



Annual Accounts

2016

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Management report for the year ending 31 December 2016

1 Purpose of the ECB's management report

The ECB is part of the Eurosystem, the primary objective of which is to maintain price stability. The ECB's main tasks, as described in the Statute of the ESCB, comprise the implementation of the monetary policy of the European Union, the conduct of foreign exchange operations, the management of the official foreign reserves of the euro area countries and the promotion of the smooth operation of payment systems.

Moreover, the ECB is responsible for the effective and consistent functioning of the Single Supervisory Mechanism (SSM), with a view to carrying out intrusive and effective banking supervision, contributing to the safety and soundness of the banking system and the stability of the financial system.

Given that the ECB's activities and operations are undertaken in support of its policy objectives, its financial result should be viewed in conjunction with its policy actions. In this respect, the management report is an integral part of the ECB's Annual Accounts as it provides readers with contextual information on the business of the ECB and the impact of the ECB's key activities and operations on its risks and financial statements.¹

Furthermore, this report provides information on the ECB's financial resources, as well as on the key processes related to the production of its financial statements.

2 Key processes and functions

The ECB's internal processes ensure the quality and accuracy of the information included in its financial statements. Moreover, a number of key functions are involved in implementing policy decisions, which have a significant influence on the reported figures.

2.1 Controls within organisational units

Within the ECB's internal control structure, each business area is responsible for managing its own operational risks and implementing controls to ensure the effectiveness and efficiency of its operations and the accuracy of the information to

¹ The "financial statements" comprise the Balance Sheet, the Profit and Loss account and the related notes. The "Annual Accounts" comprise the financial statements, the management report, the auditor's report and the note on profit distribution/allocation of losses.

be included in the financial statements of the ECB. The implementation of the budget also falls primarily under the responsibility and accountability of the individual business areas.

2.2 Budgetary processes

The Budgeting and Controlling Division (BCO) of the Directorate General Finance develops, prepares and monitors the budget in line with the strategic priorities set by the Governing Council and the Executive Board. These tasks are carried out in cooperation with the business areas, while applying the separation principle.² BCO also provides planning and resource controlling, cost-benefit analysis and investment analysis for ECB projects and contributes to these processes for ESCB projects in line with the agreed frameworks. Expenditure against agreed budgets is monitored at regular intervals by the Executive Board, taking into account the advice of BCO under the guidance of the Chief Services Officer (CSO), and by the Governing Council, with the assistance of the Budget Committee (BUCOM). In accordance with Article 15 of the ECB's Rules of Procedure, BUCOM supports the Governing Council by evaluating the ECB's annual budget proposals and the Executive Board's requests for supplementary budget funding, prior to their submission to the Governing Council for approval.

2.3 Portfolio management

The ECB holds euro-denominated securities for monetary policy purposes, acquired in the context of the Securities Markets Programme (SMP), the asset-backed securities purchase programme (ABSPP), the public sector purchase programme (PSPP), and the three covered bond purchase programmes (CBPPs).³ The purpose of the purchase programmes⁴ is the further easing of monetary and financial conditions, thereby contributing to a return of inflation rates towards levels below, but close to, 2% over the medium term. Purchases under these programmes are based on the Governing Council's decisions on the overall monthly Eurosystem purchases and are subject to predetermined eligibility criteria.

Furthermore, the ECB has a foreign reserves portfolio, which consists of US dollars, Japanese yen, gold and special drawing rights, and an own funds investment portfolio denominated in euro.

The purpose of the ECB's foreign reserves is to finance potential interventions in the foreign exchange market. This purpose determines the high-level portfolio

² The separation principle refers to the requirement laid down in the SSM Regulation for the ECB to carry out its supervisory tasks without prejudice to and separately from its tasks relating to monetary policy and any other tasks.

³ The ECB does not hold assets acquired under the corporate sector purchase programme (CSPP), which started on 8 June 2016. Purchases under the CSPP are conducted by six NCBs on behalf of the Eurosystem.

⁴ The ECB currently purchases securities under the third CBPP, the ABSPP and PSPP. Purchases under the first two CBPPs and the SMP have been terminated.

management objectives, which are, in order of priority, liquidity, safety and return. The investment of the ECB's foreign reserves is managed by a central risk management function while investment operations are conducted in a decentralised manner. For the US dollar and Japanese yen portfolios, a strategic benchmark portfolio is decided upon by the Governing Council, following a proposal from the risk management function of the ECB. Subsequently, the ECB's portfolio managers devise the tactical benchmark portfolios. Based on those portfolios, actual positions are implemented by portfolio managers at the national central banks (NCBs).

The purpose of the ECB's own funds portfolio of euro-denominated assets is to provide income to help fund the ECB's operating expenses which are not related to the performance of its supervisory tasks.⁵ In this context, the objective of the management of the own funds portfolio is to maximise returns, subject to a number of risk limits.

In addition, funds relating to the ECB's pension plans are invested in an externally managed portfolio.

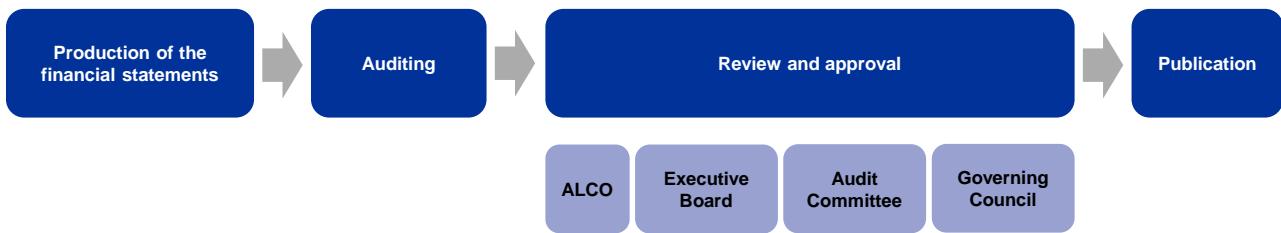
2.4 Financial risk oversight functions

The ECB's Directorate Risk Management proposes policies and procedures that ensure an appropriate level of protection against financial risks for the ECB in connection with its monetary policy securities portfolios, foreign reserves portfolio and euro-denominated own funds investment portfolio. Furthermore, the Risk Management Committee (RMC), which comprises experts from Eurosystem central banks, assists the decision-making bodies in ensuring an appropriate level of protection for the Eurosystem, including the ECB. This is achieved by managing and controlling the financial risks originating from market operations. With regard to these activities, the RMC contributes, inter alia, to the monitoring, measuring and reporting of financial risks on the balance sheet of the Eurosystem, including the ECB, and the definition and review of the associated methodologies and frameworks.

2.5 Production of the ECB's financial statements

The financial statements of the ECB are drawn up in accordance with the principles established by the Governing Council. The production and the approval process for the ECB's financial statements prior to their publication is illustrated in the chart below.

⁵ The expenditure incurred by the ECB in the performance of its supervisory tasks is recovered via annual fees levied on supervised entities.



The Financial Reporting Division of the Directorate General Finance is responsible for producing the financial statements in cooperation with other business areas and for ensuring that all related documentation is made available in a timely manner to the auditors and to the decision-making bodies.

The financial statements of the ECB are audited by independent external auditors recommended by the Governing Council and approved by the EU Council.⁶ The responsibility of the external auditors is to express an opinion as to whether the financial statements give a true and fair view of the financial position of the ECB and of the results of its operations, in accordance with the accounting policies established by the Governing Council. In this regard, the external auditors examine the books and accounts of the ECB, evaluate the adequacy of internal controls applied to the preparation and presentation of the financial statements and assess the appropriateness of the accounting policies used.

The financial reporting processes and the ECB's financial statements may also be subject to internal audits. All reports by the Directorate Internal Audit, which may include recommendations addressed to the business areas concerned, are submitted to the Executive Board.

The ECB's Assets and Liabilities Committee (ALCO), which is composed of representatives from various business areas of the ECB, systematically monitors and assesses all factors that may have an impact on the ECB's Balance Sheet and Profit and Loss Account. It reviews the financial statements and the related documentation before they are submitted to the Executive Board for endorsement.

After the Executive Board has authorised their issuance, the financial statements, together with the external auditor's opinion and all relevant documentation, are submitted to the Audit Committee⁷ for review prior to their approval by the Governing Council. The Audit Committee provides assistance to the Governing Council regarding its responsibilities concerning, inter alia, the integrity of financial information and the oversight of internal controls. In this context, the Audit Committee assesses the ECB's financial statements and considers whether they provide a true and fair view and were drawn up in accordance with approved accounting rules. It also reviews any significant accounting or financial reporting issue that could have an impact on the ECB's financial statements.

⁶ In order to reinforce public assurance as to the independence of the ECB's external auditors, the principle of audit firm rotation every five years is applied.

⁷ The Audit Committee is composed of five members: the Vice-President of the ECB, two senior governors of euro area NCBS and two external members, chosen from among high-ranking officials with experience in central banking.

The ECB's financial statements, management report and note on profit distribution/allocation of losses are approved by the Governing Council in February of each year and published immediately thereafter, together with the auditor's report.

3 Risk management

Risk management is a critical part of the ECB's activities and is conducted through a continuous process of risk identification, assessment, mitigation and monitoring. The table below presents the main risks to which the ECB is exposed, as well as their sources and the applicable risk control frameworks. The subsequent sections provide further details.

