Contents

Organisation, governance and activities

This chapter presents an overview of the internal organisation and governance of the BIS. It also reviews the activities of the Bank, and of the international groups it hosts, over the past year. These activities focus on the promotion of cooperation among central banks and other financial authorities, and on the provision of financial services to central bank customers.

Organisation and governance of the Bank

The Bank, its management and shareholders

The Bank for International Settlements is an international organisation that fosters international monetary and financial cooperation and serves as a bank for central banks. Its head office is in Basel, Switzerland, and it has two representative offices, one in the Hong Kong Special Administrative Region of the People's Republic of China and one in Mexico City. The Bank currently employs 549 staff from 44 countries.

The BIS fulfils its mandate by acting as:

- a forum to promote discussion and facilitate decision-making among central banks and within the international financial and supervisory community;
- a centre for economic and monetary research;
- a prime counterparty for central banks in their financial transactions; and
- an agent or trustee in connection with international financial operations.

The Bank has three main departments: the Monetary and Economic Department, the Banking Department and the General Secretariat. These are supplemented by the Legal Service, Internal Audit and Risk Control units, and the Financial Stability Institute, which fosters the dissemination of standards and best practices to financial sector supervisors worldwide.

The Bank also hosts the secretariats of a number of committees and organisations that focus on the promotion of financial stability. The committees are the Basel Committee on Banking Supervision, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems and the Markets Committee. They were established by the Governors of the G10 central banks over the course of the past 40 years and enjoy a significant degree of autonomy in setting their agendas and structuring their activities.

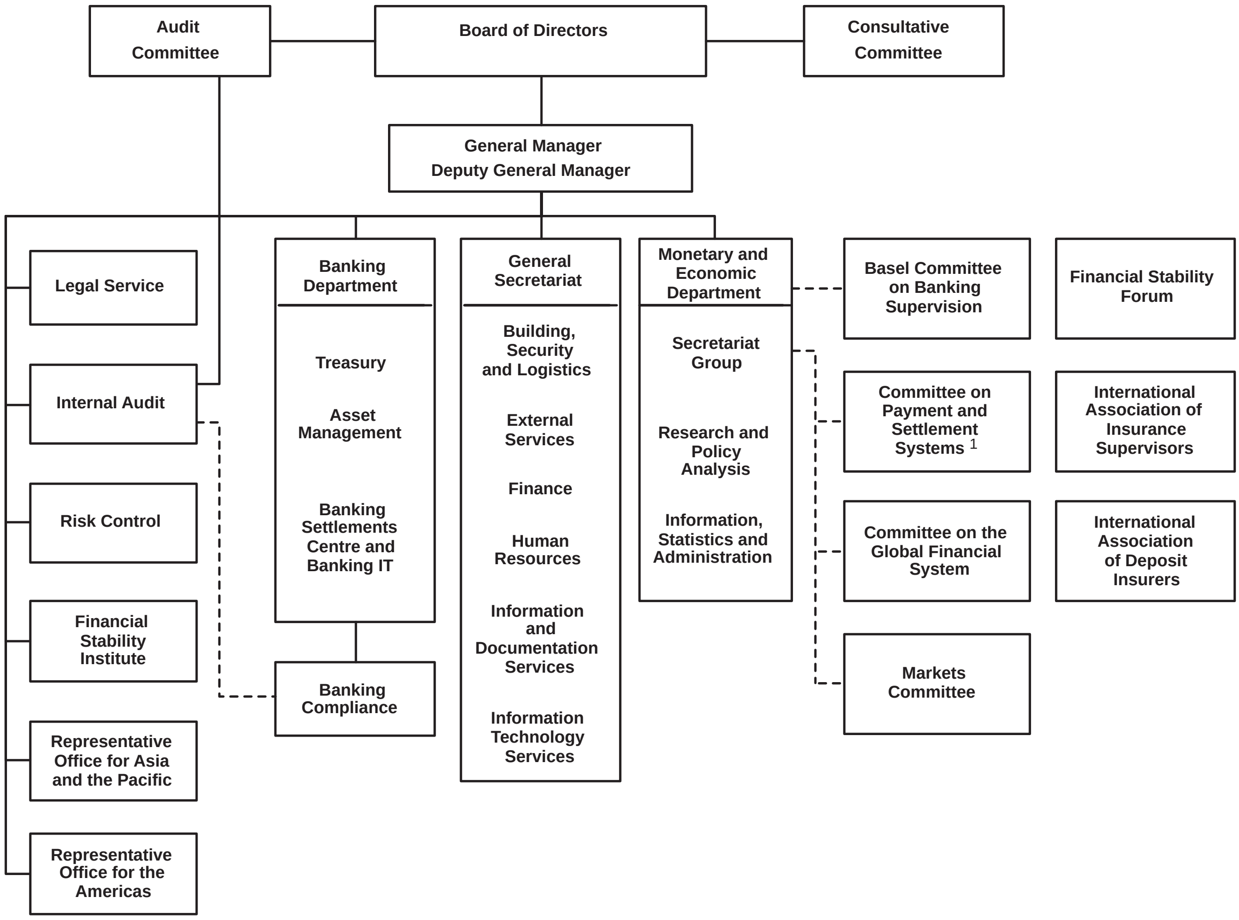
Other secretariats located at the Bank serve independent organisations with no direct reporting link to the BIS or its member central banks: the Financial Stability Forum, the International Association of Insurance Supervisors and the International Association of Deposit Insurers.

The three most important decision-making bodies of the Bank are:

- the General Meeting of member central banks. Fifty-five central banks or monetary authorities currently have rights of voting and representation at General Meetings. The Annual General Meeting is held within four months of the end of the Bank's financial year, 31 March, and is the occasion for the largest BIS gathering of central banks. In 2003, 104 central banks were represented, 79 at Governor level. Delegates from 20 international institutions also attended;
- the Board of Directors. Currently, the Board comprises 17 members. In performing its tasks, the Board is assisted by the Audit Committee and the Consultative Committee, composed of selected Directors; and
- the Management Committee, made up of senior Bank officials.

Member central banks, Directors and senior officials, and recent changes in the composition of the Board and Management are listed at the end of this chapter.

Organisation chart as of 31 March 2004



1 The CPSS secretariat also acts as secretariat for the Central Bank Counterfeit Deterrence Group.

Promotion of international financial and monetary cooperation: direct contributions of the BIS during 2003/04

Regular consultations on monetary and financial matters

The meetings of Governors and senior officials of member central banks that are held every two months represent the primary instrument through which the Bank seeks to promote international financial cooperation. The bimonthly gatherings, held principally in Basel, provide an opportunity to take the pulse of the world economy and financial markets, and to exchange views on topical issues of central bank interest or concern. The November 2003 bimonthly meeting was hosted by the Bank of Thailand in Bangkok.

Trends and forces that have shaped recent developments in global markets (discussed in the other chapters of this *Annual Report*) dominated the discussions of Governors during their regular meetings at the BIS. The Global Economy Meeting was the main forum for exchanges of views on the current state of the economic cycle among the central bank Governors of the main industrial and emerging market economies. Related conjunctural themes, as well as issues pertaining to the work of the permanent central bank committees hosted by the BIS, were addressed in the meetings of the central bank Governors of the G10 countries.

As in earlier years, Governors of all BIS member central banks participated in a set of meetings which focused on issues of a more structural nature related to monetary and financial stability. Over the period under review, the principal themes discussed were:

- European monetary integration: policy challenges for central Europe
- Housing prices: implications for monetary policy and financial stability
- Resisting exchange rate appreciation and accumulating reserves: what are the consequences for the domestic financial system?
- Resilience of financial markets and institutions: what has changed?
- Have fiscal rules failed? Implications for central banks

In January 2004, a new meeting of Governors was created to accommodate the specific needs of the group of central banks of emerging market economies and smaller industrial countries. A primary objective is to provide briefings on the activities of the various committees in whose deliberations these central banks are not directly involved. In addition, these meetings will serve as a forum for discussing issues of specific relevance to this group. Three briefings on committee activities were organised in early 2004. The first focused on a study by the Committee on the Global Financial System on foreign direct investment in the financial sector of emerging market economies. The second briefing reported on the work of the Basel Committee on Banking Supervision towards the completion of the new capital adequacy framework ("Basel II"). The third briefing covered the activities of the Committee on Payment and Settlement Systems.

Governors also had further opportunities to meet with senior representatives of the private financial sector and other financial authorities. These informal discussions focused on the shared interests of the public and private sectors in the promotion of sound and well functioning financial markets.

During the year under review, they highlighted in particular the implications for the financial system of the growth of credit risk transfer instruments.

Outside the framework of the bimonthly meetings of Governors, the Bank organises various other meetings, on a regular or ad hoc basis, for senior central bank officials on topics of monetary and financial stability. Regular meetings held during 2003/04 were:

- the biannual central bank economists' meetings. The October 2003 meeting explored the challenges that central banks face in an environment of low and comparatively stable inflation, structural supply side improvements and liberalised financial markets;
- working parties on domestic monetary policy. Originally focused exclusively on the larger industrial countries, these meetings are now also organised each year in Asia, central and eastern Europe, and Latin America; and
- the meeting of Deputy Governors of emerging market economies, which this year considered the implications of financial market globalisation for monetary policy.

Two ad hoc meetings on issues of special topical interest were organised. In June 2003, on the occasion of the Bank's Annual General Meeting, Governors from emerging market economies convened to discuss possible policy responses to external financing difficulties. In Mexico City in September, senior central bankers from small open western hemisphere economies held a roundtable discussion dealing with a broad range of policy issues of relevance to central banks.

Other areas of central bank cooperation promoted by the BIS

Research activities

In addition to providing background material for meetings of senior central bankers and secretariat services to committees, the BIS contributes to international monetary and financial cooperation by carrying out its own in-depth research and analysis of issues of interest to central banks and, increasingly, financial supervisory authorities. This work finds its way into the Bank's regular publications, such as the *Annual Report* and *Quarterly Review*, and into its *BIS Papers* and *Working Papers* series, as well as external publications such as professional journals. The deepening of links with the academic world through joint research and conferences has been important in improving the quality of this work and in catalysing further relevant study.

This research activity inevitably covers a very broad spectrum, but a specific longer-term orientation, recently established, emphasises three key areas that the BIS feels deserve special attention:

- the relationship between monetary and financial stability;
- the tensions and complementarities that arise between approaches to financial stability that focus on individual institutions and those that focus on the financial system as a whole; and
- market functioning more generally.

During the past year, the BIS's publications included a number of articles examining hypotheses about the changing interaction between monetary stability, financial stability and the business cycle. They helped lay out a broad conceptual framework that considers the relationship between micro- and macroprudential approaches to securing financial stability. Furthermore, the articles explored attempts to measure changing risk aversion and its influence on market dynamics, and the determinants of market liquidity, especially under stress. Cutting across some of these themes, several pieces of work addressed the determinants and implications of the behaviour of real estate prices.

In addition to strengthening its visiting academics programme, the BIS organised a number of conferences to further develop contacts with the academic community. In spring 2003, it hosted a conference on "Monetary stability, financial stability and the business cycle". In October 2003, together with the Federal Reserve Bank of Chicago, the Bank organised a conference on market discipline, exploring the theoretical underpinnings and the existing evidence for its effectiveness, across both countries and industries. Finally, in June 2004, a conference was held on understanding low inflation and deflation.

Cooperation in the statistical area

The regular monitoring of global economic, monetary and financial developments requires that central banks have available up-to-date, comprehensive and internationally comparable statistical data. The BIS assists in a number of ways in this area.

Through the BIS Data Bank, central banks share with one another an extensive set of economic, monetary and financial data on an ongoing basis. Last year, three more central banks became members of the Data Bank, which now covers 33 countries in all major regions of the world. The topical coverage of the Data Bank also continued to expand, with additional focus on macroprudential indicators, financial accounts data and real estate prices.

The Data Bank infrastructure is used by the BIS to exchange its international financial statistics with central banks in electronic formats. Last year, the number of central banks reporting aggregate national data on the international lending and borrowing activities of the internationally active banks in their jurisdiction grew to 38. The BIS aggregates these data into global statistics and publishes them in its *Quarterly Review* and on its website. These statistics are complemented by quarterly statistics on international claims of domestically owned banks on a worldwide consolidated basis which are now reported by 30 central banks.

The central banks of the G10 countries, whose banks are active players in the over-the-counter (OTC) derivatives markets, collect, compile and publish aggregate data on these markets through the BIS every six months. In response to recommendations by the Committee on the Global Financial System, the BIS and reporting central banks last year developed guidelines for extending these statistics to include data on credit default swaps. Data collection will begin at the end of this year and initial global results will become available in late spring 2005.

Following an agreement to conduct another triennial survey of foreign exchange and derivatives markets, a record 52 central banks undertook to collect data on the turnover in these markets in April 2004 as well as data on amounts outstanding at end-June 2004. The BIS plans to publish the preliminary global aggregate results of the turnover part of the survey in September, and data on amounts outstanding in November 2004.

Apart from providing technical support and assisting with control over data quality for the Data Bank and international financial statistics, BIS staff also share their methodological expertise with the central banks, either on a bilateral basis or by participating in various international statistical meetings. In the context of the preparation of the IMF's *Compilation Guide on Financial Soundness Indicators*, the BIS co-sponsored with the Fund a conference on real estate prices and financial stability in October 2003. An increasingly important forum is the Irving Fisher Committee on Central-Bank Statistics, which includes more than 60 central banks from around the world. In September 2004, the BIS will host a conference of this Committee that will look at statistical issues relating to prices, output, productivity and financial accounts.

The BIS is also an active member of the Inter-Agency Task Force on Finance Statistics, which last year finalised its *Guide for Compilers and Users of External Debt Statistics*. At the end of 2003, the Task Force agreed to create a Joint External Debt Hub. This exercise will link the data on various components of external debt available from, amongst others, the BIS international financial statistics with the detailed data that debtor countries will henceforth begin publishing.

Further steps have been taken to strengthen international cooperation on electronic standards for statistical information exchange. The Statistical Data and Metadata Exchange (SDMX) initiative, in which the BIS works together with the ECB, Eurostat, IMF, OECD, UN and the World Bank, has made significant progress. The SDMX website (www.sdmx.org) provides information about these efforts, including a demonstration of how new web-based technologies can improve the collection, compilation and dissemination of statistics. A new technical forum within the framework of the BIS Data Bank will provide a means for coordinating central bank requirements and priorities for SDMX.

Central bank governance

The objective of the BIS's activities in the area of central bank governance is to compile, analyse and disseminate information on institutional and organisational matters of interest to central banks. This output is non-prescriptive, recognising that the specific mandates and powers of central banks differ across the globe. The Central Bank Governance Steering Group oversees the work, which is conducted through the Network on Central Bank Governance. The Governance Steering Group comprises Governors from a broadly based and representative range of central banks. The Network spans more than 40 major central banks and monetary authorities around the world.

The Governance Steering Group provides guidance to the Bank on how best to respond to the varied needs of central banks for governance information and discusses topical questions of interest to Governors. During the past year the Governance Steering Group discussed such issues as how central banks organise their financial stability function; how they strike a balance between the efficiency and effectiveness of central bank operations; and how they prepare and implement strategic plans. In keeping with the advice of the Governance Steering Group, the Bank accords priority to requests from central banks that are critical for the effective operation of independent and accountable monetary authorities. The information that Network members and their colleagues provide is made available electronically to central banks.

Group of Computer Experts of the G10 central banks

During 2003 the Group of Computer Experts paid particular attention to issues related to improving IT organisational performance and reducing costs. It examined approaches such as the use of outsourcing, departmental reorganisation and the development of business strategy-compatible IT roadmaps, and discussed the effectiveness of cost reduction initiatives. A highlight for the Group was a workshop in Mexico City with Latin American and Caribbean central bank IT managers which focused on technological challenges, cost control and the alignment of IT with business strategies.

Discussions during the meetings of the Group and its Working Party on Security Issues in 2003 indicated that central banks are moving to major internet-based applications for the use of their external customers. Such initiatives require sophisticated security architectures and infrastructure, including public key infrastructure (PKI) technology. Reflecting this trend, the Working Party updated the Group on the evolution of PKI technology and its use in central banks. The Working Party's report showed that PKI remains a complex technology and its use entails a significant administrative overhead. Nevertheless, the discussions indicated that this burden will be readily accepted by central banks as long as there is a clear business need for the security it provides. Other topics of special interest to the Working Party during the year related to working procedures to ensure efficient and secure use of internet e-mail and to the effective implementation of business continuity measures, made more pertinent by the SARS outbreak and by power outages in North America and Italy.

Internal Audit

Over recent years, central bank internal auditors have met regularly to share experience in their area of expertise, and to explore new and challenging issues. In June 2003, the BIS participated in the 17th Annual Conference of G10 Heads of Internal Audit, hosted by the Deutsche Bundesbank and the ECB. The main topics for discussion included developing an audit approach to the operational risk management process and auditing corporate governance and IT governance. A working party on IT issues, hosted by the BIS's Internal Audit unit, prepared papers on remote access to internal computer systems, penetration testing of firewalls and methods to ensure the security of computer operating systems. The Bank's Internal Audit unit also coordinated the work of an ad hoc G10 task force on auditing business continuity management.

In February 2004, Internal Audit, together with the BIS's Asian Office, organised in Hong Kong SAR the third Meeting of Heads of Internal Audit of Asian and Pacific Central Banks and Monetary Authorities. Topics included better practices for internal audit management and enterprise risk management.

Cooperation with central bank groupings

Since 1990, the BIS has been helping the central banks of the major industrialised countries coordinate the technical assistance and training they provide to central banks of transition economies in central and eastern Europe and the former Soviet Union. A review by the G10 Governors during 2003 confirmed that this process had been very useful and that many countries in these regions were "graduating" from transition. Nevertheless, it was felt that in order to consolidate the gains, the coordination exercise should continue for another few years, albeit on a less intensive basis.

