compared to the same period a year before since the lower interest rate imposed by the Minister of Finance reduced the special benefits calculated on the loans to the staff as well as the taxes paid on them.<sup>1</sup>

Eesti Pank had 230 staff members at the end of 2002, while the respective figure was 233 at the end of 2003.

In 2003 Eesti Pank participated in the voluntary pension scheme of its staff and members of the Board of Eesti Pank, contributing the total of 0.6 million kroons under 82 contracts. Compared to 2002, the number of employees who joined the voluntary funded pension system increased by 26. Besides, Eesti Pank pays a special merit pension to two individuals in recognition of their special merits in developing the Estonian monetary and banking system. The special merit pension amounts to 1.6 times the Estonian average monthly wage. In 2003 the costs of the special merit pension stood at 0.2 million kroons.

The cost of producing notes and coins has decreased by 5.6 million kroons in 2003 against 2002. In 2002, 10-sent coins were minted and 25-kroon banknotes were printed to replenish the existing stocks and meet the cash demand. Also commemorative coins dedicated to the tenth anniversary of the reintroduction of the Estonian kroon and to the University of Tartu were minted in 2002. In 2003, 10-sent, 20-sent, and 1-kroon coins were minted.

General administrative expenses have decreased by 5.5 million kroons compared to 2002, mostly due to the decline in IT maintenance costs. Compared to 2002, IT maintenance costs were significantly lower (by about 6.2 million kroons) arising from substantial partial write-off of settlement system software in 2002.

<sup>1</sup> The interest rate stood at 7% since the beginning of 2002; between 9 January 2003 and 30 June 2003 it was 5.7% and as of 1 July 2003, 4%.

Real estate repair and administration expenses have increased by 1.7 million kroons compared to 2002. Meanwhile real estate administrative costs remained at the same level as in 2002.

The growth in training and mission expenses in 2003 has resulted mainly from the increase in the number of business trips. The amount of business trips increased by 52% in 2003 compared to 2002, i.e. by 2.4 million kroons. Business trip expenses are the travel expenses incurred by the officials on assignment, accommodation expenses, subsistence allowances, and participation fees in conferences or seminars. The growth in the number of assignments abroad in 2003 resulted mainly from the significant increase in participation in different committees and working groups of the European System of Central Banks and the European Union. All in all, 66 Bank employees were sent on 164 EU-related assignments, besides, four staff members trained with the European Central Bank in the course of 2–4 months. Mission expenses related to these assignments amounted to 2.6 million kroons.

The principal cost items among other expenses were office expenses totalling 4.2 million kroons, outsourced personnel expenses totalling 1.3 million kroons, and the cost of seminars and events organised by the Bank totalling 2.7 million kroons.

*EEK thousand*

	2003	2002
<b>General and administrative expenses</b>	<b>-65,787</b>	<b>-71,245</b>
Property renovation and administration expenses	-12,610	-10,892
Software maintenance expenses	-9,572	-15,729
Communication and transportation expenses	-3,468	-4,656
Public relations and publications	-5,177	-8,259
Legal and arbitration expenses	-1,413	-1,798
Training and business travel expenses	-9,942	-7,916
Foreign exchange reserve management expenses	-12,761	-9,591
Miscellaneous	-10,844	-12,404

## ITEM 16 – EXTRAORDINARY ITEMS AND NET CHANGES IN PROVISIONS

This item includes extraordinary income and expenses as well as income and expenses arising from establishment and reduction of allocations and provisions.

*EEK thousand*

	2003	2002
<b>Extraordinary items and net changes in provisions</b>	<b>47,980</b>	<b>22,684</b>
<b>Extraordinary income</b>	<b>48,050</b>	<b>23,896</b>
Income from sale of Bank for International Settlements shares	45,741	–
Recovery of loans in the deposit with Eesti Ühispank	1,819	288
Recovery of other loans previously provided for	206	–
Income from Sampo Pank's risk assets realisation	–	23,608
Income from allowance of loan portfolio	284	–
<b>Expenses</b>		
Provision against Eesti Pank's loan portfolio	<b>-70</b>	<b>-1,212</b>

In 2001, Eesti Pank re-sold 500 non-voting shares to the BIS in line with the decision of the General Meeting of the BIS and earned 82 million kroons on that transaction. The decision of the General Meeting of the BIS was

contested in the Hague Arbitral Tribunal by three former private shareholders. The tribunal ruled in favour of the General Meeting in its final decision regarding repurchase of the shares and recognised that the decision was compliant with the mandate of the BIS as an international organisation standing for public interests, but ruled that the BIS would have to increase the compensation for the shares paid to former owners. According to the ruling, the BIS paid Eesti Pank an additional 4.5 million Swiss francs on the 500 shares, which have been recorded as an extraordinary item in 2003 in addition to the revenue received in 2001.