Risks to which the ECB is exposed

| Risk | Component | Type of risk | Source of risk | Risk control framework |
|-------------------------------|-----------------------------|---|---|--|
| Financial risks | Credit risk ¹ | Credit default risk | <ul style="list-style-type: none"> foreign reserves holdings euro-denominated investment portfolio monetary policy securities holdings | <ul style="list-style-type: none"> eligibility criteria exposure limits diversification collateralisation financial risk monitoring |
| | | Credit migration risk | <ul style="list-style-type: none"> foreign reserves holdings euro-denominated investment portfolio | |
| | Market risk | Currency and commodity risks ² | <ul style="list-style-type: none"> foreign reserves holdings gold holdings | <ul style="list-style-type: none"> diversification revaluation accounts financial risk monitoring |
| | | Interest rate risk ³ | <ul style="list-style-type: none"> foreign reserves holdings euro-denominated investment portfolio <hr/> <ul style="list-style-type: none"> ECB's Balance Sheet as a whole | <ul style="list-style-type: none"> market risk limits asset allocation policies revaluation accounts financial risk monitoring <hr/> <ul style="list-style-type: none"> asset allocation policies financial risk monitoring |
| | Liquidity risk ⁴ | | <ul style="list-style-type: none"> foreign reserves holdings | <ul style="list-style-type: none"> asset allocation policies liquidity limits financial risk monitoring |
| Operational risk ⁵ | | | <ul style="list-style-type: none"> workforce, personnel resourcing, personnel policies internal governance and business processes systems external events | <ul style="list-style-type: none"> identifying, assessing, responding, reporting and monitoring operational risks operational risk management framework including risk tolerance policy business continuity management framework crisis management framework |

1) **Credit risk** is the risk of incurring financial losses owing to a "default event" which stems from the failure of an obligor (counterparty or issuer) to meet its financial obligations in a timely manner or a re-pricing of financial assets following a deterioration in their credit quality and ratings.

2) **Currency and commodity risks** are risks of incurring financial losses on (a) positions denominated in foreign currency, owing to fluctuations in exchange rates, and (b) on holdings of commodities, owing to fluctuations in their market prices.

3) **Interest rate risk** is the risk of incurring financial losses as a result of adverse changes in interest rates giving rise to (i) a mark-to-market decline in the value of financial instruments or (ii) a negative impact on net interest income.

4) **Liquidity risk** is the risk of incurring financial losses owing to the inability to liquidate an asset at its prevailing market value within an appropriate time frame.

5) **Operational risk** is the risk of a negative financial, business or reputational impact resulting from people, the inadequate implementation or failure of internal governance and business processes, the failure of systems on which processes rely, or external events (e.g. natural disasters or external attacks).

3.1 Financial risks

Financial risks arise from the ECB's core activities and associated exposures. The ECB decides its asset allocation and implements appropriate risk management frameworks, taking into account the objectives and purposes of the various portfolios

and the financial exposures, as well as the risk preferences of its decision-making bodies.

Financial risks can be quantified using a variety of risk measures. The ECB applies risk estimation techniques developed in-house, which rely on a joint market and credit risk simulation framework. The core modelling concepts, techniques and assumptions underlying the risk measures draw on market standards and available market data.

In order to obtain a comprehensive understanding of potential risk events that could occur at different frequencies with different degrees of severity, and to avoid reliance on a single risk measure, the ECB uses mainly two types of statistical risk measure, Value at Risk (VaR) and Expected Shortfall (ES),⁸ estimated at different confidence levels, over a one-year horizon. These risk measures do not consider (i) the liquidity risk of the ECB's portfolios, particularly its foreign reserves holdings, and (ii) the long-term risk of reductions in the net interest income earned by the ECB. For this reason, and to better understand and complement these statistical risk estimates, the ECB also regularly performs sensitivity and stress scenario analyses and longer-term projections of exposures and income.

As at 31 December 2016 the financial risks for all the ECB's portfolios combined, as measured by the VaR at a 95% confidence level over a one-year horizon, stood at €10.6 billion, which was €0.6 billion higher than the risks estimated as at 31 December 2015. This rise is mainly due to the increase in the value of the ECB's gold holdings resulting from the rise in the price of gold in 2016. The additional risk is mitigated by an increase in the respective revaluation accounts.

3.1.1 Credit risk

The risk control frameworks and limits that the ECB uses to manage its credit risk profile differ across types of operation, reflecting the policy or investment objectives of the different portfolios and the risk characteristics of the underlying assets.

The credit risk arising from the ECB's foreign reserves holdings is low, as the reserves are invested in assets with a high credit quality.

The purpose of the euro-denominated own funds portfolio is to provide the ECB with income to help fund its operating expenses which are not related to the performance of its supervisory tasks, while preserving the invested capital. Return considerations therefore play a relatively greater role in the asset allocation and risk control framework for these holdings than they do for the ECB's foreign reserves portfolio. Notwithstanding, the credit risk in respect of these holdings is kept at low levels.

⁸ VaR is defined as the maximum loss that, according to a statistical model, will not be exceeded with a given probability (confidence level). ES is defined as a probability-weighted average loss in the scenarios that exceed the VaR threshold with a given confidence level.

The securities acquired for monetary policy purposes are valued at amortised cost subject to impairment, therefore, any credit migration associated with these securities does not directly affect the financial statements of the ECB. However, these securities are still subject to credit default risk, which is kept within the risk tolerance levels of the ECB by means of the applied risk management framework.

3.1.2 Market risk

In managing its holdings, the main types of market risk to which the ECB is exposed are currency and commodity (gold price) risks. The ECB is also exposed to interest rate risk.

Currency and commodity risks

Currency and commodity risks dominate the ECB's financial risk profile. This is due to the size of its foreign reserves (mainly comprising US dollars) and gold holdings, as well as the high degree of volatility in exchange rates and gold prices.

In view of the policy role of gold and foreign reserves, the ECB does not seek to eliminate currency and commodity risks. These risks are in effect mitigated by the diversification of the holdings across different currencies and gold.

In line with the Eurosystem rules, the gold and US dollar revaluation accounts, which amounted to €13.9 billion (2015: €11.9 billion) and €12.0 billion (2015: €10.6 billion) respectively as at 31 December 2016, can be used to absorb the impact of future unfavourable movements in gold prices and the US dollar exchange rate, thereby mitigating or even preventing any impact on the ECB's Profit and Loss Account.

Interest rate risk

The ECB's foreign reserves and euro-denominated own funds portfolios are mainly invested in fixed income securities. These securities are revalued at market prices and are therefore exposed to market risk arising from interest rate movements. This mark-to-market interest rate risk is managed through asset allocation policies and market risk limits.

The interest rate risk arising from the ECB's foreign reserves holdings is low, as these reserves are mainly invested in assets with relatively short maturities in order to preserve at all times the market value of the foreign reserves, which are held for possible intervention purposes. As this is not such a major consideration for the euro-denominated own funds portfolio, the assets in this portfolio generally have longer maturities, resulting in a higher, but still limited, level of interest rate risk.

The ECB is also exposed to the risk of a mismatch between the interest rate earned on its assets and the interest rate paid on its liabilities, which has an impact on its net interest income. This risk is not directly linked to any particular portfolio, rather it is

linked to the structure of the ECB's Balance Sheet as a whole, particularly the existence of maturity and yield mismatches between assets and liabilities. Asset allocation policies, including policies and procedures that ensure that purchases are conducted at appropriate prices, are used to manage this type of risk, subject to monetary policy considerations. It is further mitigated by the existence of unremunerated liabilities on the ECB's Balance Sheet.

The ECB monitors this risk by carrying out a forward-looking analysis of its profitability. This analysis reveals that the ECB is expected to continue to earn net interest income in the coming years, despite the increasing share of monetary policy assets with low yields and long maturities on its Balance Sheet as a result of the ongoing monetary policy asset purchase programmes.

3.1.3 Liquidity risk

Owing to the role of the euro as a major reserve currency, the ECB's role as a central bank and its asset and liability structure, the ECB's main exposure to liquidity risk stems from its foreign reserves. This is because large amounts of these holdings may need to be liquidated within short periods of time, in order to carry out foreign exchange interventions. To manage this risk, asset allocation policies and limits ensure that a sufficiently large share of the ECB's holdings is invested in assets that can be liquidated quickly with a negligible impact on the price.

In 2016 the liquidity risk of the ECB's portfolios continued to be low.

3.2 Operational risk

The main objectives of the ECB's operational risk management (ORM) framework are (a) to contribute to ensuring that the ECB achieves its mission and objectives, and (b) to protect its reputation and other assets against loss, misuse and damage.

Under the ORM framework, each business area is responsible for identifying, assessing, responding to, reporting on and monitoring its operational risks and controls. Business areas with a transversal role provide specific controls at a bank-wide level. In this context, the ECB's risk tolerance policy provides guidance with regard to risk response strategies and risk acceptance procedures. It is linked to a risk matrix based on the ECB's impact and likelihood grading scales (which apply quantitative and qualitative criteria).

The ORM/BCM Section under the CSO is responsible for maintaining the ORM and business continuity management (BCM) frameworks and for providing methodological assistance in respect of ORM and BCM activities to risk and control owners. Moreover, it provides annual and ad hoc reports on operational risks to the Operational Risk Committee and the Executive Board, and it supports the decision-making bodies in their oversight role regarding the management of the ECB's operational risks and controls. It coordinates the BCM programme, the regular business continuity tests and reviews of business continuity arrangements for the

ECB's time-critical operations. Finally, it supports the Crisis Management Team, including its support structures, as well as business areas, in (exceptional) situations that have the potential to develop into an operational crisis.

4 Financial resources

The ECB's financial resources are (i) invested in assets that generate income, and/or (ii) used to directly offset losses materialising from financial risks. These financial resources consist of capital, the general risk provision, revaluation accounts and the net income for the year.