The BIS and its Financial Stability Institute (FSI) again organised a number of seminars at the Joint Vienna Institute (JVI) for central banks and supervisors from transition economies. Topics discussed related primarily to monetary and financial stability. Given progress in the region and following the establishment of the FSI, the BIS will cease to participate formally in the JVI as from August 2004. However, it will continue both to provide speakers and to organise occasional seminars.

Cooperation with various regional central bank groupings offers a useful platform for disseminating information on BIS activities and for establishing relations with central banks that do not otherwise participate directly in these activities. In this spirit, the Bank organised a number of joint events with regional groups. They included:

- a number of meetings with South East Asian Central Banks (SEACEN) to which the BIS contributed several speakers;
- a seminar with SAARCFINANCE, a body of the South Asian Association for Regional Cooperation which supports central bank cooperation in the region;
- a joint meeting with the central banks of the Southern African Development Community (SADC) in early 2004;
- occasional joint events with the Centro de Estudios Monetarios Latinoamericanos (CEMLA). The BIS also provides speakers for CEMLA seminars and workshops.

The BIS continued to support the Centre Africain d'Études Supérieures en Gestion (CESAG), within a programme sponsored by, amongst others, the Central Bank of West African States (BCEAO) and the Bank of Central African States (BEAC). A number of BIS experts were also made available for training events run by the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI).

Representative Offices

The Representative Offices for Asia and the Pacific (Asian Office) and for the Americas (Americas Office) serve as the centres for BIS activities in their respective regions. The Offices aim to promote strong relations and foster cooperation between the BIS and the central banks and monetary and supervisory authorities in the respective regions. As part of their activities, the Offices seek to improve the exchange of information and data, facilitate the organisation of meetings and seminars, and contribute to the Bank's financial and economic research on Asia-Pacific and the Americas. Research topics last year included trends in regional capital flows, the domestic implications of large foreign exchange reserves, and the impact of free trade agreements on common currency arrangements. The Offices also provide expertise for various BIS events, including those organised by the FSI, regional central banking groups, individual central banks and other entities.

The Offices support BIS banking services in Asia-Pacific and the Americas, and provide assistance to reserve managers of central banks through regular visits. A regional treasury dealing room established in the Asian Office in 2000 has further enhanced the level and scope of banking services to customers in the region.

During the period under review, the *Asian Office* continued to serve as the secretariat for the Asian Consultative Council (ACC), which is a key channel for communication between regional BIS member banks and the Board and Management of the BIS. The Office's dealing room broadened the Bank's regional investments during the year. Starting in July 2003, when 11 central banks of the Executives' Meeting of East Asia-Pacific Central Banks and Monetary Authorities (EMEAP) agreed to invest about $1 billion of foreign exchange reserves in an Asian Bond Fund, the BIS became the portfolio manager and the dealing room executed most of the purchases. The Regional Treasury also hosted two seminars for reserve managers, one in Penang, Malaysia in October 2003 and another in Hong Kong SAR in March 2004.

During the year, the Asian Office hosted and supported a series of high-level meetings in Hong Kong and elsewhere, sometimes jointly with regional central banks and other institutions:

- In June 2003, together with the Bank of Thailand, and again in December, the Office supported the EMEAP Forum of regional and global officials responsible for implementation of foreign exchange policy.
- In December 2003 and March 2004 respectively, economists from the Office organised with Korea University a workshop in Hong Kong and a conference in Seoul on Asian bond markets. The meetings brought together central bankers, finance officials, market practitioners and academics.
- The sixth Special Meeting of Asian central bank Governors took place in Hong Kong in February 2004. The meeting included a review of the current economic situation and an assessment of the motivations for accumulating official foreign exchange reserves.
- Also in February, the Office joined the FSI and the Bank of Thailand in hosting a conference on weak banks and systemic crises, featuring a comparative study of asset management companies in the region.
- Finally, in February the Office was the venue for a meeting of central bank internal auditors organised by the BIS. It also co-hosted with the Hong Kong Monetary Authority a meeting of central bank legal experts.

Extensive contacts with central banks in the region as well as close cooperation with regional supervisory authorities were the hallmark of the activities of the *Americas Office* during its first full year of operation. The Office, which was inaugurated in Mexico City in November 2002, hosted or co-organised a number of meetings for senior central bank officials:

- In September 2003, the Office hosted a special meeting for regional small open economies in Mexico City, attended by senior representatives of nine central banks.
- In December 2003, the Office supported the meeting of the G10 Group of Computer Experts and the workshop for IT managers from regional central banks in Mexico City.
- In February 2004, the Office, in collaboration with headquarters, organised a BIS Americas Reserve Management Seminar with the participation of 17 regional central banks, three European central banks and the Latin American Reserve Fund.

Financial Stability Institute

The mandate of the Financial Stability Institute (FSI) is to help strengthen financial systems and institutions worldwide, primarily by improving prudential supervision. The FSI fulfils this mandate through an intensive programme designed to disseminate standards and best practices, and by providing assistance on a broad range of key supervisory topics.

Much of the work of the FSI continues to be related to the new capital adequacy framework ("Basel II"). In line with this emphasis, the Institute recently conducted a survey of around 120 countries to help identify their current plans for the implementation of Basel II, as well as their needs for capacity building. This survey will provide guidance in developing a comprehensive plan for delivering future FSI support.

The FSI continued its programme of high-level meetings and seminars, both in Basel and at regional venues, for banking and insurance sector supervisors around the world. These gatherings serve the important purpose of fostering cross-border supervisory contacts and cooperation. Over the past year, the FSI organised a total of 55 events on a wide variety of topics. More than 1,600 representatives of central banks and banking and insurance supervisory agencies from all regions of the world participated. In addition to speaking at FSI events, Institute staff also made presentations on a broad range of similar topics at various non-FSI conferences and meetings.

An important new project is FSI Connect – an online information and learning resource that is being developed specifically to support large numbers of banking supervisors. FSI Connect will be launched in mid-2004 and will offer courses on important risk management topics, such as credit, market and operational risk management, and on capital adequacy (including Basel II). Tutorials on a full range of other banking supervisory topics will be added continuously. FSI Connect is designed for supervisors at all levels of experience and expertise. Subject matter experts at the FSI are developing the course content, working closely with other specialists from the BIS as well as with a network of experts in financial supervisory authorities and international organisations. FSI Connect is envisaged as a strong complement to the FSI's existing activities and will enable the Institute to reach a wider audience of financial sector supervisors globally.

Promotion of financial stability through the permanent committees

Basel Committee on Banking Supervision

During the year under review, the Basel Committee on Banking Supervision, chaired by Jaime Caruana, Governor of the Bank of Spain, further pursued its efforts to strengthen the prudential supervision of banking institutions, enhance transparency in financial reporting and encourage banking industry advances in risk management.

A new international capital standard

The Committee's efforts over this past year centred on the resolution of the issues related to the development of a new international framework for regulatory capital standards (widely known as "Basel II"). Other supervisors and the global banking industry have made a significant contribution to the Committee's efforts, with over 200 organisations responding to the third consultative paper released in April 2003. The vast majority of responses indicated broad support for Basel II's structure, its incentives to encourage improvements in risk management, and its leveraging of supervisory review and mechanisms of market discipline to ensure the maintenance of adequate bank capital.

The remaining concerns identified during this process were the technical specification of internal measurement methods, including the treatment of unexpected versus expected credit-related losses and of exposures arising from securitisation transactions, and the recognition of certain practices and techniques for measuring and managing credit or operational risk. These topics formed most of the agenda for the Committee and its working groups during the year. By autumn 2003, the Committee had found potential solutions to many of the most significant concerns; details were published in three separate technical papers in January 2004. At a meeting in early May 2004, the Committee resolved the remaining outstanding technical matters, such as the regulatory capital treatment of undrawn lines for revolving retail credit. The full text of the new framework will appear by the end of June 2004. This text will provide a basis for national rule-making and approval processes to continue and for banking organisations to complete their processes for implementation. It is intended that Basel II will be applied in member countries from year-end 2006, although the most advanced approaches will be subject to one further year of impact analysis and/or parallel running. These approaches will be introduced at year-end 2007.

In view of these advances, the Committee's focus has been shifting towards readying supervisors and the banking industry for the implementation of the revised capital adequacy framework. In that vein, the Committee's Accord Implementation Group (AIG) has served as a forum for supervisors to discuss practical issues and to share information on implementation efforts. To help promote consistency in the application of Basel II to internationally active banking organisations, the AIG published in August 2003 *High-level principles for the cross-border implementation of the New Accord*, and in January 2004 *Principles for the home-host recognition of AMA (advanced measurement approach) operational risk capital*. Furthermore, the AIG has sought to enhance the Committee's relationships with other supervisors, having held three meetings with supervisors from the major non-Committee member countries. It is currently coordinating a number of case studies of global banks by their principal supervisors (including several from non-member countries).

Work on accounting, auditing and compliance

The renewed public discourse on corporate governance sparked by recent reports of business fraud has highlighted the importance of sound accounting and auditing standards for the integrity of open markets. While the Committee does not set standards for its members on accounting and auditing, it recognises that transparent financial reporting helps to promote greater discipline and ultimately strengthens the soundness of the banking system. To encourage efforts under way to enhance banks' reporting, and to assess the current state of such disclosures, the Committee published in May 2003 its periodic survey of banks' public disclosures. This time it reviewed the annual reports issued by 54 banks.

The Committee recognises the concurrent need for supervision to build on the emerging foundation of global standards for the accounting and auditing professions. To support these developments, the Committee contributes to the work of the advisory boards of the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB). The Committee has likewise sought to provide guidance to supervisors and banks on emerging financial standards and has invited comment from accounting and auditing standard-setting bodies on its own projects that address related areas.

Recent events have demonstrated the substantial potential losses and the damage to their reputations that organisations may face when they fail to adhere to robust reporting, accounting and auditing standards. For banks, such risks emphasise the need to ensure compliance with all relevant legal, regulatory and accounting standards, as well as with policies set by their own boards of directors and senior managers. To this end, in August 2003 the Committee issued a consultation draft that addressed the need for banks to assess their "know your customer" policies on a global basis in order to reduce the risk of their networks becoming involved in money laundering and/or terrorist financing. This was followed by a consultative paper in October outlining supervisors' expectations for banks' compliance functions.

Other issues in banking and supervision

Over the course of the past year, the Committee discussed and published several papers on other issues in banking and supervision. It released in final form two reports related to electronic or online finance, *Risk management principles for electronic banking* and a related paper on the management and supervision of such activities when they take place across national borders. It also published for comment a revised paper, *Principles for the management and supervision of interest rate risk*. This takes account of advances in risk management practices as well as comments on proposals for the supervision of interest rate risk in the third consultative paper on the new capital adequacy framework.

Committee on the Global Financial System

The Committee on the Global Financial System (CGFS) is a central bank forum with a mandate to identify and assess potential sources of stress in global financial markets, to further the understanding of the functioning and underpinnings of financial markets, and to promote the development of well functioning and stable financial markets. The Committee is chaired by Roger W Ferguson Jr, Vice Chairman of the Board of Governors of the Federal Reserve System.

Monitoring discussions focused on a number of salient developments in financial markets over the year. These included the volatility in financial markets around the middle of 2003, from which the Committee sought to draw lessons about the dynamics of interest rate adjustments in financial markets. The implications for financial stability of the low interest rate environment were also examined. The Committee discussed the extent to which this might be contributing to rising asset prices in the fixed income, equity and housing markets, as well as to the very sharp narrowing in both corporate and sovereign spreads in credit markets. The large accumulation of foreign exchange reserves and its implications for a number of financial markets also attracted significant attention.

As part of its effort to understand the functioning and underpinnings of financial markets, the CGFS published in March 2004 a working group report, *Foreign direct investment in the financial sector of emerging market economies*. The report explores the issues that foreign direct investment raises for investing institutions, home and host countries, and the global financial system. Follow-up regional workshops will be conducted in Korea, Mexico and Poland. The CGFS also discussed the characteristics of various national mortgage markets. As background to these discussions, a case study of the Danish mortgage market was prepared. The study was published in the March 2004 issue of the *BIS Quarterly Review*.

CGFS members also met with senior executives of a number of major financial conglomerates in order to gain a better understanding of how changes in the character of decision-making, for example with regard to risk management and capital allocation, might affect the performance of the financial system as a whole.

Work is now under way on the role of ratings in the rapidly evolving markets for structured finance instruments. The working group on this issue, which was established in May 2003, is seeking inter alia to document the ratings processes in structured finance markets and to determine the implications of the growth in structured finance for central banks, given their responsibilities in the area of financial stability.

Following on from the Committee's work on credit risk transfer – a report was published in January 2003 – a template for collecting data on credit default swaps was completed. It is envisaged that reporting arrangements will be similar to those used in the BIS semiannual OTC derivatives survey, with information being made available on notional amounts outstanding and market values, the character of the risks being transferred, and the institutional identity of risk-takers and risk-shedders.

Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) contributed to the strengthening of the financial market infrastructure by promoting sound and efficient payment and settlement systems. During the year, the Committee enhanced its cooperation with other international institutions and groupings. Tommaso Padoa-Schioppa, Member of the Executive Board of the ECB, chairs the Committee.

In August 2003, the CPSS published a report, *The role of central bank money in payment systems*. The use of central bank money is part of the underlying issue of the balance between the services provided by central banks and those provided by commercial banks in the payment system. In view of the widespread and fundamental changes in payment systems that have taken place over the past decade or so, and which continue today, the report investigates whether an appropriate balance between the use of central bank and commercial bank money is being maintained.

The report shows that there is much common ground among CPSS central banks in their objectives, as well as in the main tenets of their policy concerning the role of central bank money in payment systems. However, there are often differences when it comes to the implementation of policy. In setting out both the similarities and the differences, the report aims to provide a useful factual base and a strong analytical framework that will raise awareness and stimulate debate on these key matters.

In March 2004, the CPSS and the Technical Committee of the International Organization of Securities Commissions (IOSCO) released a consultative report on *Recommendations for Central Counterparties*. A well designed central counterparty (CCP) with appropriate risk management arrangements reduces the risks faced by its participants and contributes to the goal of financial stability. At the same time, it concentrates risks and responsibilities for risk management. Therefore, the effectiveness of a CCP's risk control and the adequacy of its financial resources are critical aspects of the infrastructure of the markets it serves. In the light of moves by financial markets to develop CCPs and expand the scope of their services, the report sets out recommendations for management of the major risks that CCPs face. It also includes a methodology for assessing implementation of the recommendations. The final report is expected to be published later this year.

The Committee continued to monitor global developments in electronic money products and the policy issues they may raise. Since payments made using the internet and mobile phones have recently advanced quite rapidly, compared with e-money, the CPSS decided to include these innovative methods of payment in its *Survey of developments in electronic money and internet and mobile payments*, published in March 2004. The survey provides information on e-money products and internet and mobile payments in 95 countries or territories, as well as on the policy stance adopted by the various authorities concerned, including central banks.

An important part of the Committee's work remains devoted to the implementation of its strategy, endorsed by the G10 Governors, to reduce foreign exchange settlement risk. To this end, it continued to monitor and encourage private sector initiatives in this area.

The CPSS also pursued its efforts to further enhance its cooperation and extend its work with central banks outside the G10, particularly those of emerging market economies. In collaboration with the respective central banks, the Committee's Secretariat assisted in preparing reference studies on payment systems in a number of countries. The Committee also provided support and expertise to workshops and seminars on payment system issues organised by the BIS in cooperation with regional central banking organisations.

Markets Committee

At its regular bimonthly meetings, the Markets Committee focused on developments in the foreign exchange and related financial markets. Following established practice, the Committee, which groups senior officials from the G10 central banks responsible for market operations, also invited representatives from other major countries to join the discussions on a number of occasions. Recurring themes were:

- the impact of current account imbalances on the major exchange rates;
- yield-seeking behaviour in an environment of low interest rates;
- global currency reserve accumulation; and
- the implications of implicit or explicit policy commitments for financial markets.

Over the course of the year, members also discussed a number of specific topics, including the implications of the enlargement of the European Union for monetary union and financial markets, technical issues regarding electronic foreign exchange trading platforms, and possible factors behind recent changes in spot trading volumes across currencies.

Sheryl Kennedy, Deputy Governor of the Bank of Canada, became the Committee's chair in May 2003.

Central Bank Counterfeit Deterrence Group

The Central Bank Counterfeit Deterrence Group (CBCDG) is mandated by the Governors of the G10 central banks to investigate emerging threats to the security of banknotes and to propose countermeasures for implementation by issuing authorities. The BIS supports the work of the CBCDG by hosting its Secretariat and by acting as its agent in contractual arrangements.

In March 2004, the CBCDG announced that it had developed a Counterfeit Deterrence System, consisting of anti-counterfeiting technologies which prevent personal computers and digital imaging tools from capturing or reproducing the image of a protected banknote.

BIS contributions to broader international financial cooperation

Group of Ten

During the year, the Bank contributed actively to the work of the G10 Finance Ministers and central bank Governors, their Deputies and the working groups set up under their auspices. It did this both through its participation as an observer institution and through the provision of secretariat support to these groupings alongside the IMF and OECD.

The G10 continued to review progress on the inclusion of collective action clauses in sovereign bonds. The key features of such clauses had been set out by its Working Group on Contractual Clauses in 2002. In September 2003, G10 Ministers and Governors asked their Deputies to focus on analysing and monitoring the financial exposure of the IMF and other international financial institutions.

Financial Stability Forum

The Financial Stability Forum (FSF) promotes international financial stability through enhanced information exchange and cooperation in financial supervision and surveillance. It brings together on a regular basis national authorities responsible for financial stability, including senior officials of treasuries, central banks and financial supervisory agencies, and senior representatives of international financial institutions, international supervisory or regulatory standard-setting bodies and central bank expert groupings. The FSF Secretariat, which is composed of staff seconded from the Forum's member countries and institutions, is based at the BIS. Further information on the FSF is available at www.fsforum.org.