In 2003, the total of 1.8 million kroons accrued from recovering bad debts, and a contract termination fee was paid into Eesti Pank's deposit account with AS Eesti Ühispank, which has been recorded as an extraordinary item. At the end of 2003 the agreement on claims and the deposit agreement were bilaterally terminated (see Item 4).

Based on the generally accepted accounting principles and in order to reflect the loans issued by Eesti Pank as fairly and objectively as possible, a loan portfolio provision of Eesti Pank was set up (see 'Provision Against Loans and Other Claims') in 2002. Due to the decline in the risk rates of housing and consumer loans in 2003 the loan provision of the Bank was reduced by 0.3 million kroons. Due to the rise in study loans the respective provision was raised by 70,000 kroons.

Most of the changes related to allocations in 2002 arose from terminating the risk asset agreement with Sampo Pank, as a result of which 23.6 million kroons were recorded as income in 2002.

## ITEM 17 – PROFIT DISTRIBUTION

In 1999, the Board of Eesti Pank approved the Profit Distribution Strategy for three years. The strategy is based on the principle of avoiding too rapid shrinking of Eesti Pank's own capital and net foreign currency reserve against key economic indicators before joining the European Monetary Union.

Having evaluated the Profit Distribution Strategy in April 2003, the Board of Eesti Pank resolved to continue with the strategy and transfer 145 million kroons from the net profit of 2002 into the national budget and 456 million kroons into the special reserve fund.

## ITEM 18 – DERIVATIVES

The contract value of outstanding foreign exchange swaps used for risk hedging in managing the currency reserve amounted to 3.3 billion kroons at the end of 2003. The swaps matured in early 2004. The contract value of forward transactions amounted to 677 million kroons at the end of 2003, and they matured at the beginning of 2004. The contract value of future transactions was 295 million kroons at the end of 2003 and they also matured in early 2004.

*EEK thousand*

Derivatives	Contract amount	Market value	
		Assets	Liabilities
<b>Total as at 31.12.2002</b>	<b>4,640,044</b>	<b>85,867</b>	<b>-12,432</b>
Foreign currency forwards	400,282	13,224	-12,416
Foreign currency swaps	4,105,818	72,680	-16
Futures transactions	133,944	-37	-
<b>Total as at 31.12.2003</b>	<b>4,298,407</b>	<b>99,523</b>	<b>-32,736</b>
Foreign currency forwards	677,157	25,604	-22,422
Foreign currency swaps	3,326,350	72,203	-10,075
Futures transactions	294,900	1,716	-239

## ITEM 19 – CONTINGENCIES

	<i>EEK thousand</i>	
	<b>Balance as at 31.12.2003</b>	<b>Balance as at 31.12 2002</b>
<b>Contingent liabilities</b>	<b>10,598</b>	<b>102,951</b>
Guarantee to the European Investment Bank	–	84,864
Uncalled share capital (75%) of BIS	9,035	10,875
Contracts of printing banknotes and minting coins	1,563	7,212

### Guarantees to the European Investment Bank

On 27 November 1995, Eesti Pank, the European Investment Bank, and AS Eesti Investeerimispank entered into an agreement on renewing debt commitments while Eesti Pank and the European Investment Bank concluded an agreement on guaranteeing loans amounting to 10 million euros, maturing in 2006. The guarantee agreement between Eesti Pank and the European Investment Bank was terminated ahead of schedule in 2003.

### Bank for International Settlements (BIS)

Since 1930 Eesti Pank has a contingent liability to the Bank for International Settlements regarding the uncalled share capital (75%) of BIS denominated in Swiss gold francs, being equivalent to 9.0 million kroons as at 31 December 2003 (see Item 5).

### Printing of Banknotes and Minting of Coins

At the end of 2003 the contractual liabilities of Eesti Pank for printing banknotes and minting coins in 2004 reached 1.6 million kroons (7.2 million kroons at the end of 2002).

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& Touche**

### INDEPENDENT AUDITORS' REPORT

To the Board and the Management of Eesti Pank:

We have audited the annual accounts of Eesti Pank ("the Bank") for the year ended 31 December 2003. These annual accounts are the responsibility of the Bank's Management. Our responsibility is to express an opinion on these annual accounts based on our audit.

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

In our opinion, the annual accounts of the Bank present fairly, in all material respects, the financial position of the Bank as at 31 December 2003 and the result of its operations for the year then ended, in accordance with the Law of the Central Bank of the Republic of Estonia, the Statutes of Eesti Pank and the accounting principles adopted by the Bank.



Veiko Hintsov  
Certified auditor



Villu Vaino  
Certified auditor

*Deloitte & Touche*

AS Deloitte & Touche Audit  
25 March 2004

**Deloitte  
Touche  
Tohmatsu**