Capital

The ECB's paid-up capital amounted to €7,740 million on 31 December 2016. Detailed information is provided in note 15.1, "Capital", in the notes on the Balance Sheet.

Provision for foreign exchange rate, interest rate, credit and gold price risks

In view of the ECB's considerable exposure to financial risks as described in Section 3.1, the ECB maintains a provision for foreign exchange rate (currency), interest rate, credit and gold price (commodity) risks. The size of and continuing requirement for this provision is reviewed annually, taking a range of factors into account, including the level of holdings of risk-bearing assets, projected results for the coming year and a risk assessment. This risk assessment is described in Section 3.1 and is applied consistently over time. The risk provision, together with any amounts held in the ECB's general reserve fund, may not exceed the value of the capital paid up by the euro area NCBs.

As at 31 December 2016 the provision for foreign exchange rate, interest rate, credit and gold price risks amounted to €7,620 million, which is equal to the value of the ECB's capital paid up by the euro area NCBs as at that date.

Revaluation accounts

Unrealised gains on gold, foreign currencies and securities that are subject to price revaluation are not recognised as income in the Profit and Loss Account but are recorded directly in revaluation accounts shown on the liability side of the ECB's Balance Sheet. These balances can be used to absorb the impact of any future unfavourable movement in the respective prices and/or exchange rates, and therefore strengthen the ECB's resilience to the underlying risks.

The total amount of revaluation accounts for gold, foreign currencies and securities as at the end of December 2016 stood at €28.8 billion⁹ (2015: €25.0 billion). For further information, see the notes on accounting policies and note 14, “Revaluation accounts”, in the notes on the Balance Sheet.

Net income

The net income resulting from the ECB’s assets and liabilities in a given financial year could be used to absorb potential losses incurred in the same year if financial risks materialise. Thus, net income contributes to safeguarding the ECB’s net equity.

Developments in the ECB’s financial resources

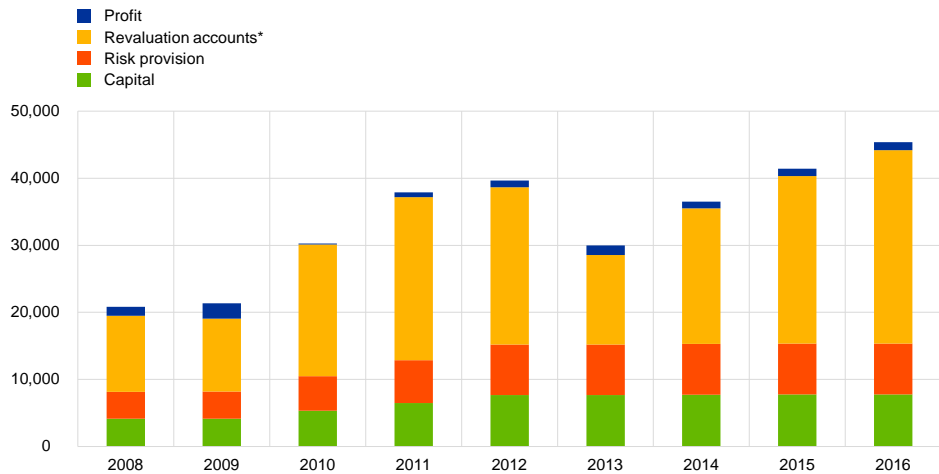
Chart 1 presents the evolution of the above-mentioned financial resources of the ECB and of the main foreign exchange rates and gold prices for the period 2008-16. During this period (a) the paid-up capital of the ECB almost doubled as a result of the decision taken by the Governing Council in 2010 to increase the subscribed capital; (b) the risk provision rose to an amount equal to the paid-up capital of the euro area NCBs; (c) the revaluation accounts exhibited a notable degree of volatility, which was mainly due to movements in foreign exchange rates and the price of gold; and (d) the net profit ranged from €0.2 billion to €2.3 billion and was influenced by a number of factors, such as the transfers to the ECB’s risk provision, developments in interest rates and the monetary policy-related securities purchases.

⁹ In addition, the balance sheet item “Revaluation accounts” includes remeasurements in respect of post-employment benefits.

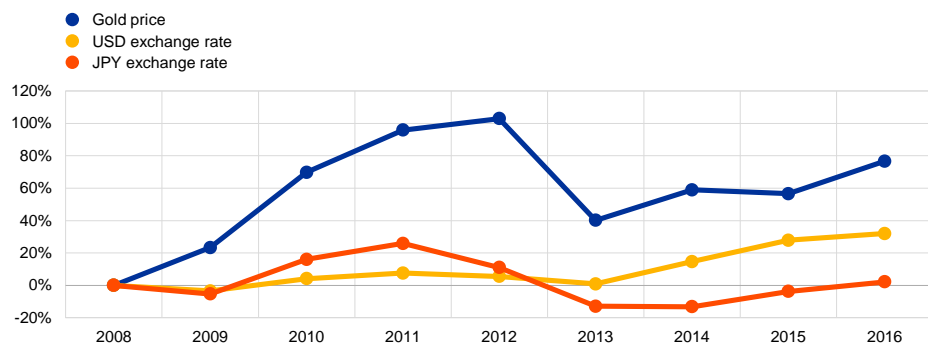
Chart 1

The ECB's financial resources, the main foreign exchange rates and gold prices¹⁰ over the period 2008-16

(EUR millions)



(percentage changes 2008)



Source: ECB.

* This includes total revaluation gains on gold, foreign currency and securities.

5 The impact of key activities on the financial statements

The table provides an overview of the main operations and functions of the ECB in pursuit of its mandate, and their impact on the ECB's financial statements. The full extent of the Eurosystem's monetary policy operations is reflected in the ECB's financial statements, together with those of the euro area NCBs, reflecting the principle of decentralised implementation of monetary policy in the Eurosystem.

¹⁰ Developments in the main foreign exchange rates and the price of gold are presented as the percentage change compared with the exchange rates and the price of gold prevailing at the end of 2008.

| Operation/Function | Impact on the ECB's financial statements |
|---|--|
| Monetary policy operations | Monetary policy operations conducted with the standard set of instruments (i.e. open market operations, standing facilities and minimum reserve requirements for credit institutions) are implemented in a decentralised manner by the NCBs of the Eurosystem. Accordingly, these operations are not reflected on the ECB's Balance Sheet. |
| Securities held for monetary policy purposes (under the CBPPs, SMP, ABSPP and PSPP) ¹¹ | Securities purchased for monetary policy purposes are recorded under the balance sheet item "Securities held for monetary policy purposes". Holdings in these portfolios are accounted for at amortised cost and an impairment test is conducted at least annually. Coupon accruals and amortised premiums and discounts are included in the Profit and Loss Account. ¹² |
| Investment activities (management of foreign reserves and own funds) | The ECB's foreign reserves are presented on-balance sheet ¹³ or are reflected in off-balance-sheet accounts until the settlement date. The own funds portfolio of the ECB is presented on-balance sheet, mainly under the item "Other financial assets". Net interest income, including coupon accruals and amortised premiums and discounts, is included in the Profit and Loss Account. ¹⁴ Unrealised price and exchange rate losses exceeding previously recorded unrealised gains on the same items, as well as realised gains and losses arising from the sale of securities, are also included in the Profit and Loss Account. ¹⁵ Unrealised gains are recorded on-balance sheet under the item "Revaluation accounts". |
| Liquidity-providing operations in foreign currency | The ECB acts as an intermediary between non-euro area central banks and the Eurosystem NCBs by means of swap transactions aimed at offering short-term foreign currency funding to Eurosystem counterparties. These operations are recorded in the balance sheet items "Liabilities to non-euro area residents denominated in euro" and "Other claims/liabilities within the Eurosystem" and have no impact on the ECB's Profit and Loss Account. |
| Payment systems (TARGET2) | Intra-Eurosystem balances of euro area NCBs vis-à-vis the ECB arising from TARGET2 are presented on the Balance Sheet of the ECB as a single net asset or liability position. The remuneration of those balances is included in the Profit and Loss Account under the items "Other interest income" and "Other interest expense". |
| Banknotes in circulation | The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation. This share is backed by claims on the NCBs, which bear interest at the rate on the main refinancing operations. This interest is included in the Profit and Loss Account under the item "Interest income arising from the allocation of euro banknotes within the Eurosystem". Expenses arising from the cross-border transportation of euro banknotes between banknote printing works and NCBs, for the delivery of new banknotes, and between NCBs, for the compensation of shortages with surplus stocks, are borne centrally by the ECB. These expenses are presented in the Profit and Loss Account under the heading "Banknote production services". |
| Banking supervision | The annual costs of the ECB in relation to its supervisory tasks are recovered via annual supervisory fees levied on the supervised entities. The supervisory fees are included in the Profit and Loss Account under the heading "Net income from fees and commissions". |

6 Financial result for 2016

In 2016 the ECB's net profit was €1,193 million (2015: €1,082 million).

Chart 2 presents the components of the ECB's Profit and Loss Account in 2016 and a comparison with 2015.

¹¹ The ECB does not purchase securities under the corporate sector purchase programme.

¹² Reported on a net basis under either "Other interest income" or "Other interest expense", depending on whether the net amount is positive or negative.

¹³ Mainly recorded under "Gold and gold receivables", "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency" and "Liabilities to non-euro area residents denominated in foreign currency".