The principal subjects discussed by the FSF during its biannual meetings are conjunctural developments, structural financial vulnerabilities and the actions needed to address them. The Forum also exchanges opinions on, and promotes coordination of, work under way to strengthen financial systems. It holds regional meetings to foster wider discussion of financial vulnerabilities and to enable regional representatives to comment on its work. In addition, the Forum's Chairman holds regular exchanges of views with private sector participants and other observers on financial stability issues through the FSF Chairman's Advisory Council.

One important theme of recent FSF meetings has been the reforms needed nationally and internationally to restore confidence in the financial reporting framework following recent corporate reporting and accounting scandals. In its initiatives to strengthen market foundations the Forum has sought to promote international and cross-sectoral coherence, including with regard to the role and functioning of credit rating agencies. A notable focus has been on improvements in the audit function, through the establishment of public oversight of national auditors and the audit profession's international standard-setting activities.

The FSF has continued to take an interest in progress to strengthen supervisory, regulatory and information exchange practices in offshore financial centres. Another concern has been to enhance transparency and disclosure in the reinsurance sector. The Forum has continued to call for improvements in the frequency and quantitative and qualitative content of public disclosures by individual reinsurers and insurance companies.

Credit risk transfer (CRT) activities have also been of strong interest to the Forum. This interest stems in part from the different perspectives on CRT activities between bank supervisors, whose concern is whether the risk has been cleanly transferred, and those in charge of investor or policyholder protection, whose entities are frequently buyers of credit risk. Following initial studies by the CGFS and the International Association of Insurance Supervisors (IAIS), a major assessment of the issues and risks involved is now under way in the Joint Forum of the Basel Committee, IOSCO and the IAIS. It is hoped that this effort will offer practical guidance for financial authorities in monitoring market developments and assessing risks at their institutions.

Throughout the year, the FSF continued to inform G7 Finance Ministers and central bank Governors, as well as the IMF's International Monetary and Financial Committee, about its views on financial vulnerabilities and other issues.

International Association of Insurance Supervisors

The International Association of Insurance Supervisors (IAIS) contributes to global financial stability by improving supervision of the insurance industry. It does this through the development of standards for insurance supervision, provision of mutual assistance and exchange of information on members' respective experiences. In collaboration with other international regulatory bodies (in the framework of the Joint Forum), the IAIS has helped develop principles for the supervision of financial conglomerates. Moreover, the IAIS actively participates in the FSF. The BIS has hosted the IAIS Secretariat since its establishment in 1998. More information on the IAIS and its publications is available at www.iaisweb.org.

During the past year, the IAIS issued a number of papers setting out supervisory standards in the insurance area. After considering members' experience in using the Insurance Core Principles in self-assessment exercises, the IAIS revised and expanded its *Insurance Core Principles and Methodology* to offer new guidance for the effective operation of supervisory systems around the world. It also published *Insurance Core Principles on Corporate Governance and a Supervisory Standard on Supervision of Reinsurers*. Ongoing work includes formulating standards, guidelines or issues papers on a broad range of matters related to disclosure, risk management, capital adequacy and supervision of insurers and reinsurers.

In response to concerns within the FSF over potential vulnerabilities in the global reinsurance markets, given the industry's linkages to other sectors, the IAIS presented in March 2004 its final report on developing a framework to enhance the transparency of the global reinsurance market and improve risk-oriented disclosure by individual reinsurance firms.

The IAIS coordinates with the IASB in its work on the Insurance Project and other major accounting projects. In particular, the IAIS provided comments on the IASB's Exposure Draft ED 5 on insurance contracts. The IAIS is also working closely with the Financial Action Task Force on anti-money laundering initiatives and combating the financing of terrorism.

In collaboration with the FSI and national insurance supervisory authorities, the IAIS organised numerous seminars and training programmes and provided training materials for insurance supervisors to help them comply with IAIS supervisory standards.

International Association of Deposit Insurers

The International Association of Deposit Insurers (IADI) was established in May 2002 and opened its Head Office at the BIS in October 2002. Currently, 51 organisations (of which 34 are full members) from around the world are involved in the activities of the IADI, including a number of central banks that have an interest in promoting the adoption or operation of effective deposit insurance systems.

The IADI's objectives are to:

- enhance the understanding of common interests and issues related to deposit insurance;
- set out guidance to increase the effectiveness of deposit insurance systems, inter alia by providing practitioner-focused and non-prescriptive advice on the establishment or enhancement of such systems;
- facilitate the sharing and exchange of expertise and information through training, development and educational programmes; and
- undertake research on issues relating to deposit insurance.

During its second year, the IADI continued to provide a forum to facilitate wider international contacts among deposit insurers and other interested parties. The second IADI Conference, held in Seoul, Korea in October 2003, was attended by policymakers from 52 countries. The main conference theme was effective deposit protection through enhanced governance arrangements. The Association also completed a major study on factors related to the design of deposit insurance systems in a number of countries and developed guidance on the use of differential premium systems.

Regional activities included committee meetings in Asia and the Caribbean. The IADI also participated in the APEC Policy Dialogue on Deposit Insurance organised by the Canada Deposit Insurance Corporation and hosted by the Central Bank of Malaysia in February 2004. In addition, the IADI collaborated with the European Bank for Reconstruction and Development on a deposit insurance seminar for policymakers from western Balkan countries.

The IADI website (www.iadi.org) and a monthly newsletter provide information on activities to members and participants. The IADI has also issued a training guide, which it has circulated widely amongst deposit insurers.

Financial services of the Bank

Banking services

The BIS offers a wide range of financial services to assist central banks and other official monetary institutions in the management of their foreign reserves. Some 140 customers, including various international financial institutions, currently make use of these services.

BIS financial services are provided out of two linked trading rooms: one at its Basel headquarters and one at its Asian Office in Hong Kong SAR. Safety and liquidity are the key features of the Bank's credit intermediation services, which are supported by a strong internal risk management framework. In accordance with best practice, a separate risk control unit reporting directly to the Deputy General Manager – and through him to the General Manager – monitors the Bank's credit exposure, liquidity, and market and operational risks.

The BIS constantly seeks to adapt its product range to respond more effectively to the evolving needs of central banks. The Bank's standard range of money market investments includes sight/notice accounts and fixed-term deposits. In response to an increasing focus by central banks on improving the return on their foreign assets, the Bank offers two financial instruments that can be traded (bought and sold back) directly with it:

- the Fixed-Rate Investment at the BIS (FIXBIS) is a highly flexible money market product that allows central banks to manage their liquidity more actively;
- the BIS Medium-Term Instrument (MTI), with maturities of up to 10 years, is targeted at central banks with longer-term reserve management objectives. Recently, the BIS launched an MTI with an embedded call feature.

The Bank also transacts foreign exchange and gold on behalf of its customers.

The BIS provides asset management services in sovereign securities or high-grade assets. These may take the form of either a specific portfolio mandate negotiated between the BIS and a central bank or an open-end fund structure allowing two or more customers to invest in a common pool of assets. In July 2003, the 11 members of the EMEAP group of central banks and monetary authorities launched the Asian Bond Fund (ABF), an investment pool with subscriptions totalling just over $1 billion. The Fund is managed by the BIS and tracks a customised benchmark comprising sovereign and quasi-sovereign issuers of the EMEAP economies (excluding Australia, Japan and New Zealand).

The BIS from time to time extends short-term credits to central banks, usually on a collateralised basis. It also acts as trustee and collateral agent (see below).

Operations of the Banking Department in 2003/04

The BIS balance sheet expanded by SDR 18.3 billion to close the financial year at SDR 167.9 billion on 31 March 2004. This represented a year-on-year increase of 12.2% and a fourth consecutive new record for the end of a financial year. The growth of the balance sheet would have been even greater but for the depreciation of the US dollar against the SDR. Had exchange rates remained constant throughout the year, the total would have increased by an additional SDR 3.9 billion.

During the early part of the financial year, the balance sheet fell, but a significant inflow of customer deposits brought the total to a high of SDR 159.6 billion towards the end of July 2003. A decline over the subsequent months was later reversed before the balance sheet reached successive new highs between November 2003 and end-March 2004. An all-time record of SDR 171.7 billion was registered on 12 March, followed by a modest contraction during the last two weeks of the financial year.

Liabilities

A major portion of the BIS's balance sheet liabilities comprises deposits received from its customers, most of which are denominated in various currencies, with the remainder in gold. On 31 March 2004 these deposits (excluding repurchase agreements) totalled SDR 140.4 billion, compared with SDR 128.5 billion at the end of the previous financial year.

Customer currency deposits rose to SDR 133.2 billion, from SDR 122.5 billion at the previous financial year-end. The currency composition of deposits underwent a marked shift during the financial year 2003/04. At 31 March 2004 the US dollar accounted for 62.4% of currency deposits, a decline from 67.1% a year earlier. Whilst customers increased their deposits at the BIS in all major reserve currency denominations, placements in non-dollar currencies, particularly euros and sterling, grew at a much faster rate than those in dollars. However, the expansion in gold deposits, from SDR 6.0 billion to SDR 7.3 billion, was mainly due to valuation factors (the rise in the market price of gold) as the underlying level of deposits received from central banks remained relatively unchanged.

The SDR 10.6 billion expansion in customer currency deposits was attributable to growth in cash account balances and tradable money market instruments. Balances on sight/notice accounts almost doubled during the course of the financial year and subscriptions to FIXBIS expanded by 11.1%. In contrast, placements in BIS fixed-term deposits declined by 8.3%. Taken together, these developments possibly reflect a shift towards liquidity in the expectation of a rising interest rate environment. Outstanding subscriptions to MTIs remained little changed at SDR 41.2 billion compared with SDR 41.7 billion the previous year. This constituted the single largest deposit instrument held by BIS customers, accounting for almost one third of total currency deposits.

A geographical breakdown of placements of currency deposits with the BIS indicates that demand from Asia was particularly strong during the period under review.

Assets

BIS assets for the most part take the form of investments with top-quality commercial banks of international standing and government and quasi-government securities, including reverse repurchase agreements. The Bank manages its credit exposure conservatively; 99.6% of its holdings are rated A or higher as at 31 March 2004 (see note 30F to the financial statements).

The Bank's holdings of currency deposits and securities, including reverse repurchase agreements, stood at SDR 153.7 billion on 31 March 2004, compared with SDR 134.7 billion at the previous financial year-end. These additional funds were invested in Treasury bills, time deposits with banks and reverse repurchase agreements, which increased by SDR 28.5 billion to SDR 120.2 billion. On the other hand, there was a SDR 4.3 billion reduction in cash balances and a further reduction of SDR 5.2 billion in debt securities. The Bank's assets in gold rose to SDR 9.1 billion from SDR 7.5 billion over the same period, reflecting the increase in the market value of gold. The share of sovereign and quasi-sovereign securities continued to rise, reaching 38.5% of total assets at 31 March 2004, up from about one third a year earlier.

The BIS uses various derivative instruments in order to manage its assets and liabilities efficiently (see note 6 to the financial statements). For the most part, these derivative instruments are of the plain vanilla variety, in particular futures and interest rate swaps.

Functions as agent and trustee

Trustee for international government loans

The Bank continued to perform its functions as trustee for the funding bonds 1990–2010 of the Dawes and Young Loans during the year (for details, see the *63rd Annual Report* of June 1993). The Deutsche Bundesbank as paying agent notified the Bank that in 2003 the Bundeswertpapierverwaltung (BWV – German Federal Securities Administration) had arranged for payment of approximately €5.2 million for redemption of funding bonds and interest. Redemption values and other details were published by the BWV in the *Bundesanzeiger (Federal Gazette)*.

The Bank maintained its reservations regarding the application by the BWV of the exchange guarantee clause for the Young Loan (stated in detail in its *50th Annual Report* of June 1980), which also extend to the funding bonds 1990–2010.

Escrow agent functions

Under an Escrow Agreement dated 13 August 2003, the BIS acts as escrow agent to hold and release funds, on certain conditions, in connection with the settlement of litigation in the United States between the families of the 270 persons who died in the Pan Am Flight 103 disaster over Lockerbie, Scotland on 21 December 1988 and the various Libyan defendants to that litigation.

Collateral agent functions

Under a number of agreements, the BIS acts as collateral agent to hold and invest collateral for the benefit of the holders of certain foreign currency denominated bonds issued by countries under external debt restructuring arrangements. Current collateral pledge agreements include those for Brazilian bonds (described in detail in the *64th Annual Report* of June 1994), Peruvian bonds (see the *67th Annual Report* of June 1997) and Côte d'Ivoire bonds (see the *68th Annual Report* of June 1998).

Institutional and administrative matters

Membership enlargement

With a view to further strengthening central bank cooperation, the Board of Directors decided on 29 June 2003 to invite an additional six central banks to become members of the Bank in accordance with Articles 6 and 8(3) of the Statutes. The Bank of Algeria, the Central Bank of Chile, Bank Indonesia, the Bank of Israel, the Reserve Bank of New Zealand and the Central Bank of the Philippines were each invited to subscribe 3,000 shares of the third tranche of the capital of the BIS. By the close of the subscription period at end-September 2003, all six central banks had taken up the Board's offer to become members of the BIS.

At its meeting in June, the Board fixed the issue price at SDR 14,018 per share. As the Bank's shares are paid up to the extent of 25%, or SDR 1,250 per share, the issue price of SDR 14,018 included a premium of SDR 12,768 per share. Following the subscription of 18,000 new shares, the number of the Bank's issued shares rose to 547,125, and the paid-up capital of the Bank in the balance sheet increased by SDR 22.5 million to SDR 683.9 million at 31 March 2004. The aggregate premium received from the subscribing central banks amounted to SDR 229.8 million, of which SDR 2.2 million was allocated to the legal reserve fund and SDR 227.6 million to the general reserve fund.

Withdrawal of privately held shares

Following the decision taken by the Extraordinary General Meeting held on 8 January 2001 to withdraw all privately held shares of the BIS (described in detail in the *71st Annual Report* of June 2001), the Bank paid registered former private shareholders compensation in the amount of 16,000 Swiss francs per share. Certain former private shareholders contested this amount (see the *72nd Annual Report* of July 2002) by initiating claims before the Arbitral

Tribunal provided for by the Hague Agreement, which, pursuant to Article 54 of the Bank's Statutes, has sole jurisdiction to hear disputes between the Bank and its former private shareholders arising from the withdrawal. The Arbitral Tribunal issued a partial award on 22 November 2002 confirming the legality of the mandatory repurchase, but nevertheless concluding that the compensation should be increased. It ruled that the former private shareholders were entitled to receive a proportionate share of the net asset value of the Bank, subject, however, to a 30% discount. This formula is equivalent to that which has been applied by the BIS to new central bank subscriptions of shares.

After further proceedings held in the course of 2003, the Arbitral Tribunal rendered its Final Award on 19 September 2003. Pursuant to this award, which is not subject to appeal, the BIS paid to each claimant in the arbitration an amount of additional compensation including interest of 9,052.90 Swiss francs per share. In accordance with its past declaration that it would voluntarily apply the decision of the Arbitral Tribunal to all registered former private shareholders in final settlement of all claims, the Bank has arranged for payment to them of the additional compensation determined by the Arbitral Tribunal. As of 31 March 2004, this additional compensation had been paid in respect of more than 96% of the withdrawn shares.

In a proceeding brought by a separate group of former private shareholders, the Commercial Court in Paris made a preliminary determination (without addressing the substance of the matter) in March 2003 that it has jurisdiction over their claims seeking to increase the amount of compensation. The BIS requested a review of this procedural decision by the Paris Court of Appeals, arguing that the Arbitral Tribunal in The Hague has exclusive jurisdiction over the matter. In a decision rendered on 25 February 2004, the Paris Court of Appeals ruled in favour of the BIS by concluding that the Paris Commercial Court has no jurisdiction over such claims. On 26 April 2004, a number of these claimants initiated a proceeding before the Cour de Cassation (the highest French private-law court) to quash the ruling of the Court of Appeals on the jurisdiction issue.

The Bank's administration

Enhancing transparency

During the year under review, the Bank undertook a number of steps to enhance the transparency of its operations and structure.

In the financial reporting area, the most visible steps were the modernisation of the Bank's accounting policies and the expansion of the information disclosed in the financial statements, which are now more in line with developments in international financial reporting. In addition, the BIS replaced the gold franc as its unit of account on 1 April 2003 with the Special Drawing Right, a basket of currencies defined by the IMF that is representative of the main currencies used in international trade and finance (these changes are described in detail in the *73rd Annual Report* of June 2003). Special attention has also been devoted to presenting a more accurate and comprehensive picture of the Bank's role, how it functions and is managed, and how it contributes to the promotion of international cooperation in the pursuit of both monetary and financial stability.

Budget policy

The process of formulating the Bank's expenditure budget for the next financial year starts about six months in advance with the setting by Management of a broad business orientation and financial framework. Within this context, business areas specify their plans and the corresponding resource requirements. The process of reconciling detailed business plans, objectives and overall resource availability culminates in the determination of a draft financial budget. This must be approved by the Board before the start of the financial year.

In drawing up the budget, a distinction is made between administrative and capital expenditures. Staff remuneration represents about half of the administrative costs. Other major expenditure categories, accounting for between 10 and 15% of administrative spending, are IT and telecommunications expenditures, and charges under the Bank's pensions system. By its nature, capital spending tends to vary significantly from year to year. Most of the Bank's administrative and capital expenditure is incurred in Swiss francs.

Administrative expenses before depreciation during the financial year 2003/04 amounted to 204.3 million Swiss francs, 5.0% below the budget of 215.1 million Swiss francs.[2] Costs for the year were reduced by the cancellation or postponement of certain building and IT projects, by curtailed travel and meeting activities resulting from the SARS outbreak and the extension of the timetable for the approval of the new capital adequacy framework ("Basel II"), and by the decline of the US dollar against the Swiss franc. Capital expenditure, at 19.7 million Swiss francs, was 11.0 million below budget: expenditure on some IT projects, in particular for the Bank's FSI Connect e-learning project and the replacement of hardware, was slower than anticipated.

In March 2004, the Board approved an increase in the administrative budget for the financial year 2004/05 of 2.2% to 219.8 million Swiss francs. The capital budget foresees an increase of 1.9 million Swiss francs to 32.6 million. The emphasis in the 2004/05 budget is on strengthening the Bank's risk management capabilities, on efforts to improve security arrangements, and on refurbishment of space for central bank meetings.

Remuneration policy

The jobs performed by BIS staff members are assessed on the basis of a number of objective criteria, including qualifications, experience and responsibilities, and are classified into distinct job grades. Regular salary surveys are conducted in which BIS salaries are compared with salaries paid in comparable institutions or market segments. These comparisons take into

[2] The Bank's budgetary accounting is cash-based and excludes certain financial accounting adjustments, principally relating to retirement benefit obligations, which take into account financial market and actuarial developments. These additional factors are included under "Operating expense" in the profit and loss account (see "Net profit and its distribution").

account differences in the taxation of salaries of the staff of the surveyed institutions. When applying the market data to BIS salaries, the Bank focuses on the upper half of market salaries in order to attract highly qualified staff.

The job grades are associated with salary ranges that are adjusted annually for the rate of inflation in Switzerland and the average rise in real salaries in the business sector of major industrial countries. In July 2003, the salary ranges were accordingly increased by 2.02%. Movements of salaries of individual staff members within each salary range are based on merit, subject to a regular evaluation of performance. The BIS does not apply a bonus scheme.

Non-Swiss and non-locally hired staff, including senior management, are entitled to an expatriation allowance. This currently amounts to 14% or 18% of annual salary depending on family status. In addition, BIS staff members have access through the Bank to health insurance and a defined benefit contributory pension plan.

With regard to the remuneration of senior management, the salaries of Heads of Department are adjusted annually, normally in line with the increase in the staff salary ranges. The salaries of the General Manager and the Deputy General Manager are reviewed periodically by the Board. As of 1 July 2003, the remuneration of senior managers was as follows (number of function holders in parentheses):

- General Manager (1) 670,740 Swiss francs
- Deputy General Manager (1) 566,500 Swiss francs
- Heads of Department (3) 536,700 Swiss francs

The Annual General Meeting approves the remuneration of members of the Board of Directors, with adjustments taking place every three years. Since 1 July 2002, the overall fixed annual remuneration paid to the Board of Directors has totalled 844,800 Swiss francs. In addition, Board members receive an attendance fee for each Board meeting in which they participate. Assuming the full Board is represented in all Board meetings, the annual total of these attendance fees amounts to 777,240 Swiss francs.

Net profit and its distribution

Net profit

The 74th financial year is the first in which the Bank has prepared its financial statements in SDR terms following the change in the unit of account on 1 April 2003. At the same time and more importantly for the longer term, the Bank has taken the opportunity to enhance its accounting policies and disclosure. This brings the annual financial statements more in line with developments in international financial reporting and provides a better picture of the Bank's financial position and performance. The principal change in the revised accounting policies, as announced in the *73rd Annual Report*, is that the Bank's financial instruments, including derivatives and gold holdings, are shown in the financial statements at their market values instead of at amortised historical cost. The accounting policies are disclosed in note 2 to the financial statements, and their financial impact for the year ended on 31 March 2003 is detailed in note 31.

The net profit for the year on the new accounting basis amounted to SDR 536.1 million, compared with the equivalent figure for the preceding year of SDR 592.8 million. The factors behind this outcome are discussed below.

Total operating income

Total operating income amounted to SDR 564.5 million in the financial year 2003/04, below the level of SDR 598.3 million in the previous year. Lower average interest rates in key financial markets than those prevailing in the previous financial year reduced income from the Bank's investment securities, which are financed by the Bank's equity. This outweighed the additional income from the growth in the volume of the Bank's equity during the year. Lower income from investment securities was partly offset by higher net income from the Bank's deposit-taking business, which grew broadly in line with the increase in currency deposits. Overall intermediation margins, after taking into account valuation movements, were similar to those in 2002/03.

Operating expense

Operating expense (see note 23 to the financial statements) amounted to SDR 142.5 million, 0.1% above the preceding year's figure of SDR 142.3 million. Administrative expense before depreciation was SDR 125.6 million, 1.6% below last year's figure of SDR 127.6 million. In terms of Swiss francs, the currency in which most of the Bank's expenditure is incurred, administrative expense before depreciation fell by 4.4% from 247.6 million Swiss francs to 236.5 million Swiss francs. These figures include the additional financial accounting adjustments, principally relating to retirement benefit obligations, referred to earlier under the heading "Budget policy".

Staff remuneration costs decreased slightly because reimbursement of income taxes on Swiss employees ended following the implementation on 1 January 2003 of a revised Headquarters Agreement with the Swiss Federal Council. Excluding this factor, staff remuneration rose broadly in line with the 3.4% increase in average full-time equivalent headcount to 509. Pension costs fell by 32.7 million Swiss francs to 30.2 million Swiss francs, since the charge for the previous financial year included a one-off payment of 33.9 million Swiss francs to the staff pension fund. Other staff-related expenses increased by 21.5 million Swiss francs, principally as a result of higher charges for post-retirement benefit obligations under the Bank's health and accident insurance scheme.

The depreciation charge increased from SDR 14.7 million to SDR 16.9 million and includes additional depreciation of SDR 3.3 million following an impairment review of the market value of the Bank's buildings.

Operating profit and other profit items

As a result of the foregoing factors, operating profit was SDR 422.0 million in 2003/04, 7.5% below the level of SDR 456.0 million in the preceding year.

In an environment of lower average interest rates, the profit on sales of investment securities in the portfolios financed by the Bank's equity amounted to SDR 154.4 million, compared to gains of SDR 147.0 million in 2002/03.

The charges disclosed under the heading "Shares repurchased – impact of arbitral award" relate to the Final Award of the Hague Arbitral Tribunal of 19 September 2003, which resulted in a higher compensation price per share, as well as additional interest payable and a currency translation loss from the retranslation of the compensation provision from Swiss francs into SDRs at the exchange rate of 19 September 2003.

Proposed distribution of the net profit for the year

On the basis of Article 51 of the Statutes, the Board of Directors recommends that the net profit of SDR 536.1 million for the financial year 2003/04 be applied by the General Meeting in the following manner:

1. SDR 104.0 million in payment of a dividend of SDR 225 per share;
2. SDR 86.4 million to be transferred to the general reserve fund;
3. SDR 20.5 million to be transferred to the special dividend reserve fund; and
4. SDR 325.2 million, representing the remainder of the available net profit, to be transferred to the free reserve fund. This fund can be used by the Board of Directors for any purpose that is in conformity with the Statutes.

The Board of Directors has proposed that the above-mentioned dividend be declared for the first time in SDRs, the Bank's new unit of account, instead of in Swiss francs. If approved, it will be paid on 2 July 2004 in any constituent currency of the SDR, or in Swiss francs, to the shareholders whose names were contained in the Bank's share register on 31 March 2004.

As regards the level of the dividend, the preceding financial year's dividend of 400 Swiss francs was equivalent to SDR 214.8 at the exchange rate ruling on 31 March 2003. The proposed dividend of SDR 225 per share for 2003/04 therefore represents a 4.7% increase over the dividend for 2002/03.

The dividend will be paid on 470,073 shares (the dividend payable in respect of the 18,000 new shares which were issued during the financial year being settled on a pro rata basis according to the relevant value date of subscription). The number of issued and paid-up shares before the repurchase of shares is 547,125. Of these shares, 77,052 are held in treasury, comprising 74,952 shares repurchased from former private shareholders and central banks, and 2,100 other shares. No dividend will be paid on treasury shares.

Allocation of changes to the Bank's statutory reserves at 31 March 2003

Revaluations

The introduction of the SDR and the new accounting policies increased the Bank's statutory reserves at 31 March 2003 by SDR 577.2 million. The increase resulted from the revaluation of the Bank's gold and the financial instruments in the balance sheet from their amortised historical cost to their market values. The Board of Directors recommends that this increase (see note 31C to the financial statements) be applied in the following manner:

1. SDR 19.3 million to the legal reserve fund;
2. SDR 266.5 million to the general reserve fund;
3. SDR 291.4 million to the free reserve fund.

The transfers to the legal and general reserve funds relate to the revaluation adjustments to the market value of gold from its former statutory value, $208 per ounce. They leave the balance on the legal reserve fund at 10% of the paid-up capital, in accordance with Article 51(1) of the Statutes. The transfer to the free reserve fund represents the net revaluation surplus of the Bank's financial instruments (other than its own gold and investment securities) from their amortised historical cost to their market value.

Reclassifications

In addition, certain items in the Bank's equity have been reclassified as a result of the changes mentioned above. These reclassifications reduced the Bank's statutory reserves at 31 March 2003 by a net amount of SDR 49.8 million (see note 31B to the financial statements). The Board of Directors recommends that this net reduction be applied as follows:

1. SDR 92.1 million to be transferred to the free reserve fund from share capital;
2. SDR 429.7 million to be transferred to the free reserve fund from the valuation difference account;
3. SDR 571.6 million to be transferred from the free reserve fund to the gold revaluation reserve account.

The transfer from share capital represents the rounding down of the nominal value of the Bank's shares from its precise converted amount of SDR 5,696 to SDR 5,000, and is in accordance with the resolution passed by the Extraordinary General Meeting of 10 March 2003. The transfer of SDR 429.7 million is the transfer of the balance at 31 March 2003 on the valuation difference account, which has been closed following the change in the Bank's accounting policy for currency translation differences. The transfer to the gold revaluation reserve account within the heading "Other equity accounts" represents the excess of the market value of the Bank's own gold over its former statutory value at 31 March 2003.

Report of the auditors

The Bank's financial statements have been duly audited by PricewaterhouseCoopers AG, who have confirmed that they give a true and fair view of the Bank's financial position at 31 March 2004 and the results of its operations for the year then ended. The report of the auditors is to be found immediately following the financial statements.

Board of Directors

Nout H E M Wellink, Amsterdam
Chairman of the Board of Directors,
President of the Bank

Hans Tietmeyer, Frankfurt am Main
Vice-Chairman

Vincenzo Desario, Rome
David Dodge, Ottawa
Antonio Fazio, Rome
Toshihiko Fukui, Tokyo
Timothy F Geithner, New York
Sir Edward George, London
Alan Greenspan, Washington
Hervé Hannoun, Paris
Lars Heikensten, Stockholm
Mervyn King, London
Christian Noyer, Paris
Guy Quaden, Brussels
Jean-Pierre Roth, Zurich
Alfons Vicomte Verplaetse, Brussels
Axel A Weber, Frankfurt am Main

Alternates

Bruno Bianchi or Giovanni Carosio, Rome
Roger W Ferguson or Karen H Johnson, Washington
Peter Praet or Jan Smets, Brussels
Jürgen Stark or Stefan Schönberg, Frankfurt am Main
Marc-Olivier Strauss-Kahn or Michel Cardona, Paris
Paul Tucker or Paul Fisher, London

Subcommittees of the Board of Directors

Consultative Committee
Audit Committee

both chaired by Hans Tietmeyer

Senior officials

Malcolm D Knight	General Manager
André Icard	Deputy General Manager
Gunter D Baer	Secretary General, Head of Department
William R White	Economic Adviser, Head of Monetary and Economic Department
Robert D Sleeper	Head of Banking Department
Mario Giovanoli	General Counsel
Günter Pleines	Deputy Head of Banking Department
Peter Dittus	Deputy Secretary General
Már Gudmundsson	Deputy Head of Monetary and Economic Department
Josef Tošovský	Chairman, Financial Stability Institute

Changes among the Board of Directors and senior officials

On 1 July 2003, Mervyn King succeeded Sir Edward George as Governor of the Bank of England and became an ex officio Director of the Board of Directors. To replace Lord Kingsdown, who resigned as a member of the Board at end-June 2003, Mr King appointed Sir Edward George from 1 July 2003 for the unexpired period of Lord Kingsdown's term of office, ie until 6 May 2005. At the Board Meeting in June 2003, Hans Tietmeyer was elected to replace Lord Kingsdown as Vice-Chairman of the Board for the unexpired period of Mr Tietmeyer's term of office, ie until 31 December 2005. At the same meeting, the Board re-elected Nout Wellink, President of the Netherlands Bank, as a member of the Board for a further period of three years, expiring on 30 June 2006.

On 10 June 2003, William McDonough relinquished his membership of the Board. Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, appointed Jamie Stewart, Acting President of the Federal Reserve Bank of New York, as a member of the Board. When Mr Stewart relinquished his membership of the Board in December 2003, Mr Greenspan appointed Timothy F Geithner, the new President of the Federal Reserve Bank of New York, for the unexpired period of Mr Stewart's term, ie until 12 September 2006.

At its meeting in September 2003, the Board re-elected Toshihiko Fukui, Governor of the Bank of Japan, and David Dodge, Governor of the Bank of Canada, as members of the Board for a further period of three years, ending on 12 September 2006.

In October 2003, Jean-Claude Trichet, Governor of the Bank of France, reappointed Hervé Hannoun as a member of the Board of Directors for a further period of three years, expiring on 27 November 2006. On 1 November 2003, Christian Noyer succeeded Jean-Claude Trichet as Governor of the Bank of France and became an ex officio Director of the Board of Directors.

At its meeting in March 2004, the Board re-elected Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, for a further period of three years, ending on 31 March 2007.

On 27 April 2004, Ernst Welteke resigned from his post as the President of the Deutsche Bundesbank. Axel Weber succeeded him on 30 April and became an ex officio Director of the Board of Directors from that date.

As regards the senior officials of the Bank, Renato Filosa relinquished his position as Manager in the Monetary and Economic Department (MED) in August 2003. Már Gudmundsson was appointed Deputy Head of MED as from 23 June 2004.

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The Board noted with deep regret the death of Rémi Gros on 10 January 2004 at the age of 73. Mr Gros joined the Bank in 1966 and became Head of the Banking Department in 1985. From February 1992 until his retirement in December 1995, he was also the Bank's Assistant General Manager.

BIS member central banks[3]

Bank of Algeria

Central Bank of the Argentine Republic

Reserve Bank of Australia

Austrian National Bank

National Bank of Belgium

Central Bank of Bosnia and Herzegovina

Central Bank of Brazil

Bulgarian National Bank

Bank of Canada

Central Bank of Chile

The People's Bank of China

Croatian National Bank

Czech National Bank

National Bank of Denmark

Bank of Estonia

European Central Bank

Bank of Finland

Bank of France

Deutsche Bundesbank

Bank of Greece

Hong Kong Monetary Authority

National Bank of Hungary

Central Bank of Iceland

Reserve Bank of India

Bank Indonesia

Central Bank & Financial Services Authority of Ireland

Bank of Israel

Bank of Italy

Bank of Japan

The Bank of Korea

Bank of Latvia

The Bank of Lithuania

National Bank of the Republic of Macedonia

Central Bank of Malaysia

Bank of Mexico

Netherlands Bank

Reserve Bank of New Zealand

Central Bank of Norway

Central Bank of the Philippines

National Bank of Poland

Bank of Portugal

National Bank of Romania

Central Bank of the Russian Federation

Saudi Arabian Monetary Agency

Monetary Authority of Singapore

National Bank of Slovakia

Bank of Slovenia

South African Reserve Bank

Bank of Spain

Sveriges Riksbank

Swiss National Bank

Bank of Thailand

Central Bank of the Republic of Turkey

Bank of England

Board of Governors of the Federal Reserve System

[3] In accordance with Article 15 of its Statutes, the Bank's capital is held by central banks only. The legal status of the Yugoslav issue of the capital of the BIS is currently under review following the constitutional changes in February 2003 which transformed the Federal Republic of Yugoslavia into the State Union of Serbia and Montenegro, with two separate central banks.

Financial statements

as at 31 March 2004

Following the introduction of the SDR as the Bank's reporting currency, the Bank has updated and expanded its accounting policies and disclosures.

The financial statements on pages 192 to 213 have been prepared on this revised basis; they were approved on 10 May 2004.

Nout H E M Wellink President	Malcolm D Knight General Manager

The financial statements for the financial year ended 31 March 2004 are presented in a form approved by the Board of Directors pursuant to Article 49 of the Bank's Statutes.

Balance sheet

As at 31 March 2004

SDR millions	Notes	**2004**	2003 as restated
Assets			
Cash and sight accounts with banks	3	18.9	4,300.7
Gold and gold deposits	4	9,073.8	7,541.9
Treasury bills	5	30,240.7	20,724.5
Securities purchased under resale agreements	5	21,835.2	12,255.0
Time deposits and advances to banks	5	68,162.4	58,728.2
Government and other securities	5	33,483.1	38,732.6
Derivative financial instruments	6	3,321.1	3,966.1
Accounts receivable	7	1,609.6	3,173.9
Land, buildings and equipment	8	190.0	196.4
Total assets		**167,934.8**	149,619.3
Liabilities			
Currency deposits	9	133,152.5	122,519.0
Gold deposits	10	7,293.5	6,022.6
Securities sold under repurchase agreements	11	1,225.3	73.2
Derivative financial instruments	6	4,339.7	3,234.1
Accounts payable	12	12,169.4	8,242.3
Other liabilities	13	144.4	598.9
Total liabilities		**158,324.8**	140,690.1
Shareholders' equity			
Share capital	14	683.9	661.4
Statutory reserves		8,230.8	7,522.7
Profit and loss account	31	536.1	575.4
Less: shares held in treasury	14, 15	(852.6)	(739.1)
Other equity accounts		1,011.8	908.8
Total equity		**9,610.0**	8,929.2
Total liabilities and equity		**167,934.8**	149,619.3

Note 31 describes the impact on the 2003 financial statements of the change in the Bank's reporting currency from the gold franc to the SDR and the Bank's revised accounting policies.