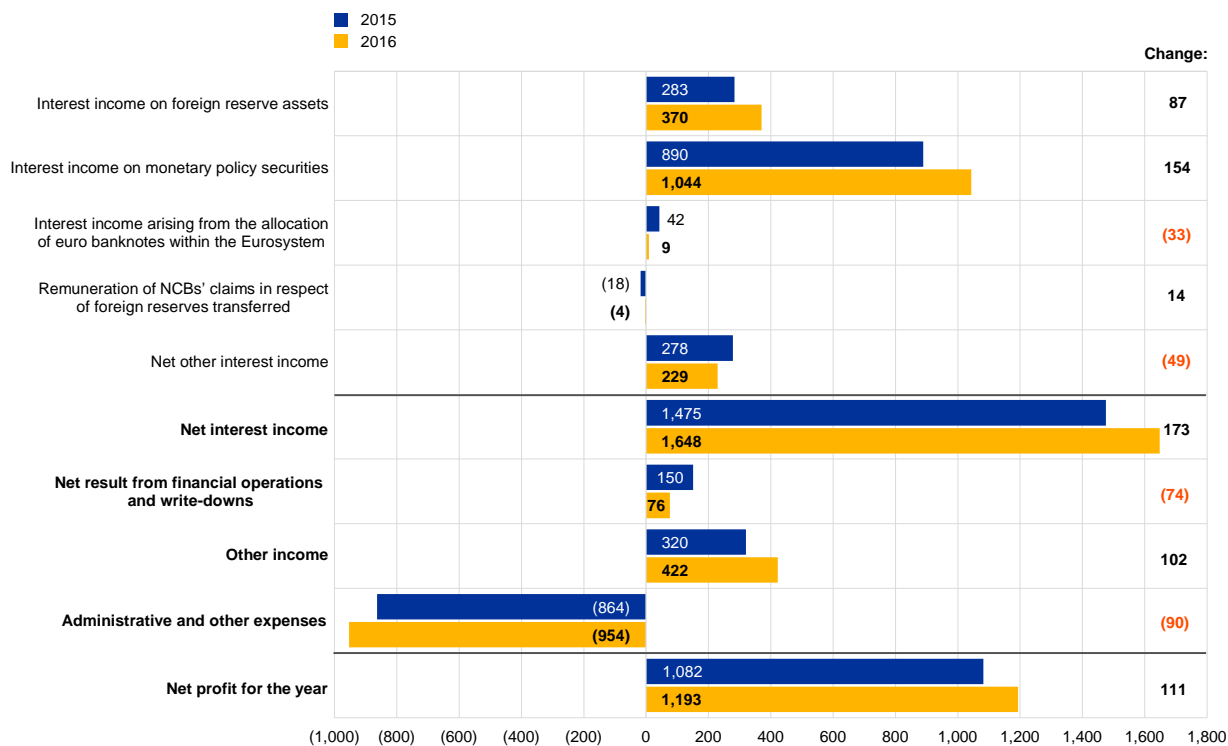
¹⁴ Income related to the ECB's foreign reserves is disclosed under the item "Interest income on foreign reserve assets", while the interest income and expenses on its own funds are reflected in "Other interest income" and "Other interest expense".

¹⁵ Recorded under the items "Write-downs on financial assets and positions" and "Realised gains/losses arising from financial operations", respectively.

Chart 2

Breakdown of the ECB's Profit and Loss Account in 2016 and 2015

(EUR millions)



Source: ECB.

Highlights

- Interest income on foreign reserve assets increased by €87 million mainly as a result of the higher interest income earned on securities denominated in US dollars.
- Interest income on securities purchased for monetary policy purposes increased from €890 million in 2015 to €1,044 million in 2016. The reduction in income owing to the maturing of securities purchased under the SMP and the first and second CBPPs was more than offset by income arising from the asset purchase programme (APP).¹⁶
- Interest income on the ECB's share of the total euro banknotes in circulation and interest expense payable to the NCBs in respect of foreign reserves transferred fell by €33 million and €14 million respectively, as a result of the lower average rate on the main refinancing operations in 2016.

¹⁶ The APP consists of the CBPP3, ABSPP, PSPP and the corporate sector purchase programme (CSPP). The ECB does not purchase securities under the CSPP. Further details on the APP can be found [on the ECB's website](#).

- Net other interest income decreased, mainly owing to the lower interest income on the own funds portfolio resulting from the low-yield environment in the euro area.
- The net result of financial operations and write-downs on financial assets decreased by €74 million, mainly owing to the higher year-end write-downs stemming from the overall decrease in the market prices of securities held in the US dollar portfolio.
- The total administrative expenses of the ECB, including depreciation, amounted to €954 million, compared with €864 million in 2015. This increase was due to higher costs incurred in connection with the Single Supervisory Mechanism (SSM). The full SSM-related costs are recovered via fees charged to the supervised entities. As a result, other income increased to €422 million (2015: €320 million).

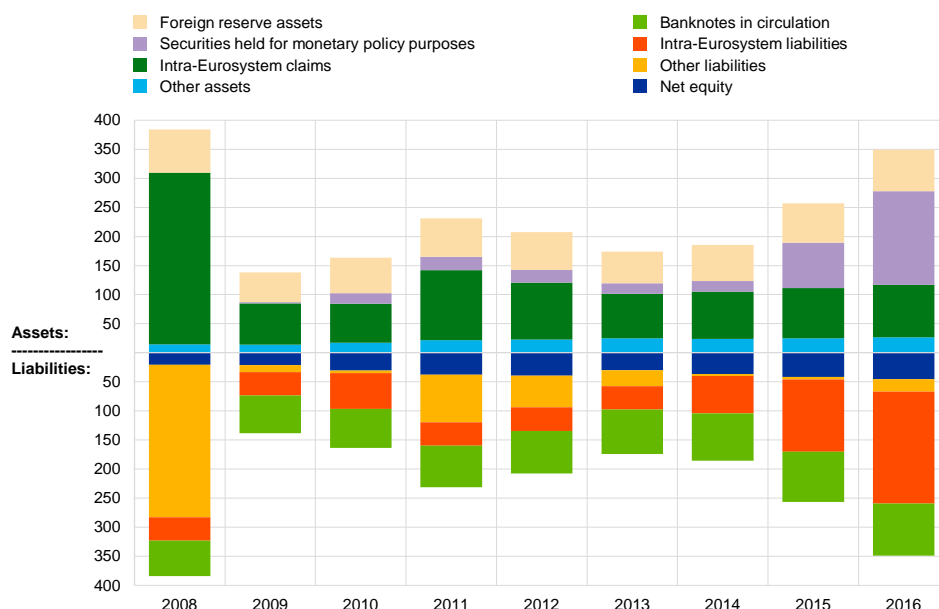
7 Long-term developments in the ECB's financial statements

Charts 3 and 4 present the evolution of the Balance Sheet and Profit and Loss Account of the ECB, as well as their components, over the period 2008-16.

Chart 3

Evolution of the ECB's Balance Sheet in the period 2008-16¹⁷

(EUR billions)



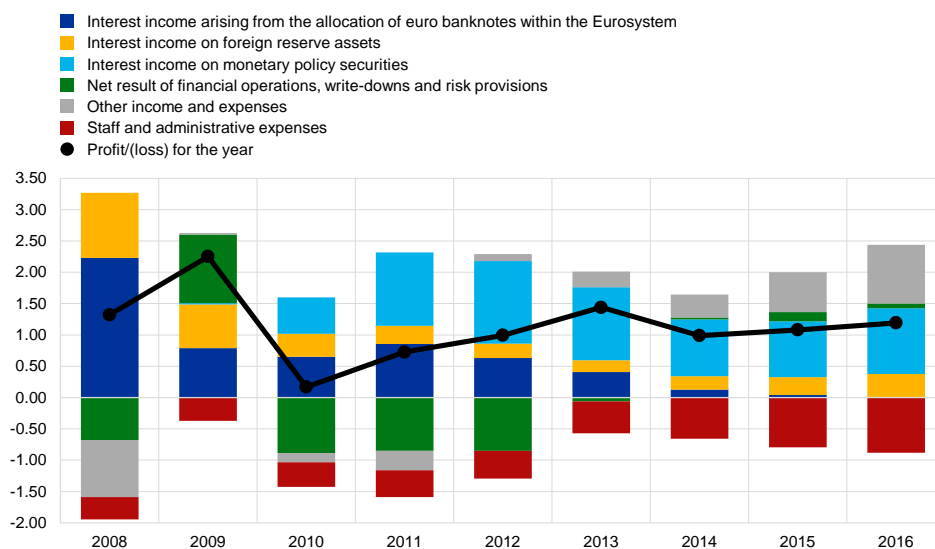
Source: ECB.

¹⁷ The chart displays year-end values.

Chart 4

Evolution of the ECB's Profit and Loss Account in the period 2008-16

(EUR billions)



Source: ECB.

The contraction of the ECB's Balance Sheet in the period 2008-14 was mainly due to the improved US dollar funding conditions for Eurosystem counterparties and the resulting gradual reduction in US dollar liquidity-providing operations offered by the Eurosystem. This led to a reduction in the ECB's intra-Eurosystem claims and its other liabilities. In the fourth quarter of 2014 the ECB's Balance Sheet started to expand, triggered by the acquisition of covered bonds and asset-backed securities under the third covered bond purchase programme (CBPP3) and the ABSPP. This balance sheet expansion continued in 2015 and 2016, owing to the acquisition of securities issued by euro area central, regional or local governments and recognised agencies in connection with the PSPP. The securities purchased under all of these programmes were settled via TARGET2 accounts and therefore resulted in a corresponding increase in intra-Eurosystem liabilities.

The ECB's net profit over the same period was influenced by the following factors.