Profit and loss account

For the financial year ended 31 March 2004

SDR millions	Notes	**2004**	2003 as restated
Interest income	18	3,493.9	4,135.2
Interest expense	19	(2,681.1)	(3,228.9)
Net valuation movements	20	(258.7)	(314.3)
Net interest income		**554.1**	592.0
Net fees and commissions income	21	1.4	1.7
Net foreign exchange gains	22	9.0	4.6
Total operating income		**564.5**	598.3
Operating expense	23	(142.5)	(142.3)
Operating profit		**422.0**	456.0
Net gains/(losses) on sales of investment securities	24	154.4	147.0
Shares repurchased – impact of arbitral award	15		
Interest expense		(32.9)	(10.2)
Currency translation loss		(7.4)	–
Net profit for the financial year		**536.1**	592.8

The net profit for the financial year ended 31 March 2003 shown above has been translated using average rates of exchange. It differs from the balance on the profit and loss account (SDR 575.4 million) shown in the restated 2003 balance sheet, which is based on year-end rates of exchange. This difference is attributable to the change in the Bank's reporting currency from the gold franc to the SDR.

Statement of proposed profit allocation

For the financial year ended 31 March 2004

SDR millions	**2004**
Net profit for the financial year	**536.1**
Transfer to legal reserve fund	–
Proposed dividend:	
SDR 225 per share on 452,073 shares	(101.7)
On 18,000 newly issued shares (pro rata as from the value date of share subscription)	(2.3)
	(104.0)
Proposed transfers to other reserves:	**432.1**
General reserve fund	(86.4)
Special dividend reserve fund	(20.5)
Free reserve fund	(325.2)
Profit after allocation to reserves	–

The proposed profit allocation is in accordance with Article 51 of the Bank's Statutes.

Movements in the Bank's statutory reserves

For the financial year ended 31 March 2004

						2004
SDR millions	Notes	Legal reserve fund	General reserve fund	Special dividend reserve fund	Free reserve fund	Total statutory reserves
Equity at 31 March 2003 – as restated	31	**66.1**	**2,379.7**	**105.3**	**4,971.6**	**7,522.7**
Allocation of 2002/03 profit		–	41.4	4.2	432.7	478.3
New shares issued	14	2.2	227.6	–	–	229.8
Balance at 31 March 2004 per balance sheet before proposed profit allocation		**68.3**	**2,648.7**	**109.5**	**5,404.3**	**8,230.8**
Proposed transfers to reserves		–	86.4	20.5	325.2	432.1
Balance at 31 March 2004 after proposed profit allocation		**68.3**	**2,735.1**	**130.0**	**5,729.5**	**8,662.9**

Movements in the Bank's equity

For the financial year ended 31 March 2004

							2004	2003
SDR millions	Notes	Share capital	Statutory reserves	Profit and loss	Shares held in treasury	Other equity accounts	Total equity	Total equity as restated
Equity at 31 March 2003 – as restated	**31**	**661.4**	**7,522.7**	**575.4**	**(739.1)**	**908.8**	**8,929.2**	8,569.0
Payment of 2002/03 dividend		–	–	(97.1)	–	–	(97.1)	(81.9)
Allocation of 2002/03 profit		–	478.3	(478.3)	–	–	–	–
Shares repurchased – impact of arbitral award	15	–	–	–	(113.5)	–	(113.5)	(196.1)
New shares issued	14	22.5	229.8	–	–	–	252.3	–
Net valuation movements on investment securities	5	–	–	–	–	(158.7)	(158.7)	303.9
Net valuation movements on own gold holdings	4	–	–	–	–	261.7	261.7	17.3
Currency translation movement	31	–	–	–	–	–	–	(275.8)
Net profit for the financial year		–	–	536.1	–	–	536.1	592.8
Balance at 31 March 2004 per balance sheet before proposed profit allocation		**683.9**	**8,230.8**	**536.1**	**(852.6)**	**1,011.8**	**9,610.0**	8,929.2
Proposed dividend		–	–	(104.0)	–	–	(104.0)	
Proposed transfers to reserves		–	432.1	(432.1)	–	–	–	
Balance at 31 March 2004 after proposed profit allocation		**683.9**	**8,662.9**	**–**	**(852.6)**	**1,011.8**	**9,506.0**	

Statutory reserves include share premiums of SDR 811.7 million.

Notes to the financial statements

1. Introduction

The Bank for International Settlements (BIS, "the Bank") is an international financial institution which was established pursuant to the Hague Agreements of 20 January 1930, the Bank's Constituent Charter and its Statutes. The headquarters of the Bank are at Centralbahnplatz 2, 4002 Basel, Switzerland. The Bank maintains representative offices in Hong Kong, Special Administrative Region of the People's Republic of China (for Asia and the Pacific) and in Mexico City, Mexico (for the Americas).

The objectives of the BIS, as laid down in Article 3 of its Statutes, are to promote the cooperation of central banks, to provide additional facilities for international financial operations and to act as trustee or agent for international financial settlements. Fifty-six central banks are currently members of the Bank. Rights of representation and voting at General Meetings are exercised in proportion to the number of BIS shares issued in the respective countries. The Board of Directors of the Bank is composed of the Governors of the central banks of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States of America, as well as appointed directors from six of those countries.

These financial statements incorporate the balance sheet and profit and loss account, as required by Article 49 of the Bank's Statutes.

2. Significant accounting policies

A. Reporting currency

With effect from 1 April 2003, the reporting currency of the Bank is the Special Drawing Right (SDR) as defined by the International Monetary Fund (IMF).

Prior to 1 April 2003 the Bank's reporting currency was the gold franc (GF). The change in reporting currency was made to assist in managing the Bank's operations and economic capital efficiently and to enhance the transparency of its financial statements.

The SDR is calculated from a basket of major trading currencies according to Rule O–1 as adopted by the Executive Board of the IMF on 29 December 2000 and effective 1 January 2001. As currently calculated, one SDR is equivalent to the sum of USD 0.577, EUR 0.426, JPY 21 and GBP 0.0984. The composition of this currency basket is subject to review every five years by the IMF.

All figures in these financial statements are presented in SDR millions unless otherwise stated.

B. Changes in accounting policies and disclosures

In parallel with the introduction of the SDR as the Bank's reporting currency, the Bank has reviewed its accounting policies and aligned them more closely with its business operations. As a result, a number of changes in accounting policies and disclosures have been put into effect as from 1 April 2003. These changes better reflect and give more information on the Bank's financial position and performance, and are summarised below.

Balance sheet recognition of financial instruments

In order to reflect the increasingly market-related nature of the Bank's operations, most financial instruments are included in the balance sheet on a trade date basis at their market values. Derivative financial instruments are reflected on both sides of the balance sheet at their gross market values. The exceptions to this general rule are listed below in the notes entitled "Financial instruments (other than gold and gold deposits)" and "Gold and gold deposits". In prior years, financial instruments were included on a value date basis at amortised historical cost, with derivatives presented on a net basis.

Profit and loss/equity recognition of financial instruments

Movements in the values of banking financial assets and liabilities (relating to the Bank's activities in accepting and reinvesting customer deposits) and all derivative financial instruments are included in the profit and loss account. For the Bank's investment assets (which comprise its gold and currency investments funded by its own equity) the historical cost interest income and realised gains are included in the profit and loss account, and unrealised movements in market value are taken directly to revaluation reserves in equity. In the financial year ended 31 March 2003 the historical cost interest income and realised gains were included in the Bank's profit and loss account, but unrealised movements in market value were not recognised in the profit and loss account or equity.

Currency translation differences

Currency translation differences are included in the profit and loss account. In prior years they were included in the valuation difference account within equity.

The revised accounting policies for individual items in the financial statements are described in more detail below. Note 31 shows a reconciliation from the GF financial statements at 31 March 2003 to the SDR financial statements incorporating the changes in accounting policies described above. The comparative figures for the financial year ended 31 March 2003 have been restated to reflect the changes in accounting policies.

C. Currency translation

Financial instruments are translated into SDR at the exchange rates ruling at the balance sheet date. Other assets and liabilities are recorded in SDR at the exchange rates ruling at the date of the transaction. Profits and losses are translated into SDR at an average rate. Exchange differences arising from the retranslation of financial instruments and from the settlement of transactions are recognised in the profit and loss account.

D. Valuation methodology

In general the Bank values its assets, liabilities and derivatives at market value. To derive market value, the Bank uses reliable quoted market prices from active markets. Where these are not available (for instruments such as non-exchange-traded derivatives) the Bank determines market values based on financial models using a discounted cash flow analysis. A discounted cash flow analysis is dependent on estimates for future cash flows, interest rates, exchange rates and prepayment speeds, and upon credit, liquidity and volatility factors.

E. Financial instruments (other than gold and gold deposits)

These financial instruments constitute the majority of the Bank's balance sheet and include cash and sight accounts with banks, treasury bills, securities purchased under resale agreements, time deposits and advances to banks, government and other securities, derivative financial instruments, currency deposits and securities sold under repurchase agreements.

For all these financial instruments, the historical cost profits resulting from the accrual of interest and the amortisation of premiums paid and discounts received are included in interest income (for assets and derivatives) or interest expense (for liabilities). Realised profits on disposal, buyback and early termination are included in net valuation movements.

The Bank includes most financial instruments in its balance sheet on a trade date basis at market value. Derivatives are included as either assets or liabilities, depending on whether the contract has a positive or a negative market value for the Bank. Very short-term financial instruments (both assets and liabilities) are an exception to this general rule of accounting using market values. These financial instruments typically have notice periods of three days or less, and they are included in the balance sheet on a value date basis at their principal value plus accrued interest. They are included under the balance sheet headings "Cash and sight accounts with banks" and "Currency deposits".

The treatment of unrealised gains or losses on revaluation is dependent on the designation of the financial instrument, as described below:

1. Currency deposits principally from central banks and international institutions, and related banking assets and derivatives

The Bank acts as a market-maker in certain of its currency deposit instruments. The market risk inherent in this activity is managed globally and so the Bank accounts for all these financial instruments at market value, with all movements in value included in net valuation movements in the profit and loss account.

2. Assets, liabilities and derivatives relating to the investment of the Bank's equity

These assets are held for the long term, but not necessarily to maturity. They are accounted for as investment assets and are initially included in the balance sheet at cost. They are subsequently revalued to market value, with unrealised gains or losses included in the securities revaluation reserve, which is reported under the balance sheet heading "Other equity accounts".

The related liabilities are principally short-term repurchase agreements. Due to their short-term nature they are included in the balance sheet at market value with all valuation movements included in net valuation movements in the profit and loss account.

The related derivatives are used to manage the Bank's market risk or for trading purposes. They are included in the balance sheet at market value with all valuation movements included in net valuation movements in the profit and loss account.

F. Gold and gold deposits

Gold assets and liabilities are included in the balance sheet at their weight in gold (translated at the gold market price and USD exchange rate into SDR) plus accrued interest. Interest on gold deposits is included in interest income (for assets) or interest expense (for liabilities) on an accruals basis.

The Bank's own holdings of gold are classified as investment assets. The excess in value of the Bank's own gold holdings over its former statutory value (approximately SDR 151 per ounce, equating to USD 208 per ounce as at 31 March 2003) is taken to the gold revaluation reserve, which is reported under the balance sheet heading "Other equity accounts".

Gains or losses on revaluation of gold deposit liabilities from third parties and the related gold deposit assets are included in net valuation movements in the profit and loss account.

G. Accounts receivable and accounts payable

Accounts receivable and accounts payable are principally very short-term amounts relating to the settlement of financial transactions. They are included in the balance sheet at cost.

H. Land, buildings and equipment

The cost of the Bank's buildings and equipment is capitalised and depreciated on a straight line basis over the estimated useful lives of the assets concerned, as follows:

Buildings – 50 years

Building installations and machinery – 15 years

Information technology equipment – 4 years

Other equipment – 4 to 10 years

The Bank's land is not depreciated. The Bank undertakes a regular review of impairment of land, buildings and equipment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to that amount. Capital expenditure and disposals are translated at the exchange rate prevailing on the date of the transaction.

I. Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of events arising before the balance sheet date and it is probable that economic resources will be required to settle the obligation, provided that the amount of the obligation can be reasonably estimated.

J. Retirement benefit obligations

The Bank operates a defined benefit pension fund for its staff. It also operates unfunded arrangements for directors' pensions and health and accident insurance for current and former staff members.

Pension fund

The liability in respect of the staff pension fund is based on the present value of the defined benefit obligation at the balance sheet date, less the market value of the fund assets at the balance sheet date, together with adjustments for unrecognised actuarial gains and losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by the estimated future cash outflows, using discount interest rates of highly rated corporate debt securities which have terms to maturity approximating the terms of the related liability.

The amount charged to the profit and loss account represents the sum of the current service cost of the benefits accruing for the year under the scheme, and interest at the discount rate on the defined benefit obligation. In addition, actuarial gains and losses arising from experience adjustments (where the actual outcome is different from the actuarial assumptions previously made), changes in actuarial assumptions and amendments to the pension fund regulations are charged to the profit and loss account over the service period of staff concerned. The resulting assets or liabilities are included under the headings "Accounts receivable" or "Other liabilities" in the balance sheet.

Unfunded arrangements

The liabilities in respect of the unfunded directors' pension arrangement and health and accident insurance scheme are based on the present value of the defined benefit obligation calculated on an identical basis to the staff pension fund. In the case of the health and accident scheme (where the entitlement is based in principle on the employee remaining in service up to 50 years of age and the completion of a minimum service period of 10 years), the expected costs of these benefits are accrued over the period of employment, using the projected unit credit method. These obligations are valued annually by independent actuaries.

Corridor accounting

Where the defined benefit obligation exceeds the higher of the liability or any assets used to fund the obligation in the financial statements by more than a corridor of 10%, the resulting excess outside the corridor is amortised over the expected remaining working life of the staff concerned.

K. Use of estimates

The preparation of the financial statements requires the Bank's Management to make some estimates in arriving at the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the financial year. To arrive at these estimates the Management uses available information, makes assumptions and exercises judgment. Subsequent actual results could materially differ from those estimates.

3. Cash and sight accounts with banks

Cash and sight accounts with banks consist of cash balances with central and commercial banks that are available to the Bank on demand.

4. Gold and gold deposit assets

The composition of the Bank's total gold holdings was as follows:

SDR millions	**2004**	2003
Gold bars held at central banks	5,463.9	4,534.2
Total gold time deposits	3,609.9	3,007.7
Total gold and gold deposit assets	**9,073.8**	7,541.9

Included in the above are the Bank's own gold holdings, which at 31 March 2004 amounted to SDR 1,780.7 million, equivalent to 192 tonnes of fine gold (31 March 2003: SDR 1,519.0 million; 192 tonnes). The Bank's own gold holdings are included in the balance sheet at their weight in gold (translated at the gold market price and the USD exchange rate into SDR) plus accrued interest. The excess of this value over the former statutory value of approximately SDR 151 per ounce is included in the gold revaluation reserve (reported under the balance sheet heading "Other equity accounts") and realised gains or losses on the disposal of own gold are recognised in the profit and loss account. The opening balance in the gold revaluation reserve at 1 April 2003 was SDR 571.6 million. The reserve increased by SDR 261.7 million during the financial year ended 31 March 2004, resulting in a balance at 31 March 2004 of SDR 833.3 million.

5. Banking and investment assets

Banking and investment assets comprise treasury bills, securities purchased under resale agreements, time deposits and advances to banks and government and other securities. Banking assets comprise those assets that represent the reinvestment of customer deposits. Investment assets comprise the currency investments funded by the Bank's own equity.

Securities purchased under resale agreements ("reverse repurchase agreements") are transactions under which the Bank places a fixed-term deposit with a counterparty which provides collateral in the form of securities. The rate on the deposit is fixed at the beginning of the transaction,

SDR millions	2004			2003		
	Banking assets	Investment assets	Total	Banking assets	Investment assets	Total
Treasury bills	**30,240.7**	–	**30,240.7**	20,724.5	–	20,724.5
Securities purchased under resale agreements	**20,609.7**	**1,225.5**	**21,835.2**	12,181.8	73.2	12,255.0
Time deposits and advances to banks						
Advances	–	–	–	387.6	–	387.6
Fixed-term	65,515.0	–	65,515.0	53,562.9	–	53,562.9
Notice/call accounts	2,640.6	6.8	2,647.4	4,767.2	10.5	4,777.7
	68,155.6	**6.8**	**68,162.4**	58,717.7	10.5	58,728.2
Government and other securities						
Government	3,853.5	4,978.4	8,831.9	8,630.7	4,612.4	13,243.1
Financial institutions	15,508.2	1,221.8	16,730.0	14,299.3	1,189.6	15,488.9
Other (including public sector securities)	6,584.3	1,336.9	7,921.2	8,391.5	1,609.1	10,000.6
	25,946.0	**7,537.1**	**33,483.1**	31,321.5	7,411.1	38,732.6
Total banking and investment assets	**144,952.0**	**8,769.4**	**153,721.4**	122,945.5	7,494.8	130,440.3

and there is an irrevocable commitment to return the collateral subject to the repayment of the deposit. During the term of the agreement, the market value of collateral is monitored, and additional collateral is obtained where appropriate to protect against credit exposure.

Time deposits and advances to banks are investments made with central banks, international institutions and commercial banks and include fixed-term loans, notice accounts and advances to central banks and international institutions as part of committed and uncommitted standby facilities.

Government and other securities are investments made with central banks, international institutions and commercial banks and include fixed and floating rate bonds and asset-backed securities.

The table above analyses the Bank's holdings of banking and investment assets.

The Bank's investment assets are included in the balance sheet at market value. The excess of this value over the historical cost value is included in the securities revaluation reserve (reported under the balance sheet heading "Other equity accounts"), and realised gains or losses on the disposal of investment assets are recognised in the profit and loss account. The opening balance in the securities revaluation reserve at 1 April 2003 was SDR 337.2 million. The reserve decreased by SDR 158.7 million during the financial year ended 31 March 2004, resulting in a balance of SDR 178.5 million at 31 March 2004.

The following tables analyse the balance in the securities revaluation reserve as at 31 March 2004 and 31 March 2003.

As at 31 March 2004 *SDR millions*	Market value of assets	Historical cost	Securities revaluation reserve	Gross gains	Gross losses
Securities purchased under resale agreements	1,225.5	1,225.5	–	–	–
Time deposits and advances to banks	6.8	6.8	–	–	–
Government and other securities	7,537.1	7,358.6	178.5	193.0	(14.5)
Total	**8,769.4**	**8,590.9**	**178.5**	**193.0**	**(14.5)**

As at 31 March 2003 *SDR millions*	Market value of assets	Historical cost	Securities revaluation reserve	Gross gains	Gross losses
Securities purchased under resale agreements	73.2	73.2	–	–	–
Time deposits and advances to banks	10.5	10.5	–	–	–
Government and other securities	7,411.1	7,073.9	337.2	337.6	(0.4)
Total	7,494.8	7,157.6	337.2	337.6	(0.4)

6. Derivative financial instruments

SDR millions	2004 Notional amounts	2004 Market values Assets	2004 Market values Liabilities	2003 Notional amounts	2003 Market values Assets	2003 Market values Liabilities
Bond futures	212.7	0.0	(0.0)	211.4	0.1	(0.8)
Bond options	388.4	0.1	(0.0)	562.4	1.4	(0.7)
Cross-currency interest rate swaps	11,388.0	241.4	(2,454.5)	10,638.0	68.3	(1,791.1)
Currency forwards	2,209.5	17.7	(5.6)	824.6	2.3	(8.0)
Currency options bought and sold	16.6	0.0	(0.0)	327.2	1.7	(1.7)
Currency swaps	37,990.0	53.7	(750.1)	51,717.0	159.1	(202.8)
Forward rate agreements	17,623.0	4.7	(5.0)	26,437.5	8.6	(9.1)
Interest rate futures	42,143.9	0.4	(0.4)	18,511.9	1.3	(0.4)
Interest rate swaps	85,894.0	3,003.1	(1,099.1)	125,018.0	3,723.3	(1,219.5)
Swaptions	1,589.4	0.0	(25.0)	–	–	–
Total derivative financial instruments	**199,455.5**	**3,321.1**	**(4,339.7)**	234,248.0	3,966.1	(3,234.1)

The Bank uses the following types of derivative instruments for economic hedging and trading purposes:

Currency forwards represent commitments to purchase foreign currencies at a future date. This includes undelivered spot transactions.

Foreign currency, interest rate and bond futures are contractual obligations to receive or pay a net amount based on changes in currency rates, interest rates or bond prices on a future date at a specified price established in an organised market. Futures contracts are collateralised by cash or marketable securities and changes in the futures contract value are settled daily with the exchange.

Forward rate agreements are individually negotiated interest rate forward contracts that result in cash settlement at a future date for the difference between a contracted rate of interest and the prevailing market rate.

Currency swaps, cross-currency interest rate swaps and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of interest rates and currencies (cross-currency interest rate swaps). Except for certain currency swaps and cross-currency interest rate swaps, no exchange of principal takes place.

Foreign currency and bond options are contractual agreements under which the seller grants the purchaser the right, but not the obligation, to either buy (call option) or sell (put option), by or on a set date, a specific amount of a foreign currency or a bond at a predetermined price. In consideration, the seller receives a premium from the purchaser.

Swaptions are options under which the seller grants the purchaser the right, but not the obligation, to enter into a currency or interest rate swap at a predetermined price by or on a set date.

The table above analyses the market value of derivative financial instruments.

7. Accounts receivable

SDR millions	**2004**	2003
Financial transactions awaiting settlement	1,598.0	3,143.1
Other assets	11.6	30.8
Total accounts receivable	**1,609.6**	3,173.9

"Financial transactions awaiting settlement" relates to short-term receivables (typically due in three days or less) where transactions have been effected but cash has not yet been transferred. This includes assets that have been sold and liabilities that have been issued.

8. Land, buildings and equipment

SDR millions	Land	Buildings	Other equipment	2004 Total	2003 Total
Historical cost					
Opening balance at 1 April	41.2	185.1	79.4	305.7	298.0
Capital expenditure	–	–	10.5	10.5	8.4
Disposals and retirements	–	–	(1.8)	(1.8)	(0.7)
Balance at 31 March	**41.2**	**185.1**	**88.1**	**314.4**	305.7
Depreciation					
Accumulated depreciation at 1 April	–	61.2	48.1	109.3	95.3
Depreciation	–	7.1	9.8	16.9	14.7
Disposals and retirements	–	–	(1.8)	(1.8)	(0.7)
Balance at 31 March	**–**	**68.3**	**56.1**	**124.4**	109.3
Net book value at 31 March	**41.2**	**116.8**	**32.0**	**190.0**	196.4

The depreciation charge for the financial year ended 31 March 2004 includes an additional charge of SDR 3.3 million following an impairment review of the Bank's land and buildings.

9. Currency deposits

Currency deposits are book entry claims on the Bank and are analysed in the table below.

SDR millions	2004	2003
Deposit instruments repayable at one to two days' notice		
Medium-Term Instruments (MTIs)	41,198.8	41,744.4
FIXBIS	35,212.5	31,681.8
	76,411.3	73,426.2
Other currency deposits		
Other deposit instruments (FRIBIS)	6,200.2	6,063.0
Sight and notice accounts and fixed-term deposits	50,541.0	43,029.8
	56,741.2	49,092.8
Total currency deposits	**133,152.5**	122,519.0

The Bank has undertaken to repay at market value certain deposit instruments, in whole or in part, at one to two business days' notice. The resulting gains or losses are included in the profit and loss account heading "Net valuation movements".

Currency deposits (other than sight and notice accounts) are included in the balance sheet at market value. This value differs from the amount that the Bank is contractually required to pay at maturity to the holder of the deposit. For total currency deposits the amount that the Bank is contractually required to pay at maturity to the holder of the deposit, plus accrued interest to 31 March 2004, is SDR 128,682.8 million (31 March 2003: 120,913.1 million).

10. Gold deposit liabilities

Gold deposits placed with the Bank originate entirely from central banks.

11. Securities sold under repurchase agreements

Securities sold under repurchase agreements ("repurchase agreements") are transactions under which the Bank receives a fixed-term deposit from a counterparty to which it provides collateral in the form of securities. The rate on the deposit is fixed at the beginning of the transaction, and there is an irrevocable commitment to repay the deposit subject to the return of the securities. They originate entirely from commercial banks.

12. Accounts payable

Accounts payable consist of financial transactions awaiting settlement, relating to short-term payables (typically payable within three days or less) where transactions have been effected but cash has not yet been transferred. This includes assets that have been purchased and liabilities that have been repurchased.

13. Other liabilities

SDR millions	2004	2003
Retirement benefit obligations – see note 17		
Directors' pensions	4.0	4.0
Health and accident benefits	111.2	97.1
Payable to former shareholders	14.5	208.9
Other	14.7	288.9
Total other liabilities	**144.4**	598.9

14. Share capital

The Extraordinary General Meeting on 10 March 2003 amended the Bank's Statutes to redenominate the Bank's share capital from gold francs to SDR as from 1 April 2003, and to adjust the nominal value (par value) of each share accordingly. In order to obtain a round sum amount the nominal value of each share was reduced from its precise converted value of SDR 5,696 at 31 March 2003 to SDR 5,000 (of which 25% is paid up). The resulting excess of SDR 92.1 million in paid-up share capital was transferred to the free reserve fund (see note 31). The Bank's capital and reserves in total were not affected by this adjustment.

The Bank's share capital consists of:

	2004	2003
	SDR million	*GF million*
Authorised capital: 600,000 shares, each of SDR 5,000 par value (2003: GF 2,500)	3,000.0	1,500.0
Issued capital: 547,125 shares (2003 – 529,125)	2,735.6	1,322.8
Paid-up capital (25%)	**683.9**	330.7

During the financial year ended 31 March 2004 the Bank issued 3,000 shares each to the central banks of Algeria, Chile, Indonesia, Israel, New Zealand and the Philippines. This increased the number of member central banks to 56 (31 March 2003: 50).

The number of shares eligible for dividend is:

	2004	2003
Issued shares	547,125	529,125
Less: shares held in treasury		
Repurchase of shares in the financial year ended 31 March 2001	(74,952)	(74,952)
Others	(2,100)	(2,100)
Outstanding shares eligible for dividend	**470,073**	452,073
Of which:		
Eligible for full dividend	452,073	452,073
New shares eligible for dividend pro rata from the value date of subscription	18,000	–

15. Repurchase of shares

The Extraordinary General Meeting on 8 January 2001 amended the Bank's Statutes to restrict the right to hold shares in the BIS exclusively to central banks, thereby effecting a mandatory repurchase from private (ie non-central bank) shareholders of 72,648 shares on which the American, Belgian and French central banks exercise voting rights. The compensation paid was 16,000 Swiss francs per share. At the same time the Bank repurchased 2,304 shares of these three issues from other central banks. The Bank holds these shares in treasury and will, in due course, redistribute them to the Bank's existing central bank shareholders in a manner which the Board considers appropriate.

Three former private shareholders expressed dissatisfaction with the amount of compensation paid to them by the Bank in connection with the mandatory repurchase of shares and initiated proceedings with the Arbitral Tribunal in The Hague. These proceedings were completed with the final award of the Arbitral Tribunal on 19 September 2003, remitting an additional compensation of CHF 7,977.56 per share. The Bank applied the award to all former shareholders, and the cost of repurchasing the total of 74,952 shares above was increased by SDR 153.8 million, as follows:

SDR millions	2004
Charged to shares held in treasury:	
Additional compensation in excess of provision	113.5
Charged to the profit and loss account:	
Additional interest thereon in excess of provision	32.9
Currency translation loss	7.4
Total	**153.8**

16. Earnings per share

	2004	2003
Net profit for the financial year (SDR millions)	536.1	592.8
Weighted average number of shares entitled to dividend	462,114	452,073
Earnings per share – (SDR per share)	**1,160**	1,311

The dividend proposed for the financial year ended 31 March 2004 is SDR 225 per share (2003: CHF 400, equivalent to SDR 214.8).

17. Retirement benefit obligations

A. Directors' pensions

The Bank operates an unfunded defined benefit arrangement for its directors, whose entitlement is based on a minimum service period of four years. The movement in the accounts during the year was as follows:

SDR millions	2004	2003
Opening liability	4.0	3.6
Contributions paid	(0.3)	(0.2)
Charged to the profit and loss account	0.4	0.3
Exchange differences	(0.1)	0.3
Closing liability – see note 13	**4.0**	4.0

B. Staff pensions

The Bank operates a final salary defined benefit Pensions System for its staff. The Pensions System is based on a fund which is similar in nature to a trust fund, having no separate legal personality. Its assets are administered by the Bank for the sole benefit of current and former members of staff who participate in the arrangement. The fund is valued annually by independent actuaries. The latest actuarial valuation was carried out at 30 September 2003.

SDR millions	**2004**	2003
Present value of funded obligations	527.8	511.3
Market value of fund assets	(525.4)	(480.9)
	2.4	30.4
Unrecognised actuarial gains / (losses)	(2.4)	(30.4)
Liability	**–**	**–**

The movement in the accounts during the year was as follows:

SDR millions	**2004**	2003
Opening (asset) / liability	–	–
Contributions paid	(14.5)	(30.1)
Charged to the profit and loss account	14.5	30.1
Closing (asset) / liability	**–**	**–**

The principal actuarial assumptions used in the calculations above were as follows:

	2004	2003
Discount rate – market rate of highly rated Swiss corporate bonds	3.5%	3.5%
Expected return on scheme assets	5.0%	5.0%

C. Health and accident benefits

The Bank also provides unfunded post-retirement health care and accident benefits, based on a minimum service period of 10 years. The methodology used for the determination of the costs and obligations arising from this arrangement and the actuarial assumptions used in calculating these benefits are identical to those for the Pensions System, except that there is an additional assumption for long-term medical inflation of 5% per annum.

The movement in the accounts during the year was as follows:

SDR millions	**2004**	2003
Opening liability	97.1	81.6
Contributions paid	(1.2)	(3.4)
Charged to the profit and loss account	16.4	8.6
Exchange differences	(1.1)	10.3
Closing liability – see note 13	**111.2**	97.1
Unrecognised actuarial loss	18.1	22.9
Present value of obligation	129.3	120.0

18. Interest income

SDR millions	**2004**	2003
Interest on investment assets		
Securities purchased under resale agreements	9.9	17.8
Time deposits and advances to banks	25.4	29.1
Government and other securities	269.8	317.9
	305.1	364.8
Interest on banking assets		
Treasury bills	233.4	217.5
Securities purchased under resale agreements	104.3	103.5
Time deposits and advances to banks	1,106.7	1,567.1
Government and other securities	721.6	838.0
	2,166.0	2,726.1
Interest on derivative financial instruments	**1,022.3**	1,043.8
Other interest	**0.5**	0.5
Total interest income	**3,493.9**	4,135.2

19. Interest expense

SDR millions	**2004**	2003
Interest on gold deposits	7.0	11.3
Interest on currency deposits	2,665.7	3,201.7
Interest on securities sold under repurchase agreements	8.4	15.9
Total interest expense	**2,681.1**	3,228.9

20. Net valuation movements

SDR millions	**2004**	2003
Unrealised valuation movements on banking financial assets	(98.9)	439.5
Realised gains / (losses) on banking financial assets	32.1	31.7
Unrealised valuation movements on financial liabilities	583.8	(1,341.8)
Realised gains / (losses) on financial liabilities	(327.1)	(418.5)
Valuation movements on derivative financial instruments	(448.6)	974.8
Net valuation movements	**(258.7)**	(314.3)

21. Net fees and commissions income

SDR millions	**2004**	2003
Fees and commissions income	5.8	6.0
Fees and commissions expense	(4.4)	(4.3)
Net fees and commissions income	**1.4**	1.7

22. Net foreign exchange gains

Net foreign exchange gains comprise transaction and translation gains.

23. Operating expense

The following table analyses the Bank's operating expense in Swiss francs (CHF), the currency in which most expenditure is incurred.

CHF millions	**2004**	2003
Board of Directors		
Directors' fees	1.6	1.5
Pensions	0.6	0.6
Travel, external Board meetings and other costs	1.5	1.3
	3.7	3.4
Management and staff		
Remuneration	96.1	96.3
Pensions	30.2	62.9
Other personnel-related expense	44.4	22.9
	170.7	182.1
Office and other expense	**62.1**	62.0
Administrative expense in CHF millions	**236.5**	247.5
Administrative expense in SDR millions	125.6	127.6
Depreciation in SDR millions	16.9	14.7
Operating expense in SDR millions	**142.5**	142.3

The charge for pensions in the financial year ended 31 March 2003 includes a special contribution of CHF 33.9 million to the Bank's staff pension fund. The charge for other personnel-related expense increased in the year ended 31 March 2004, principally as a result of the increase in health and accident expense which is disclosed in SDR in note 17.

The average number of full-time equivalent employees during the financial year ended 31 March 2004 was 509 (2003: 493).

24. Net gains on sales of investment securities

SDR millions	**2004**	2003
Gross realised gains	172.5	153.8
Gross realised losses	(18.1)	(6.8)
Net gains on investment securities	**154.4**	147.0

25. Taxes

The Bank's legal status in Switzerland is set out in its Headquarters Agreement with the Swiss Federal Council. Under the terms of this document the Bank is exempted from virtually all direct and indirect taxes at both federal and local government level in Switzerland.

Similar agreements exist with the government of the People's Republic of China for the Asian Office in Hong Kong SAR and with the Mexican government for the Office of the Americas.

26. Exchange rates

The following table shows the principal rates and prices used to translate balances in foreign currency and gold into SDR:

	Spot rate as at 31 March		Average rate financial year ended	
	2004	2003	**2004**	2003
USD	0.675	0.728	0.700	0.755
EUR	0.827	0.793	0.821	0.749
JPY	0.00649	0.00613	0.00620	0.00620
GBP	1.239	1.150	1.183	1.167
CHF	0.530	0.537	0.531	0.511
Gold	286.5	244.1	263.8	245.4

27. Off-balance sheet items

Fiduciary transactions are effected in the Bank's name on behalf of, and at the risk of, the Bank's customers without recourse to the Bank. They are not included in the Bank's balance sheet and comprise:

SDR millions	**2004**	2003
Nominal value of securities held under:		
Safe custody arrangements	9,153.5	8,309.6
Collateral pledge agreements	2,346.2	3,556.4
Portfolio management mandates	2,903.3	2,158.9
Total	**14,403.0**	14,024.9

The financial instruments held under the above arrangements are deposited with external custodians, either central banks or commercial institutions.

28. Commitments

The Bank provides a number of committed standby facilities for its central bank and international institution customers. As at 31 March 2004 the outstanding commitments to extend credit under these committed standby facilities were SDR 2,867.2 million (31 March 2003: SDR 2,780.5 million), of which SDR 118.2 million was uncollateralised (31 March 2003: SDR 150.0 million).

29. Related parties

The Bank currently defines related parties as the members of the Board of Directors and those Senior Officials of the Bank who are members of its Executive Committee.

The Bank offers personal deposit accounts for all staff members and its Directors. These accounts bear interest at a rate as determined by the Bank's President. At 31 March 2004, the balance on these accounts relating to members of the Board of Directors and Senior Officials amounted to SDR 7.4 million (31 March 2003: SDR 7.5 million).

30. Capital and risk management

A. The risks that the Bank faces

The Bank is exposed to risk on its transactions in financial instruments, in particular:

Credit risk. The risk of a financial loss arising from a counterparty's failure to service its debt in a timely manner. This is the largest risk that the Bank faces.

Market risk. The risk of a decline in the total value of the Bank's assets and liabilities due to adverse changes in such market variables as interest rates, exchange rates and gold prices.

Liquidity risk. The risk of being unable to meet its obligations to pay as they fall due without incurring unacceptable losses.

Operational risk. This is the risk of financial losses, damage to the Bank's reputation, or both, resulting from inadequate or failed processes, people or systems, or from external events.

B. How the Bank manages these risks

Organisation structure

The Bank is operated to serve the central banking community whilst earning an adequate return to maintain its capital strength. Assets and liabilities are organised into two books:

Currency and gold deposits principally from central banks and international institutions, and related banking assets and derivatives.