- The rate on the main refinancing operations decreased, significantly reducing the seigniorage income of the ECB. The average rate for 2016 was 0.01%, compared with 4% for 2008, and, as a result, the interest income on banknotes in circulation fell from €2.2 billion in 2008 to €0.01 billion in 2016.
- The general risk provision for foreign exchange rate, interest rate, credit and gold price risks was increased, particularly in the period 2010-12. In this period a cumulative amount of €3.5 billion was transferred to the risk provision, reducing the reported profits by an equal amount.
- Interest income earned on foreign reserve assets declined gradually from €1.0 billion in 2008 to €0.2 billion in 2013, mainly owing to the reduction in US dollar yields and the resulting decrease in interest income earned on the US

dollar portfolio. However, this trend has been reversed over the past three years and in 2016 this income amounted to €0.4 billion.

- Security holdings acquired under the monetary policy asset purchase programmes have generated, on average, 57% of the ECB's overall net interest income since 2010.
- The establishment of the SSM in 2014 has contributed to a significant increase in staff and administrative expenses. However, the SSM-related costs are recovered annually via fees levied on the supervised entities.

Financial statements of the ECB

Balance Sheet as at 31 December 2016

| ASSETS | Note number | 2016 € | 2015 € |
|--|-------------|------------------------|------------------------|
| Gold and gold receivables | 1 | 17,820,761,460 | 15,794,976,324 |
| Claims on non-euro area residents denominated in foreign currency | 2 | | |
| Receivables from the IMF | 2.1 | 716,225,836 | 714,825,534 |
| Balances with banks and security investments, external loans and other external assets | 2.2 | 50,420,927,403 | 49,030,207,257 |
| | | 51,137,153,239 | 49,745,032,791 |
| Claims on euro area residents denominated in foreign currency | 2.2 | 2,472,936,063 | 1,862,714,832 |
| Other claims on euro area credit institutions denominated in euro | 3 | 98,603,066 | 52,711,983 |
| Securities of euro area residents denominated in euro | 4 | | |
| Securities held for monetary policy purposes | 4.1 | 160,815,274,667 | 77,808,651,858 |
| Intra-Eurosystem claims | 5 | | |
| Claims related to the allocation of euro banknotes within the Eurosystem | 5.1 | 90,097,085,330 | 86,674,472,505 |
| Other assets | 6 | | |
| Tangible and intangible fixed assets | 6.1 | 1,239,325,587 | 1,263,646,830 |
| Other financial assets | 6.2 | 20,618,929,223 | 20,423,917,583 |
| Off-balance-sheet instruments revaluation differences | 6.3 | 839,030,321 | 518,960,866 |
| Accruals and prepaid expenses | 6.4 | 2,045,522,937 | 1,320,068,350 |
| Sundry | 6.5 | 1,799,777,235 | 1,180,224,603 |
| | | 26,542,585,303 | 24,706,818,232 |
| Total assets | | 348,984,399,128 | 256,645,378,525 |

| LIABILITIES | Note number | 2016 € | 2015 € |
|---|----------------|------------------------|------------------------|
| Banknotes in circulation | 7 | 90,097,085,330 | 86,674,472,505 |
| Other liabilities to euro area credit institutions denominated in euro | 8 | 1,851,610,500 | 0 |
| Liabilities to other euro area residents denominated in euro | 9 | | |
| Other liabilities | 9.1 | 1,060,000,000 | 1,026,000,000 |
| Liabilities to non-euro area residents denominated in euro | 10 | 16,730,644,177 | 2,330,804,192 |
| Intra-Eurosystem liabilities | 11 | | |
| Liabilities equivalent to the transfer of foreign reserves | 11.1 | 40,792,608,418 | 40,792,608,418 |
| Other liabilities within the Eurosystem (net) | 11.2 | 151,201,250,612 | 83,083,520,309 |
| | | 191,993,859,030 | 123,876,128,727 |
| Other liabilities | 12 | | |
| Off-balance-sheet instruments revaluation differences | 12.1 | 660,781,618 | 392,788,148 |
| Accruals and income collected in advance | 12.2 | 69,045,958 | 95,543,989 |
| Sundry | 12.3 | 1,255,559,836 | 891,555,907 |
| | | 1,985,387,412 | 1,379,888,044 |
| Provisions | 13 | 7,706,359,686 | 7,703,394,185 |
| Revaluation accounts | 14 | 28,626,267,808 | 24,832,823,174 |
| Capital and reserves | 15 | | |
| Capital | 15.1 | 7,740,076,935 | 7,740,076,935 |
| Profit for the year | | 1,193,108,250 | 1,081,790,763 |
| Total liabilities | | 348,984,399,128 | 256,645,378,525 |

Profit and Loss Account for the year ending 31 December 2016

| | Note number | 2016 € | 2015 € |
|---|----------------|----------------------|----------------------|
| Interest income on foreign reserve assets | 22.1 | 370,441,770 | 283,205,941 |
| Interest income arising from the allocation of euro banknotes within the Eurosystem | 22.2 | 8,920,896 | 41,991,105 |
| Other interest income | 22.4 | 1,604,648,023 | 1,732,919,191 |
| <i>Interest income</i> | | <i>1,984,010,689</i> | <i>2,058,116,237</i> |
| Remuneration of NCBs' claims in respect of foreign reserves transferred | 22.3 | (3,611,845) | (17,576,514) |
| Other interest expense | 22.4 | (332,020,205) | (565,387,082) |
| <i>Interest expense</i> | | <i>(335,632,050)</i> | <i>(582,963,596)</i> |
| Net interest income | 22 | 1,648,378,639 | 1,475,152,641 |
| Realised gains/losses arising from financial operations | 23 | 224,541,742 | 214,433,730 |
| Write-downs on financial assets and positions | 24 | (148,172,010) | (64,053,217) |
| Transfer to/from provisions for foreign exchange rate, interest rate, credit and gold price risks | | 0 | 0 |
| Net result of financial operations, write-downs and risk provisions | | 76,369,732 | 150,380,513 |
| Net income/expense from fees and commissions | 25 | 371,322,769 | 268,332,261 |
| Income from equity shares and participating interests | 26 | 869,976 | 908,109 |
| Other income | 27 | 50,000,263 | 51,023,378 |
| Total net income | | 2,146,941,379 | 1,945,796,902 |
| Staff costs | 28 | (466,540,231) | (440,844,142) |
| Administrative expenses | 29 | (414,207,622) | (351,014,617) |
| Depreciation of tangible and intangible fixed assets | | (64,769,605) | (64,017,361) |
| Banknote production services | 30 | (8,315,671) | (8,130,019) |
| Profit for the year | | 1,193,108,250 | 1,081,790,763 |

Frankfurt am Main, 7 February 2017

European Central Bank

Mario Draghi
President

Accounting policies¹⁸

Form and presentation of the financial statements

The financial statements of the ECB have been drawn up in accordance with the following accounting policies,¹⁹ which the Governing Council of the ECB considers to achieve a fair presentation of the financial statements, reflecting at the same time the nature of central bank activities.

Accounting principles

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

Recognition of assets and liabilities

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

Basis of accounting

The accounts have been prepared on a historical cost basis, modified to include the market valuation of marketable securities (other than securities held for monetary policy purposes), gold and all other on-balance-sheet and off-balance-sheet assets and liabilities denominated in foreign currency.

Transactions in financial assets and liabilities are reflected in the accounts on the basis of the date on which they were settled.

With the exception of spot transactions in securities, transactions in financial instruments denominated in foreign currency are recorded in off-balance-sheet accounts on the trade date. At the settlement date the off-balance-sheet entries are reversed and transactions are booked on-balance-sheet. Purchases and sales of foreign currency affect the net foreign currency position on the trade date, and realised results arising from sales are also calculated on that date. Accrued interest,

¹⁸ The detailed accounting policies of the ECB are laid down in Decision (EU) 2016/2247 of the ECB of 3 November 2016 on the annual accounts of the ECB (ECB/2016/35), OJ L 347, 20.12.2016, p. 1.

¹⁹ These policies, which are reviewed and updated regularly as deemed appropriate, are consistent with the provisions of Article 26.4 of the Statute of the ESCB, which require a harmonised approach to the rules governing the accounting and financial reporting of Eurosystem operations.

premiums and discounts related to financial instruments denominated in foreign currency are calculated and recorded daily, and the foreign currency position is also affected daily by these accruals.

Gold and foreign currency assets and liabilities

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

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

Gold is valued at the market price prevailing at the balance sheet date. No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is accounted for on the basis of the price in euro per fine ounce of gold, which, for the year ending 31 December 2016, was derived from the exchange rate of the euro against the US dollar on 30 December 2016.

The special drawing right (SDR) is defined in terms of a basket of currencies. To revalue the ECB's holdings of SDRs, the value of the SDR was calculated as the weighted sum of the exchange rates of five major currencies (the US dollar, euro, Japanese yen, pound sterling and Chinese renminbi) converted into euro as at 30 December 2016.

Securities

Securities held for monetary policy purposes

Securities currently held for monetary policy purposes are accounted for at amortised cost subject to impairment.

Other securities

Marketable securities (other than securities held for monetary policy purposes) and similar assets are valued either at the mid-market prices or on the basis of the relevant yield curve prevailing on the balance sheet date, on a security-by-security basis. Options embedded in securities are not separated for valuation purposes. For the year ending 31 December 2016, mid-market prices on 30 December 2016 were used. Illiquid equity shares and any other equity instruments held as permanent investments are valued at cost subject to impairment.

Income recognition

Income and expenses are recognised in the period in which they are earned or incurred.²⁰ Realised gains and losses arising from the sale of foreign currency, gold and securities are taken to the Profit and Loss Account. Such realised gains and losses are calculated by reference to the average cost of the respective asset.

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

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

Impairment losses are taken to the Profit and Loss Account and are not reversed in subsequent years unless the impairment decreases and the decrease can be related to an observable event that occurred after the impairment was first recorded.