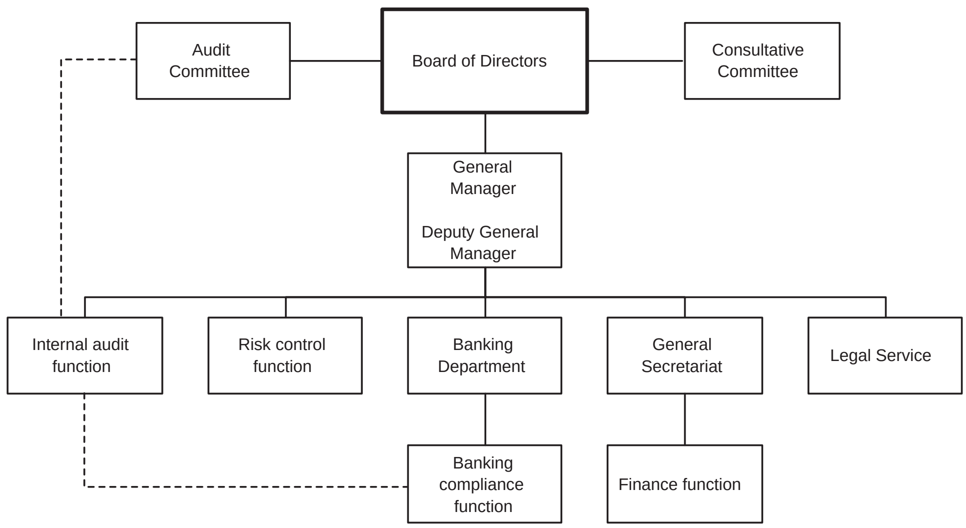
In this book the Bank takes limited interest rate, gold price and foreign currency risk.

Assets, liabilities and derivatives relating to the investment of the Bank's equity.

The Bank holds most of its equity in financial instruments denominated in the constituent currencies of the SDR, which are managed using a benchmark of bonds with a fixed duration target. The remainder of the Bank's equity is held in gold.

The Bank manages risk through a framework including an independent risk control function and regular reporting of risk positions to appropriate management committees. The Bank's risk methodologies and risk policies are documented in a detailed risk manual, which is reviewed on a regular basis. The Bank's credit limits are documented in a counterparty manual. All changes to credit limits require management approval.

Finance, legal and banking compliance functions augment the risk control function. The role of the finance function is to produce the Bank's financial statements and to control its expenditure through setting and monitoring the annual budget. The legal function provides legal advice and support covering a wide range of issues relating to the Bank's activities. The banking compliance function ensures that Banking Department business and members of the Banking Department and risk control function comply with the Bank's Code of Conduct, specific Banking Rules, applicable laws and best financial market practice.



The internal audit function reviews internal control procedures and reports on how they comply with internal standards and industry best practices. The scope of internal audit work includes the review of risk management procedures, internal control systems, information systems and governance processes.

The Deputy General Manager is responsible for the Bank's risk control and internal audit functions, and the internal audit function also reports to the Audit Committee. The reporting lines of these key control-related functions are shown in the diagram above.

C. Risk methodologies

The Bank uses a comprehensive range of quantitative methodologies for valuing financial instruments and for measuring risk to the Bank's net profit and its equity. The Bank reassesses its quantitative methodologies in the light of its changing risk environment and evolving best practice.

Economic capital is a key quantitative risk methodology used by the Bank. Economic capital is a measure designed to estimate the amount of equity needed to absorb the potential losses arising from exposures on any given date, to a statistical level of confidence determined by the Bank's aim to remain of the highest creditworthiness. Many of the Bank's internal limits and reports are expressed in terms of the economic capital usage. The Bank calculates economic capital covering credit risk, market risk and operational risk.

To calculate economic capital for credit risk the Bank uses an internal model for credit portfolio value-at-risk that is based on the Bank's assessment of:

- The probability of default of individual counterparties;
- The correlations of losses associated with individual counterparties; and
- The loss that the Bank would incur as a result of the default.

The market risk economic capital measure is derived from the Bank's value-at-risk (VaR) methodology. This is discussed in more detail in section I below.

The Bank's operational risk economic capital measure is based on a model that incorporates the Bank's experience of operational losses and external loss data.

In computing its credit, market and operational risk economic capital measures the Bank uses as key assumptions a one-year time horizon and a 99.995% level of confidence.

D. Capital adequacy

The Bank maintains a very strong capital position, which is measured using its economic capital model and the framework proposed by the Basel Accord of July 1988 (the Basel Capital Accord). The table below shows the Bank's capital as at 31 March 2004.

SDR millions	**2004**
Share capital	683.9
Statutory reserves	8,230.8
Less: shares held in treasury	(852.6)
Tier 1 capital	**8,062.1**
Profit and loss account	536.1
Other equity accounts	1,011.8
Total capital	**9,610.0**

The Basel Accord ratios measure capital adequacy by comparing the Bank's eligible capital with its risk-weighted assets. The risk weighted assets are derived by applying a series of risk weightings to the Bank's assets and derivatives, based on the Basel Accord. The Bank's capital ratios are high due to the proportion of sovereign debt (which is zero risk-weighted) within the Bank's assets. The Bank's Tier 1 ratio was 34.7% as at 31 March 2004.

E. Credit risk

Credit risk includes:

Default risk – the risk that a counterparty will not fulfil its obligations in accordance with the agreed terms of a transaction. Default risk arises on financial assets and derivatives, as well as committed facilities that the Bank provides for central banks and international institutions.

Settlement risk – the risk of failure of the settlement or clearing of financial transactions where the exchange of cash, securities or other assets is not simultaneous.

Transfer risk – the risk that a counterparty is unable to meet its foreign currency obligations due to restricted access to foreign currency.

F. Default risk

The Bank controls its default risk on both a counterparty and a portfolio level. Credit exposures are restricted using a series of credit limits covering individual counterparties and countries of risk. The Bank conducts its own detailed independent credit analysis resulting in the assignment of internal credit grades. Based on this analysis the Bank sets its credit limits.

Default risk on the Bank's holdings of securities is reduced by the highly liquid nature of most of the assets. Securities are sold when the Bank's management considers that a counterparty has an unacceptable risk of default. Default risk on over-the-counter (OTC) derivatives is mitigated using collateral management agreements.

The following tables show credit exposure by sector and credit rating as at 31 March 2004.

Sector of risk	%
Sovereign	29.0
Financial institution	65.0
Other	6.0
	100.0

BIS internal credit grade (expressed as equivalent long-term rating)	%
AAA	25.1
AA	54.9
A	19.6
BBB+ and below (including unrated risks)	0.4
	100.0

G. Settlement risk

The Bank minimises settlement risk by:

- Using established clearing centres;
- Where possible settling transactions only once both parties have fulfilled their obligations (the delivery versus payment settlement mechanism);
- Where possible requiring net settlement of payments on derivative financial instruments;
- Using cash correspondent banks with the ability to stop payments at short notice; and
- Calculating and limiting the settlement risk on a counterparty basis.

H. Transfer risk

The Bank calculates and sets limits for transfer risk on a per country basis.

I. Market risk

The main components of the Bank's market risk are gold price risk, currency risk and interest rate risk. The Bank incurs market risk primarily through the assets relating to the management of its equity. The Bank measures market risk using the value-at-risk (VaR) methodology, and by computing sensitivities to certain market risk factors. VaR expresses the statistical estimate of the maximum potential loss on the current portfolio assuming a specified time horizon and measured to a specified level of confidence.

Market risk economic capital is measured and managed on a combined basis across all components of market risk. Management limits the Bank's market risk economic capital usage.

All VaR models, while forward-looking, are based on past events and dependent on the quality of available market data. VaR limits are supplemented with a framework of other limits and reporting, including specific stress tests and detailed monitoring of the largest market risk positions.

J. Gold price risk

Gold price risk is the potential impact on the market value of assets and liabilities from changes in gold prices. The Bank is exposed to gold price risk principally through its own holdings of gold, which comprise 192 tonnes. This is held in custody or placed on deposit with commercial banks. At 31 March 2004 approximately 18% of its equity were gold holdings (31 March 2003: 17%). The Bank can also have small exposures to gold price risk through its banking activities with central and commercial banks. Gold price risk is measured within the Bank's aggregate market risk economic capital framework.

K. Currency risk

Currency risk is the potential impact on the market value of assets and liabilities from changes in exchange rates against the SDR. The Bank is exposed to currency risk principally through the assets relating to the management of its equity. The Bank is also exposed to currency risk through managing its customer deposits and through acting as an intermediary in foreign exchange transactions between central and commercial banks. The Bank reduces its currency exposures by matching the assets relating to the management of its equity to the constituent currencies of the SDR on a regular basis, and by allowing only small currency exposures relating to customer deposits and foreign exchange transaction intermediation.

The following table shows the Bank's currency positions as at 31 March 2004 after adjusting for its own holdings of gold. These currency positions principally relate to the repurchase of the BIS shares during the financial year ended 31 March 2001 (see note 15).

Net assets *SDR millions*	**2004**
Swiss franc	(655.6)
US dollar	297.9
Euro	111.3
Japanese yen	130.9
Pound sterling	57.7
Swedish krona	54.3
Other currencies	3.5

L. Interest rate risk

Interest rate risk is the potential impact on the market value of assets and liabilities from changes in interest rates. The Bank is exposed to interest rate risk principally through the interest-bearing assets relating to the management of its equity. These assets are managed using a benchmark of bonds with a fixed duration target. The Bank is also exposed to limited interest rate risk through its activities in accepting and reinvesting customer deposits.

The Bank closely monitors interest rate risk including the sensitivity of market values to movements in interest rates. Market risk is restricted using economic capital, VaR and stress test-based limits.

M. Liquidity risk

Net movements in the currency and gold deposits from central banks and international institutions are the key determinants of the size of the Bank's balance sheet. The Bank has undertaken to repurchase at market value certain of its currency deposit instruments at one or two days' notice. The Bank is managed to preserve a high degree of liquidity to ensure that it is able to meet the requirements of its customers at all times.

The Bank has developed a liquidity management framework based on a statistical model using prudent assumptions with regard to cash inflows and the liquidity of liabilities. Within this framework, the Board has set a limit for the Bank's liquidity ratio which requires liquid assets to be equal to at least 100% of the potential liquidity requirement faced by the Bank. In addition, liquidity stress tests are performed which assume extreme withdrawal scenarios considerably beyond the estimated potential liquidity requirement. These stress tests define additional liquidity requirements which must also be met by holdings of liquid assets. The Bank's liquidity has consistently been materially above its minimum liquidity ratio limit.

The following tables (including derivatives on a net basis) show assets and liabilities at carrying amounts categorised by contractual maturity date:

As at 31 March 2004 *SDR millions*	up to 1 month	1 to 3 months	4 to 6 months	6 to 9 months	9 to 12 months	1 to 5 years	Over 5 years	Maturity undefined	Total
Assets									
Cash and sight accounts with banks	18.9	–	–	–	–	–	–	–	18.9
Gold and gold deposits	247.5	315.8	603.0	514.2	532.2	1,397.2	–	5,463.9	9,073.8
Treasury bills	5,903.4	15,450.9	6,615.6	908.9	1,361.9	–	–	–	30,240.7
Securities purchased under resale agreements	21,771.1	64.1	–	–	–	–	–	–	21,835.2
Time deposits and advances to banks	31,589.7	16,640.8	15,138.2	3,814.4	979.3	–	–	–	68,162.4
Government and other securities	1,785.5	2,948.1	3,085.9	2,164.1	1,533.6	17,661.3	4,304.6	–	33,483.1
Accounts receivable	1,602.2	–	–	–	–	3.9	–	3.5	1,609.6
Land, buildings and equipment	–	–	–	–	–	–	–	190.0	190.0
Total	**62,918.3**	**35,419.7**	**25,442.7**	**7,401.6**	**4,407.0**	**19,062.4**	**4,304.6**	**5,657.4**	**164,613.7**
Liabilities									
Currency deposits									
Deposit instruments repayable at 1-2 days' notice	(4,798.2)	(12,072.9)	(14,572.6)	(5,828.5)	(4,015.2)	(31,727.3)	(3,396.6)	–	(76,411.3)
Other currency deposits	(42,269.9)	(7,438.1)	(6,374.4)	(560.3)	(98.3)	(0.2)	–	–	(56,741.2)
Gold deposits	(5,625.0)	(250.5)	(510.1)	(347.5)	(291.7)	(268.7)	–	–	(7,293.5)
Securities sold under repurchase agreements	(1,161.2)	(64.1)	–	–	–	–	–	–	(1,225.3)
Accounts payable	(12,169.4)	–	–	–	–	–	–	–	(12,169.4)
Other liabilities	(26.6)	–	–	–	–	–	–	(117.8)	(144.4)
Total	**(66,050.3)**	**(19,825.6)**	**(21,457.1)**	**(6,736.3)**	**(4,405.2)**	**(31,996.2)**	**(3,396.6)**	**(117.8)**	**(153,985.1)**
Net derivative financial instruments	(102.9)	(485.8)	(144.6)	3.2	(100.4)	(109.8)	(78.3)	–	(1,018.6)
Maturity gap	**(3,234.9)**	**15,108.3**	**3,841.0**	**668.5**	**(98.6)**	**(13,043.6)**	**829.7**	**5,539.6**	**9,610.0**

As at 31 March 2003 *SDR millions*	up to 1 month	1 to 3 months	4 to 6 months	6 to 9 months	9 to 12 months	1 to 5 years	Over 5 years	Maturity undefined	Total
Assets									
Cash and sight accounts with banks	4,300.7	–	–	–	–	–	–	–	4,300.7
Gold and gold deposits	317.8	330.8	480.7	273.9	289.4	1,315.2	–	4,534.1	7,541.9
Treasury bills	4,031.4	10,324.1	5,410.0	345.6	613.4	–	–	–	20,724.5
Securities purchased under resale agreements	12,255.0	–	–	–	–	–	–	–	12,255.0
Time deposits and advances to banks	17,174.8	16,553.4	14,615.0	7,071.4	3,281.9	31.7	–	–	58,728.2
Government and other securities	2,193.7	4,476.8	2,174.8	3,179.2	4,836.7	17,311.4	4,560.0	–	38,732.6
Accounts receivable	3,164.8	–	–	–	–	4.4	–	4.7	3,173.9
Land, buildings and equipment	–	–	–	–	–	–	–	196.4	196.4
Total	**43,438.2**	**31,685.1**	**22,680.5**	**10,870.1**	**9,021.4**	**18,662.7**	**4,560.0**	**4,735.2**	**145,653.2**
Liabilities									
Currency deposits									
Deposit instruments repayable at 1-2 days' notice	(5,972.5)	(8,427.6)	(8,054.3)	(6,984.9)	(6,420.8)	(35,809.2)	(1,756.9)	–	(73,426.2)
Other currency deposits	(30,886.4)	(8,174.8)	(7,073.0)	(1,118.3)	(1,402.7)	(437.6)	–	–	(49,092.8)
Gold deposits	(4,802.8)	(291.0)	(321.8)	(153.0)	(242.4)	(211.6)	–	–	(6,022.6)
Securities sold under repurchase agreements	(73.2)	–	–	–	–	–	–	–	(73.2)
Accounts payable	(8,242.3)	–	–	–	–	–	–	–	(8,242.3)
Other liabilities	(288.9)	–	–	(207.0)	–	–	–	(103.4)	(599.3)
Total	**(50,266.1)**	**(16,893.4)**	**(15,449.1)**	**(8,463.2)**	**(8,065.9)**	**(36,458.4)**	**(1,756.9)**	**(103.4)**	**(137,456.4)**
Net derivative financial instruments	10.3	116.6	(80.3)	(114.4)	(35.1)	1,061.6	(226.7)	–	732.0
Maturity gap	**(6,817.6)**	**14,908.3**	**7,151.1**	**2,292.5**	**920.4**	**(16,734.1)**	**2,576.4**	**4,631.8**	**8,928.8**

N. Operational risk

Operational risk includes the risk of losses, damage to reputation, or both, resulting from risks in connection with:

- Processes (an internal policy or process is inadequate, poorly designed or unsuitable, or is not properly understood, implemented, followed or enforced);
- People (eg insufficient personnel, lack of requisite knowledge, inadequate training, inadequate supervision, loss of key personnel, lack of integrity or ethical standards);
- Systems (hardware, software application, operating systems or infrastructure are poorly designed, unsuitable, inadequate, unavailable, fails, or do not operate as intended); and
- External events (the occurrence of an event having a negative impact on the Bank but outside its control).

Risk events can result in a loss or damage the reputation of the Bank. They originate from one or more risk causes, including fraud, information management, employment and culture, safety and security, process management and execution, third-party relationship and technology.

The Bank seeks to manage operational risk through internal controls, including policies, procedures, practices and organisational structures, designed to provide reasonable assurance that risk events will be prevented, or, if not, be detected as early as possible and have their consequences mitigated. The Bank allocates economic capital for operational risk on the basis of a statistical model.

31. Impact of accounting changes

A. Redenomination of share capital

The replacement of the gold franc by the SDR as the Bank's reporting currency as from 1 April 2003 required a conversion into SDR of the gold franc amounts in which the share capital of the Bank had previously been denominated. The Extraordinary General Meeting of the Bank held on 10 March 2003 decided that the nominal value of the Bank's shares would be rounded down from its precise converted amount (SDR 5,696 at 31 March 2003) to SDR 5,000. This resulted in a reduction of 12.2% in the share capital of the Bank at 31 March 2003, following which the excess amount of SDR 92.1 million was transferred from the Bank's share capital to its reserve funds. There was no impact on the Bank's equity from this change. The adjustments to shareholders' equity are shown in section C below.

B. Conversion and restatement of the Bank's balance sheet

The table below shows how the figures in the published audited balance sheet at 31 March 2003 have been converted into SDR and restated to reflect the revised accounting policies. The figures in the balance sheet at 31 March 2003 are stated after allocation of the year's net profit and incorporate the prior year transfer of GF 1,639.4 million to the Bank's statutory reserves approved at the 2003 Annual General Meeting.