Premiums or discounts arising on securities are amortised over the securities' remaining contractual life.

Reverse transactions

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

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

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

Reverse transactions (including securities lending transactions) conducted under a programme offered by a specialised institution are recorded on the Balance Sheet

²⁰ A minimum threshold of €100,000 applies for administrative accruals and provisions.

only where collateral has been provided in the form of cash and this cash remains uninvested.

Off-balance-sheet instruments

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

Interest rate instruments are revalued on an item-by-item basis. Daily changes in the variation margin of open interest rate futures contracts, as well as interest rate swaps that are cleared via a central counterparty, are recorded in the Profit and Loss Account. The valuation of forward transactions in securities and of interest rate swaps that are not cleared via a central counterparty is carried out by the ECB based on generally accepted valuation methods using observable market prices and rates, as well as discount factors from the settlement dates to the valuation date.

Post-balance-sheet events

The values of assets and liabilities are adjusted for events that occur between the annual balance sheet date and the date on which the Executive Board authorises the submission of the ECB's Annual Accounts to the Governing Council for approval, if such events materially affect the condition of assets and liabilities at the balance sheet date.

Important post-balance-sheet events that do not affect the condition of assets and liabilities at the balance sheet date are disclosed in the notes.

Intra-ESCB balances/intra-Eurosystem balances

Intra-ESCB balances result primarily from cross-border payments in the EU that are settled in central bank money in euro. These transactions are for the most part initiated by private entities (i.e. credit institutions, corporations and individuals). They are settled in TARGET2 – the Trans-European Automated Real-time Gross settlement Express Transfer system – and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are netted out and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. This position in the books of the ECB represents the net claim or liability of each NCB against the rest of the ESCB. Intra-Eurosystem balances of euro area NCBs vis-à-vis the ECB arising from TARGET2, as well as other intra-Eurosystem balances denominated in euro (e.g. interim profit distributions to NCBs), are presented on the Balance Sheet of the ECB as a single net asset or liability position and disclosed under “Other claims within the Eurosystem (net)” or “Other liabilities within the Eurosystem (net)”. Intra-ESCB

balances of non-euro area NCBs vis-à-vis the ECB, arising from their participation in TARGET2,²¹ are disclosed under “Liabilities to non-euro area residents denominated in euro”.

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

Intra-Eurosystem balances arising from the transfer of foreign reserve assets to the ECB by NCBs joining the Eurosystem are denominated in euro and reported under “Liabilities equivalent to the transfer of foreign reserves”.

Treatment of fixed assets

Fixed assets, including intangible assets, but with the exception of land and works of art, are valued at cost less depreciation. Land and works of art are valued at cost. For the depreciation of the ECB's main building, costs are assigned to the appropriate asset components which are depreciated in accordance with their estimated useful lives. Depreciation is calculated on a straight-line basis over the expected useful life of the assets, beginning in the quarter after the asset is available for use. The useful lives applied for the main asset classes are as follows:

| | |
|--|--------------------|
| Buildings | 20, 25 or 50 years |
| Plant in building | 10 or 15 years |
| Technical equipment | 4, 10 or 15 years |
| Computers, related hardware and software, and motor vehicles | 4 years |
| Furniture | 10 years |

The depreciation period for capitalised refurbishment expenditure relating to the ECB's existing rented premises is adjusted to take account of any events that have an impact on the expected useful life of the affected asset.

Fixed assets costing less than €10,000 are written off in the year of acquisition.

Fixed assets that comply with the capitalisation criteria but are still under construction or development are recorded under the heading “Assets under construction”. The related costs are transferred to the relevant fixed asset headings once the assets are available for use.

²¹ As at 31 December 2016 the non-euro area NCBs participating in TARGET2 were Българска народна банка (Bulgarian National Bank), Danmarks Nationalbank, Hrvatska narodna banka, Narodowy Bank Polski and Banca Națională a României.

The ECB's pension plans, other post-employment benefits and other long-term benefits

The ECB operates defined benefit plans for its staff and the members of the Executive Board, as well as for the members of the Supervisory Board employed by the ECB.

The staff pension plan is funded by assets held in a long-term employee benefit fund. The compulsory contributions made by the ECB and the staff are 20.7% and 7.4% of basic salary respectively and are reflected in the defined benefit pillar of the plan. Staff can make additional contributions on a voluntary basis in a defined contribution pillar that can be used to provide additional benefits.²² These additional benefits are determined by the amount of voluntary contributions together with the investment returns arising from these contributions.

Unfunded arrangements are in place for the post-employment and other long-term benefits of members of the Executive Board and members of the Supervisory Board employed by the ECB. For staff, unfunded arrangements are in place for post-employment benefits other than pensions and for other long-term benefits.

Net defined benefit liability

The liability recognised in the Balance Sheet under "Other liabilities" in respect of the defined benefit plans is the present value of the defined benefit obligation at the balance sheet date, less the fair value of plan assets used to fund the obligation.

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 calculated by discounting the estimated future cash flows using a rate which is determined by reference to market yields at the balance sheet date on high quality euro-denominated corporate bonds that have similar terms of maturity to the term of the pension obligation.

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

Net defined benefit cost

The net defined benefit cost is split into components reported in the Profit and Loss Account and remeasurements in respect of post-employment benefits shown in the Balance Sheet under "Revaluation accounts".

²² The funds accumulated by a staff member through voluntary contributions can be used at retirement to purchase an additional pension. This pension is included in the defined benefit obligation from that point on.

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

- (a) the current service cost of the defined benefits accruing for the year;
- (b) net interest at the discount rate on the net defined benefit liability;
- (c) remeasurements in respect of other long-term benefits, in their entirety.

The net amount shown under “Revaluation accounts” comprises the following items:

- (a) actuarial gains and losses on the defined benefit obligation;
- (b) the actual return on plan assets, excluding amounts included in the net interest on the net defined benefit liability;
- (c) any change in the effect of the asset ceiling, excluding amounts included in the net interest on the net defined benefit liability.

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

Banknotes in circulation

The ECB and the euro area NCBs, which together comprise the Eurosystem, issue euro banknotes.²³ The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month in accordance with the banknote allocation key.²⁴

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, which is disclosed in the Balance Sheet under the liability item “Banknotes in circulation”. The ECB’s share of the total euro banknote issue is backed by claims on the NCBs. These claims, which bear interest,²⁵ are disclosed under the sub-item “Intra-Eurosystem claims: claims related to the allocation of euro banknotes within the Eurosystem” (see “Intra-ESCB balances/intra-Eurosystem balances” in the notes on accounting policies). Interest income on these claims is included in the Profit and Loss Account under the item “Interest income arising from the allocation of euro banknotes within the Eurosystem”.

²³ Decision ECB/2010/29 of 13 December 2010 on the issue of euro banknotes (recast), OJ L 35, 9.2.2011, p. 26, as amended.

²⁴ “Banknote allocation key” means the percentages that result from taking into account the ECB’s share in the total euro banknote issue and applying the subscribed capital key to the NCBs’ share in that total.

²⁵ Decision (EU) 2016/2248 of the ECB of 3 November 2016 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (ECB/2016/36), OJ L 347, 20.12.2016, p. 26.

Interim profit distribution

An amount that is equal to the sum of the ECB's income on euro banknotes in circulation and income arising from the securities held for monetary policy purposes purchased under (a) the Securities Markets Programme; (b) the third covered bond purchase programme; (c) the asset-backed securities purchase programme; and (d) the public sector purchase programme is distributed in January of the following year by means of an interim profit distribution, unless otherwise decided by the Governing Council.²⁶ It is distributed in full unless it is higher than the ECB's net profit for the year, and subject to any decisions by the Governing Council to make transfers to the provision for foreign exchange rate, interest rate, credit and gold price risks. The Governing Council may also decide to reduce the amount of the interim profit distribution by the amount of the costs incurred by the ECB in connection with the issue and handling of euro banknotes.

Reclassifications

Interest income (e.g. coupon interest) and interest expense (e.g. premium amortisation) arising from securities held for monetary policy purposes were previously presented on a gross basis under the headings "Other interest income" and "Other interest expense" respectively. With a view to harmonising at the Eurosystem level the reporting of interest income and expense arising from monetary policy operations, the ECB has decided that from 2016 these items will be presented on a net basis under either "Other interest income" or "Other interest expense", depending on whether the net amount is positive or negative. The comparable amounts for 2015 have been adjusted as follows:

| | Published in 2015 € | Adjustment owing to reclassification € | Restated amount € |
|------------------------|------------------------|--|----------------------|
| Other interest income | 2,168,804,955 | (435,885,764) | 1,732,919,191 |
| Other interest expense | (1,001,272,846) | 435,885,764 | (565,387,082) |

The reclassification had no impact on the net profit reported for 2015.

Other issues

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

²⁶ Decision (EU) 2015/298 of the ECB of 15 December 2014 on the interim distribution of the income of the ECB (recast) (ECB/2014/57), OJ L 53, 25.2.2015, p. 24, as amended.

In accordance with Article 27 of the Statute of the ESCB, and on the basis of a recommendation of the Governing Council, the EU Council has approved the appointment of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart (Federal Republic of Germany) as the external auditors of the ECB for a five-year period up to the end of the financial year 2017.

Notes on the Balance Sheet

1 Gold and gold receivables

As at 31 December 2016 the ECB held 16,229,522 ounces²⁷ of fine gold. No transactions in gold took place in 2016 and the ECB's holdings therefore remained unchanged compared with their level as at 31 December 2015. The increase in the euro equivalent value of these holdings was due to the rise in the price of gold in 2016 (see "Gold and foreign currency assets and liabilities" in the notes on accounting policies and note 14, "Revaluation accounts").

2 Claims on non-euro area and euro area residents denominated in foreign currency

2.1 Receivables from the IMF

This asset represents the ECB's holdings of SDRs as at 31 December 2016. It arises as the result of a two-way SDR buying and selling arrangement with the International Monetary Fund (IMF), whereby the IMF is authorised to arrange sales or purchases of SDRs against euro, on behalf of the ECB, within minimum and maximum holding levels. For accounting purposes, SDRs are treated as a foreign currency (see "Gold and foreign currency assets and liabilities" in the notes on accounting policies).

2.2 Balances with banks and security investments, external loans and other external assets; and claims on euro area residents denominated in foreign currency

These two items consist of balances with banks and loans denominated in foreign currency, and investments in securities denominated in US dollars and Japanese yen.

| Claims on non-euro area residents | 2016 € | 2015 € | Change € |
|-----------------------------------|-----------------------|-----------------------|----------------------|
| Current accounts | 6,844,526,120 | 4,398,616,340 | 2,445,909,780 |
| Money market deposits | 2,005,810,644 | 1,666,345,182 | 339,465,462 |
| Reverse repurchase agreements | 503,747,273 | 831,266,648 | (327,519,375) |
| Security investments | 41,066,843,366 | 42,133,979,087 | (1,067,135,721) |
| Total | 50,420,927,403 | 49,030,207,257 | 1,390,720,146 |

²⁷ This corresponds to 504.8 tonnes.

| Claims on euro area residents | 2016 € | 2015 € | Change € |
|-------------------------------|----------------------|----------------------|--------------------|
| Current accounts | 1,211,369 | 953,098 | 258,271 |
| Money market deposits | 1,964,182,715 | 1,861,761,734 | 102,420,981 |
| Reverse repurchase agreements | 507,541,979 | 0 | 507,541,979 |
| Security investments | 0 | 0 | 0 |
| Total | 2,472,936,063 | 1,862,714,832 | 610,221,231 |

The increase in these items in 2016 was mainly due to the appreciation of both the US dollar and the Japanese yen against the euro.

The ECB's net foreign currency holdings of US dollars and Japanese yen,²⁸ as at 31 December 2016, were as follows:

| | 2016 Currency in millions | 2015 Currency in millions |
|--------------|------------------------------|------------------------------|
| US dollars | 46,759 | 46,382 |
| Japanese yen | 1,091,844 | 1,085,596 |

3 Other claims on euro area credit institutions denominated in euro

As at 31 December 2016 this item consisted of current accounts with euro area residents.

4 Securities of euro area residents denominated in euro

4.1 Securities held for monetary policy purposes

As at 31 December 2016 this item consisted of securities acquired by the ECB within the scope of the three covered bond purchase programmes, the Securities Markets Programme (SMP), the asset-backed securities purchase programme (ABSPP) and the public sector purchase programme (PSPP).

Purchases under the first covered bond purchase programme were completed on 30 June 2010, while the second covered bond purchase programme ended on 31 October 2012. The SMP was terminated on 6 September 2012.

²⁸ These holdings comprise assets minus liabilities denominated in the given foreign currency that are subject to foreign currency revaluation. They are included under the headings "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Accruals and prepaid expenses", "Off-balance-sheet instruments revaluation differences" (liabilities side) and "Accruals and income collected in advance" and take into account foreign exchange forward and swap transactions included in off-balance-sheet items. Price gains on financial instruments denominated in foreign currency arising as a result of revaluations are not included.

In 2016 the Eurosystem programmes constituting the asset purchase programme (APP),²⁹ i.e. the third covered bond purchase programme (CBPP3), the ABSPP and the PSPP, were supplemented by a fourth component, the corporate sector purchase programme (CSPP).³⁰ In 2016 the Governing Council took decisions that had a direct impact on the pace of monthly purchases and the duration of the APP.³¹ These decisions were (i) to increase the combined monthly net APP purchases by the NCBs and the ECB from €60 billion to €80 billion on average from April 2016; and (ii) to continue the net APP purchases after March 2017 at a monthly pace of €60 billion until the end of December 2017 or beyond, if necessary, and, in any case, until the Governing Council sees a sustained adjustment in the path of inflation that is consistent with its inflation aim.³² The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the APP.

The securities purchased under all of these programmes are valued on an amortised cost basis subject to impairment (see “Securities” in the notes on accounting policies).

The amortised cost of the securities held by the ECB, as well as their market value³³ (which is not recorded on the Balance Sheet or in the Profit and Loss Account but is provided for comparison purposes only), are as follows:

| | 2016 € | | 2015 € | | Change € | |
|--|------------------------|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Amortised cost | Market value | Amortised cost | Market value | Amortised cost | Market value |
| First covered bond purchase programme | 1,032,305,522 | 1,098,106,253 | 1,786,194,503 | 1,898,990,705 | (753,888,981) | (800,884,452) |
| Second covered bond purchase programme | 690,875,649 | 743,629,978 | 933,230,549 | 1,013,540,352 | (242,354,900) | (269,910,374) |
| Third covered bond purchase programme | 16,550,442,553 | 16,730,428,857 | 11,457,444,451 | 11,396,084,370 | 5,092,998,102 | 5,334,344,487 |
| Securities Markets Programme | 7,470,766,415 | 8,429,995,853 | 8,872,443,668 | 10,045,312,608 | (1,401,677,253) | (1,615,316,755) |
| Asset-backed securities purchase programme | 22,800,124,065 | 22,786,088,513 | 15,321,905,622 | 15,220,939,054 | 7,478,218,443 | 7,565,149,459 |
| Public sector purchase programme | 112,270,760,463 | 112,958,545,591 | 39,437,433,065 | 39,372,318,024 | 72,833,327,398 | 73,586,227,567 |
| Total | 160,815,274,667 | 162,746,795,045 | 77,808,651,858 | 78,947,185,113 | 83,006,622,809 | 83,799,609,932 |

The decrease in the amortised cost of the portfolios held under the first and second covered bond purchase programmes and the SMP was due to redemptions.

The Governing Council assesses on a regular basis the financial risks associated with the securities held under all these programmes.

²⁹ Further details on the APP can be found [on the ECB's website](#).

³⁰ Under this programme, the NCBs may purchase investment-grade euro-denominated bonds issued by non-bank corporations established in the euro area. The ECB does not purchase securities under this programme.

³¹ See the ECB's press releases of [10 March 2016](#) and of [8 December 2016](#).

³² In the pursuit of price stability, the ECB aims at maintaining inflation rates below, but close to, 2% over the medium term.

³³ Market values are indicative and are derived on the basis of market quotes. When market quotes are not available, market prices are estimated using internal Eurosystem models.

Impairment tests are conducted on an annual basis, using data as at the year-end, and are approved by the Governing Council. In these tests, impairment indicators are assessed separately for each programme. In cases where impairment indicators were observed, further analysis has been performed to confirm that the cash flows of the underlying securities have not been affected by an impairment event. Based on the results of this year's impairment tests, no losses have been recorded for the securities held in the monetary policy portfolios in 2016.

5 Intra-Eurosystem claims

5.1 Claims related to the allocation of euro banknotes within the Eurosystem

This item consists of the claims of the ECB vis-à-vis the euro area NCBs relating to the allocation of euro banknotes within the Eurosystem (see "Banknotes in circulation" in the notes on accounting policies). The remuneration of these claims is calculated daily at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations³⁴ (see note 22.2, "Interest income arising from the allocation of euro banknotes within the Eurosystem").

6 Other assets

6.1 Tangible and intangible fixed assets

These assets comprised the following items on 31 December 2016:

³⁴ Since 16 March 2016 the interest rate used by the Eurosystem in its tenders for main refinancing operations has been 0.00%.

| | 2016 € | 2015 € | Change € |
|---|----------------------|----------------------|---------------------|
| Cost | | | |
| Land and buildings | 1,011,662,911 | 1,027,242,937 | (15,580,026) |
| Plant in building | 221,888,762 | 219,897,386 | 1,991,376 |
| Computer hardware and software | 88,893,887 | 77,350,193 | 11,543,694 |
| Equipment, furniture and motor vehicles | 96,197,706 | 92,000,437 | 4,197,269 |
| Assets under construction | 3,024,459 | 244,590 | 2,779,869 |
| Other fixed assets | 9,713,742 | 9,453,181 | 260,561 |
| Total cost | 1,431,381,467 | 1,426,188,724 | 5,192,743 |
| Accumulated depreciation | | | |
| Land and buildings | (72,284,513) | (79,468,891) | 7,184,378 |
| Plant in building | (31,590,282) | (15,827,521) | (15,762,761) |
| Computer hardware and software | (57,935,440) | (45,530,493) | (12,404,947) |
| Equipment, furniture and motor vehicles | (29,107,438) | (20,831,615) | (8,275,823) |
| Other fixed assets | (1,138,207) | (883,374) | (254,833) |
| Total accumulated depreciation | (192,055,880) | (162,541,894) | (29,513,986) |
| Net book value | 1,239,325,587 | 1,263,646,830 | (24,321,243) |

The net decrease in the cost category “Land and buildings” and the corresponding accumulated depreciation was mainly due to the derecognition of capitalised refurbishment expenditure relating to items that were no longer in use.

6.2 Other financial assets

This item consists mainly of the investment of the ECB's own funds³⁵ held as a direct counterpart to the capital and reserves and the provision for foreign exchange rate, interest rate, credit and gold price risks. It also includes 3,211 shares in the Bank for International Settlements (BIS) at the acquisition cost of €41.8 million.