	Balance sheet	Translated into SDR	Revaluations	Reclassifi-cations	Trade date adjustments	Balance sheet
	GF millions					*SDR millions*
Column/notes	1	2	3	4	5	6
Assets						
Cash and sight accounts with banks	3,041.5	4,300.7	–	–	–	4,300.7
Gold and gold deposits	3,299.6	4,665.6	2,876.3	–	–	7,541.9
Treasury bills	14,027.3	19,834.6	0.5	–	889.4	20,724.5
Securities purchased under resale agreements	5,302.2	7,497.3	–	–	4,757.7	12,255.0
Time deposits and advances to banks	40,209.1	56,855.6	48.4	–	1,824.2	58,728.2
Government and other securities	26,791.0	37,882.4	737.5	–	112.7	38,732.6
Derivative financial instruments	–	–	3,966.1	–	–	3,966.1
Accounts receivable	21.7	30.7	–	–	3,143.2	3,173.9
Land, buildings and equipment	138.9	196.4	–	–	–	196.4
Total assets	**92,831.3**	**131,263.3**	**7,628.8**	**–**	**10,727.2**	**149,619.3**
Liabilities						
Currency deposits	83,759.4	118,435.6	1,596.0	–	2,487.4	122,519.0
Gold deposits	2,638.4	3,730.7	2,291.9	–	–	6,022.6
Securities sold under repurchase agreements	51.8	73.2	–	–	–	73.2
Derivative financial instruments	–	–	3,234.1	–	–	3,234.1
Accounts payable	–	–	–	–	8,242.3	8,242.3
Other liabilities	960.6	1,358.4	(759.5)	–	–	598.9
Total liabilities	**87,410.2**	**123,597.9**	**6,362.5**	**–**	**10,729.7**	**140,690.1**
Shareholders' equity						
Share capital	330.7	467.6	285.9	(92.1)	–	661.4
Statutory reserves	4,947.2	6,995.3	577.2	(49.8)	–	7,522.7
Profit and loss account	362.0	511.9	66.0	–	(2.5)	575.4
Shares held in treasury	(522.7)	(739.1)	–	–	–	(739.1)
Other equity accounts	–	–	337.2	571.6	–	908.8
Valuation difference account	303.9	429.7	–	(429.7)	–	–
Total equity	**5,421.1**	**7,665.4**	**1,266.3**	**–**	**(2.5)**	**8,929.2**
Total liabilities and equity	**92,831.3**	**131,263.3**	**7,628.8**	**–**	**10,727.2**	**149,619.3**

Notes to the conversion and restatement of the Bank's balance sheet

1. The figures in this column contain the published audited balance sheet figures in gold francs as at 31 March 2003, before allocation of the year's net profit.
2. The figures in this column are translated from the gold franc figures in column 1 to SDR at the exchange rate of the balance sheet date, SDR 1 = GF 0.7072146 (SDR 1 = USD 1.3730456). The net profit of GF 362.0 million is the statutory net profit of the Bank based on former accounting policies. The figure is translated

into SDR in the above table at the exchange rate of 31 March 2003. Section D below shows the conversion and restatement of the Bank's profit and loss account.

3. The adjustments in this column principally relate to the following revaluations:

   Gold and gold deposits are revalued from the gold franc value of USD 208 per ounce of gold to the market value of SDR 244.11 (USD 335.18) per ounce at 31 March 2003.

   Financial instruments in currencies are revalued from amortised historical cost to market value. The unrealised gains on investment securities were transferred to the securities revaluation reserve (included in "Other equity accounts").

   Derivative financial instruments are revalued from amortised historical cost (included as a net value in liabilities) to gross market value.

4. The amounts in this column comprise:

   The adjustment of the Bank's share capital following the rounding down of the nominal value of the Bank's shares from its precise converted amount (SDR 5,696) to SDR 5,000. The excess amount of SDR 92.1 million was transferred from share capital to the free reserve fund. There was no impact on the Bank's equity from this change.

   The transfer of the balance on the valuation difference account to reserves, as a result of the change to the Bank's accounting policy for currency translation differences.

   The reclassification from statutory reserves to the gold revaluation reserve of the excess of the market value of the Bank's own gold holdings of SDR 244.11 (USD 335.18) per ounce over its former value of USD 208 per ounce.

5. The figures in this column relate to the adjustment to reflect the Bank's assets and liabilities on a trade date basis instead of the previous value date basis.

6. The figures in this column are the final SDR balance sheet figures and are equal to the sum of the figures in columns 2 to 5.

C. Conversion and restatement of the Bank's statutory reserves

The table below shows how the Bank's shareholders' equity in the published audited gold franc accounts at 31 March 2003 (as approved by the AGM of 30 June 2003) has been converted into SDR and restated to reflect the revised accounting policies.

	Balance sheet	Translated into SDR	Revaluations	Reclassifi-cations	Balance sheet
	GF millions				*SDR millions*
Column/notes	1	2	3	4	5
Legal reserve fund	33.1	46.8	19.3	–	66.1
General reserve fund	1,494.5	2,113.2	266.5	–	2,379.7
Special dividend reserve fund	74.5	105.3	–	–	105.3
Free reserve fund	3,345.1	4,730.0	291.4	(49.8)	4,971.6
Total statutory reserves	**4,947.2**	**6,995.3**	**577.2**	**(49.8)**	**7,522.7**

Notes to the conversion and restatement of the Bank's statutory reserves

1. The figures in this column contain the published audited balance sheet figures in gold francs as at 31 March 2003, before allocation of the year's net profit.

2. The figures in this column are translated from the gold franc figures in column 1 to SDR at the exchange rate of the balance sheet date, SDR 1 = GF 0.7072146 (SDR 1 = USD 1.3730456).

3. The figures in this column relate to the revaluations of gold and gold deposits (accounted for in the legal and general reserve funds) and of financial instruments (accounted for in the free reserve fund). This is described in more detail in Section B, note 3 to the restatement of the balance sheet above.

4. The amount in this column comprises:

   The adjustment of the Bank's share capital following the rounding down of the nominal value of the Bank's shares from its precise converted amount (SDR 5,696) to SDR 5,000. The excess amount of SDR 92.1 million was transferred from share capital to the free reserve fund.

   The transfer of the balance on the valuation difference account to reserves, as a result of the change to the Bank's accounting policy for currency translation differences.

   The reclassification from statutory reserves to the gold revaluation reserve of the excess of the market value of the Bank's own gold holdings of SDR 244.11 (USD 335.18) per ounce over its former value of USD 208 per ounce.

5. The figures in this column are the final SDR balance sheet figures and are equal to the sum of the figures in columns 2 to 4.

D. Conversion and restatement of the Bank's profit and loss account

The table below shows how the figures in the published audited gold franc profit and loss account for the financial year ended 31 March 2003 (as approved by the AGM of 30 June 2003) have been converted into SDR and restated to reflect the revised accounting policies. The line descriptions in the table below are those in last year's profit and loss account: they have been renamed in the current year's profit and loss account.

	Profit and loss account	Translated into SDR	Revaluations	Trade date adjustments	Reclassification	Profit and loss account
	GF millions					*SDR millions*
Column/notes	1	2	3	4	5	6
Net interest and other operating income	**359.2**	**525.4**	**66.0**	**(2.5)**	**9.4**	**598.3**
Less: costs of administration	(98.3)	(142.3)	–	–	–	(142.3)
Operating profit	**260.9**	**383.1**	**66.0**	**(2.5)**	**9.4**	**456.0**
Profits on sales of investment securities	108.2	156.4	–	–	(9.4)	147.0
Shares repurchased – interest on arbitral award	(7.1)	(10.2)	–	–	–	(10.2)
Net profit for the financial year	**362.0**	**529.3**	**66.0**	**(2.5)**	–	**592.8**
Adjustment to the year-end rate of exchange						(17.4)
Balance on profit and loss account						**575.4**

Notes to the conversion and restatement of the Bank's profit and loss account

1. The figures in this column are extracted from the published audited profit and loss account in gold francs for the financial year ended 31 March 2003.
2. The SDR equivalent figures are translated from the gold franc figures in column 1 at the average exchange rate for the financial year.
3. The adjustment in this column represents the change in the net unrealised profit in accounting for the Bank's financial assets, financial liabilities and derivatives at market value through the profit and loss account.
4. This represents the small profit impact from recognising movements in the market value of the Bank's assets, liabilities and derivatives on a trade date basis instead of a value date basis.
5. This column represents the reclassification of valuation profits on derivative instruments following the introduction of the Bank's revised accounting policies.
6. The figures in this column are the final SDR profit and loss account figures and are equal to the sum of the figures in columns 2 to 4.

E. Currency translation movement

Included in "Movements in the Bank's equity" on page 195 is a negative currency translation movement in the financial year ended 31 March 2003 of SDR 275.8 million. This movement arose because the proportion of the Bank's investment assets (other than gold and gold deposits) in US dollars (67% at 31 March 2002) was higher than the proportion of the US dollar in the SDR basket of currencies (approximately 46%), and the US dollar declined by about 10% against the SDR during the financial year.

Prior to 1 April 2003, the proportion of investment assets invested in each currency broadly reflected the relative importance of the main currencies in the international foreign exchange reserves and financial transactions. The resulting exchange movements from this passive currency risk management policy were reflected in an equity account, the valuation difference account.

In parallel with the replacement of the gold franc by the SDR as the Bank's reporting currency, the Bank changed its policy so as to align the currency composition of its investment assets (other than gold and gold deposits) with that of the SDR basket of currencies. A temporary exception to this policy exists because of the repurchase of the shares in the BIS during the financial year ended 31 March 2001 pending their redistribution by the Board (see note 31).

The negative currency translation movement has therefore been taken to equity rather than included in net profit because it arises from the change in reporting currency on 1 April 2003, and does not reflect the operating performance of the Bank.

32. Subsequent event

In addition to the proceedings before the Hague Arbitral Tribunal which led to the Final Award of 19 September 2003 (see note 15), the withdrawal of privately held BIS shares gave rise to a proceeding brought by a separate group of former private shareholders before the Commercial Court in Paris. That Court made a preliminary determination (without addressing the substance of the matter) in March 2003 that it has jurisdiction over claims seeking to increase the amount of compensation. The Bank subsequently requested review of this procedural decision by the Paris Court of Appeals, arguing that the Arbitral Tribunal in The

Hague has exclusive jurisdiction over the matter. In a decision rendered on 25 February 2004, the Paris Court of Appeals ruled in favour of the Bank by concluding that the Paris Commercial Court had no jurisdiction over such claims. In April 2004, a proceeding was initiated before the French Cour de Cassation by a small group of former private shareholders for the quashing of the ruling of the appeal court on the jurisdiction issue. The Bank considers this action to be without merit. Accordingly, no separate provision has been made for these claims.

Report of the auditors

Report of the auditors
to the Board of Directors and to the General Meeting
of the Bank for International Settlements, Basel

We have audited the accompanying financial statements (pages 192 to 213), of the Bank for International Settlements. These financial statements incorporate the balance sheet and profit and loss account, as required by the Bank's Statutes, and the notes thereto. The financial statements have been prepared by the Management of the Bank in accordance with the Statutes and with the principles of valuation described under significant accounting policies in the notes. Our responsibility under the Statutes of the Bank is to form an independent opinion on the balance sheet and profit and loss account based on our audit and to report our opinion to you.

Our audit included examining, on a test basis, evidence supporting the amounts in the balance sheet and profit and loss account and related disclosures. We have received all the information and explanations which we have required to obtain assurance that the balance sheet and profit and loss account are free of material misstatement, and believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements, including the notes thereto, have been properly drawn up and give a true and fair view of the financial position of the Bank for International Settlements at 31 March 2004 and the results of its operations for the year then ended so as to comply with the Statutes of the Bank.

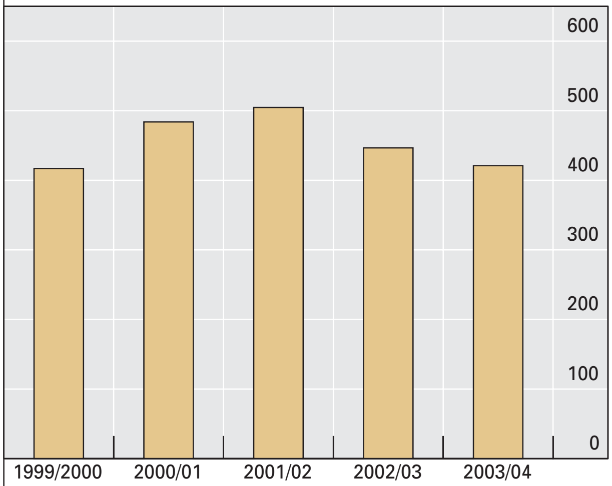
PricewaterhouseCoopers AG

Anthony W Travis Albert Schönenberger

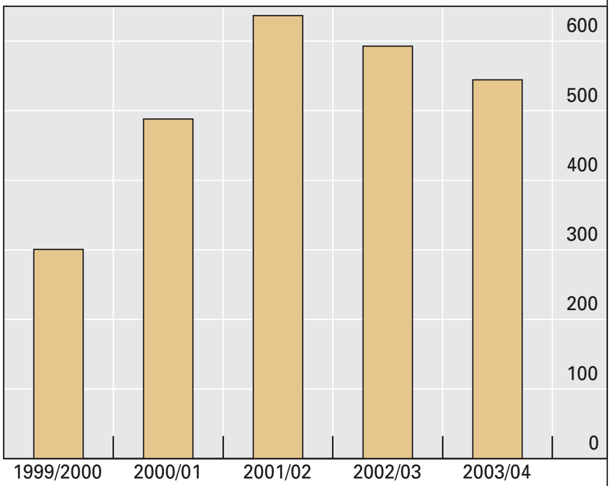
Basel, 10 May 2004

Five-year graphical summary

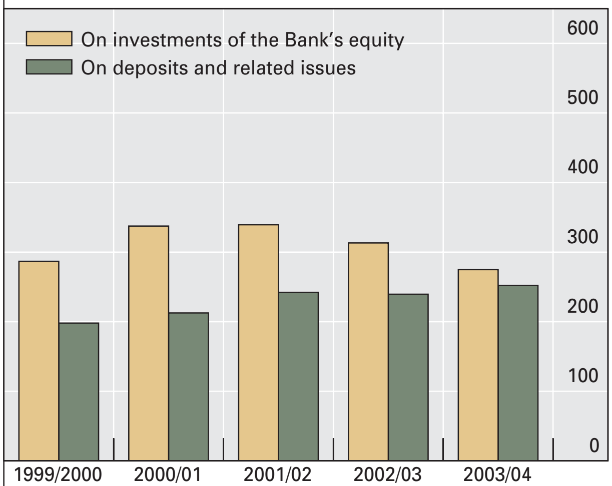
Operating profit
SDR millions



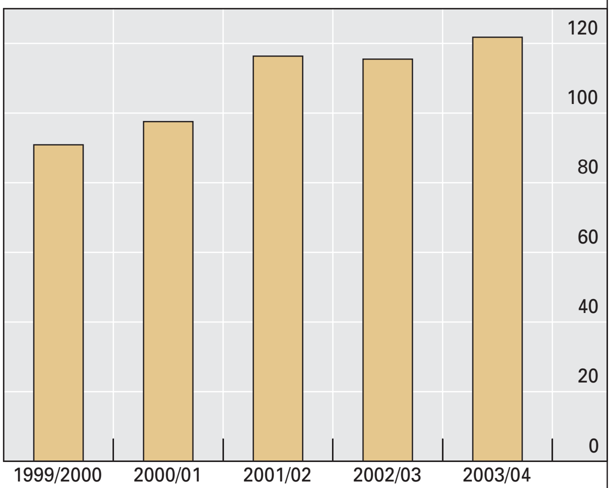
Net profit
SDR millions



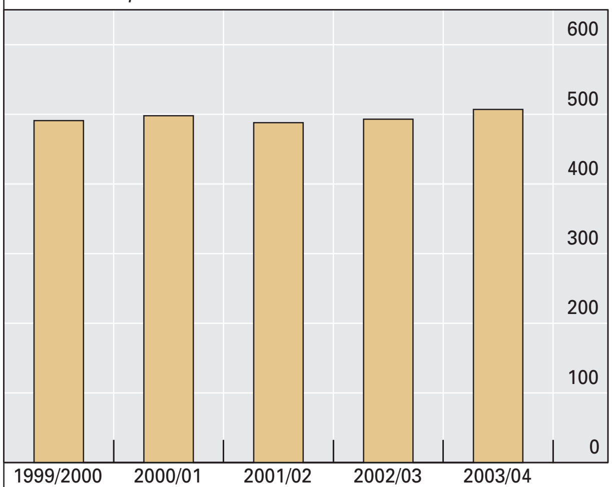
Net interest earned on currency investments
SDR millions



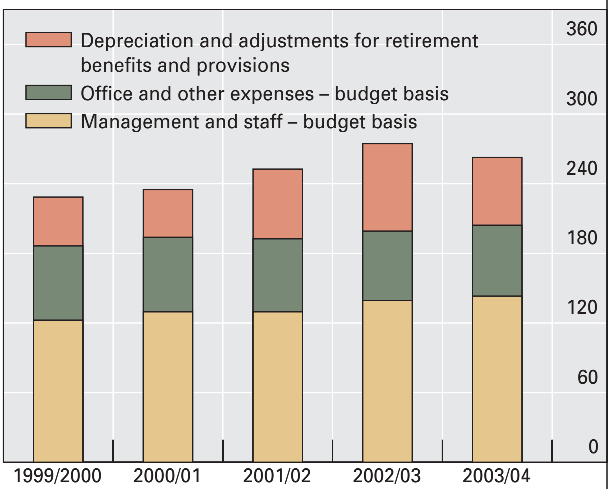
Average currency deposits (value date accruals basis)
SDR billions



Average number of employees
Full-time equivalent



Operating expense
CHF millions



Note: The financial information for the years prior to 2002/03 is based on best estimates.

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