The components of this item are as follows:

| | 2016 € | 2015 € | Change € |
|---------------------------------------|-----------------------|-----------------------|--------------------|
| Current accounts in euro | 30,000 | 30,000 | - |
| Securities denominated in euro | 19,113,074,101 | 19,192,975,459 | (79,901,358) |
| Reverse repurchase agreements in euro | 1,463,994,460 | 1,188,997,789 | 274,996,671 |
| Other financial assets | 41,830,662 | 41,914,335 | (83,673) |
| Total | 20,618,929,223 | 20,423,917,583 | 195,011,640 |

The net increase in this item in 2016 was due mainly to the reinvestment of interest income generated on the own funds portfolio.

³⁵ Repurchase agreements conducted in the context of the management of the own funds portfolio are reported under “Sundry” on the liabilities side (see note 12.3, “Sundry”).

6.3 Off-balance-sheet instruments revaluation differences

This item is composed mainly of valuation changes in swap and forward transactions in foreign currency that were outstanding on 31 December 2016 (see note 19, “Foreign exchange swap and forward transactions”). These valuation changes are the result of the conversion of such transactions into their euro equivalents at the exchange rates prevailing on the balance sheet date, compared with the euro values resulting from the conversion of the transactions at the average cost of the respective foreign currency on that date (see “Off-balance-sheet instruments” and “Gold and foreign currency assets and liabilities” in the notes on accounting policies).

Valuation gains on outstanding interest rate swap transactions are also included in this item (see note 18, “Interest rate swaps”).

6.4 Accruals and prepaid expenses

In 2016 this item included accrued coupon interest on securities, including outstanding interest paid at acquisition, amounting to €1,924.5 million (2015: €1,186.6 million) (see note 2.2, “Balances with banks and security investments, external loans and other external assets; and Claims on euro area residents denominated in foreign currency”, note 4, “Securities of euro area residents denominated in euro”, and note 6.2, “Other financial assets”).

Moreover, this item includes (a) accrued income from common Eurosystem projects (see note 27, “Other income”); (b) accrued interest income on other financial assets; and (c) miscellaneous prepayments.

6.5 Sundry

This item included the accrued amounts of the ECB’s interim profit distribution (see “Interim profit distribution” in the notes on accounting policies and note 11.2, “Other liabilities within the Eurosystem (net)”).

It also included balances related to swap and forward transactions in foreign currency outstanding on 31 December 2016 that arose from the conversion of such transactions into their euro equivalents at the respective currency’s average cost on the balance sheet date, compared with the euro values at which the transactions were initially recorded (see “Off-balance-sheet instruments” in the notes on accounting policies).

7 Banknotes in circulation

This item consists of the ECB’s share (8%) of the total euro banknotes in circulation (see “Banknotes in circulation” in the notes on accounting policies).

8 Other liabilities to euro area credit institutions denominated in euro

On 8 December 2016 the Governing Council decided that Eurosystem central banks will have the possibility to also accept cash as collateral in their PSPP securities lending facilities without having to reinvest it. For the ECB, these operations are conducted via a specialised institution.

As at 31 December 2016 such PSPP securities lending transactions with a value of €1.9 billion conducted with euro area credit institutions remained outstanding. Cash received as collateral was transferred to TARGET2 accounts (see note 11.2, “Other liabilities within the Eurosystem (net)”). As the cash remained uninvested at the year-end, these transactions were recorded on the Balance Sheet (see “Reverse transactions” in the notes on accounting policies).³⁶

9 Liabilities to other euro area residents denominated in euro

9.1 Other liabilities

This item comprises deposits by members of the Euro Banking Association (EBA) which are used as a guarantee fund for the EURO1³⁷ settlement in TARGET2 system.

10 Liabilities to non-euro area residents denominated in euro

As at 31 December 2016 this item comprised an amount of €9.5 billion (2015: €1.5 billion), consisting of balances held with the ECB by non-euro area central banks that arise from, or are the counterpart of, transactions processed via the TARGET2 system. The increase in these balances in 2016 was due to payments from euro area residents to non-euro area residents (see note 11.2, “Other liabilities within the Eurosystem (net)”).

This item also included an amount of €4.1 billion (2015: €0.8 billion) arising from the standing reciprocal currency arrangement with the Federal Reserve. Under this arrangement, US dollars are provided by the Federal Reserve to the ECB by means of swap transactions, with the aim of offering short-term US dollar funding to Eurosystem counterparties. The ECB simultaneously enters into back-to-back swap transactions with euro area NCBs, which use the resulting funds to conduct US

³⁶ Securities lending transactions that do not result in uninvested cash collateral at the year-end are recorded in off-balance-sheet accounts (see note 16, “Securities lending programmes”).

³⁷ EURO1 is a payment system operated by the EBA.

dollar liquidity-providing operations with Eurosystem counterparties in the form of reverse transactions. The back-to-back swap transactions result in intra-Eurosystem balances between the ECB and the NCBs (see note 11.2, “Other liabilities within the Eurosystem (net)”). Furthermore, the swap transactions conducted with the Federal Reserve and the euro area NCBs result in forward claims and liabilities that are recorded in off-balance-sheet accounts (see note 19, “Foreign exchange swap and forward transactions”).

The remainder of this item consisted of an amount of €3.1 billion (2015: €0) arising from outstanding PSPP securities lending transactions conducted with non-euro area residents whereby cash was received as collateral and transferred to TARGET2 accounts (see note 8, “Other liabilities to euro area credit institutions denominated in euro”).

11 Intra-Eurosystem liabilities

11.1 Liabilities equivalent to the transfer of foreign reserves

These represent the liabilities to the euro area NCBs that arose from the transfer of foreign reserve assets to the ECB when they joined the Eurosystem. No changes occurred in 2016.

| | Since 1 January 2015 € |
|--|------------------------------|
| Nationale Bank van België/Banque Nationale de Belgique | 1,435,910,943 |
| Deutsche Bundesbank | 10,429,623,058 |
| Eesti Pank | 111,729,611 |
| Central Bank of Ireland | 672,637,756 |
| Bank of Greece | 1,178,260,606 |
| Banco de España | 5,123,393,758 |
| Banque de France | 8,216,994,286 |
| Banca d'Italia | 7,134,236,999 |
| Central Bank of Cyprus | 87,679,928 |
| Latvijas Banka | 163,479,892 |
| Lietuvos bankas | 239,453,710 |
| Banque centrale du Luxembourg | 117,640,617 |
| Central Bank of Malta | 37,552,276 |
| De Nederlandsche Bank | 2,320,070,006 |
| Oesterreichische Nationalbank | 1,137,636,925 |
| Banco de Portugal | 1,010,318,483 |
| Banka Slovenije | 200,220,853 |
| Národná banka Slovenska | 447,671,807 |
| Suomen Pankki – Finlands Bank | 728,096,904 |
| Total | 40,792,608,418 |

The remuneration of these liabilities is calculated daily at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations, adjusted to reflect a zero return on the gold component (see note 22.3, “Remuneration of NCBs’ claims in respect of foreign reserves transferred”).

11.2 Other liabilities within the Eurosystem (net)

In 2016 this item consisted mainly of the TARGET2 balances of the euro area NCBs vis-à-vis the ECB (see “Intra-ESCB balances/intra-Eurosystem balances” in the notes on accounting policies). The net increase in this position resulted mainly from purchases of securities under the APP (see note 4, “Securities of euro area residents denominated in euro”), which were settled via TARGET2 accounts. The impact of the purchases was partially offset by (a) the settlement in TARGET2 of payments from euro area residents to non-euro area residents (see note 10, “Liabilities to non-euro area residents denominated in euro”); (b) cash received as collateral against the lending of PSPP securities (see note 8, “Other liabilities to euro area credit institutions denominated in euro”, and note 10, “Liabilities to non-euro area residents denominated in euro”); (c) the increase in the amounts related to the back-to-back swap transactions conducted with NCBs in connection with US dollar liquidity-providing operations; and (d) redemptions of securities purchased under the SMP and the first two covered bond purchase programmes, which were also settled via TARGET2 accounts.

The remuneration of TARGET2 positions, with the exception of balances arising from back-to-back swap transactions in connection with US dollar liquidity-providing operations, is calculated daily at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations.

This item also included the amount due to euro area NCBs in respect of the ECB's interim profit distribution (see "Interim profit distribution" in the notes on accounting policies).

| | 2016 € | 2015 € |
|---|------------------------|-----------------------|
| Due to euro area NCBs in respect of TARGET2 | 1,058,484,156,256 | 812,734,808,529 |
| Due from euro area NCBs in respect of TARGET2 | (908,249,140,203) | (730,463,422,714) |
| Due to euro area NCBs in respect of the ECB's interim profit distribution | 966,234,559 | 812,134,494 |
| Other liabilities within the Eurosystem (net) | 151,201,250,612 | 83,083,520,309 |

12 Other liabilities

12.1 Off-balance-sheet instruments revaluation differences

This item is composed mainly of valuation changes in swap and forward transactions in foreign currency that were outstanding on 31 December 2016 (see note 19, "Foreign exchange swap and forward transactions"). These valuation changes are the result of the conversion of such transactions into their euro equivalents at the exchange rates prevailing on the balance sheet date, compared with the euro values resulting from the conversion of the transactions at the average cost of the respective foreign currency on that date (see "Off-balance-sheet instruments" and "Gold and foreign currency assets and liabilities" in the notes on accounting policies).

Valuation losses on outstanding interest rate swaps are also included in this item (see note 18, "Interest rate swaps").

12.2 Accruals and income collected in advance

As at 31 December 2016 this item included income collected in advance in connection with the Single Supervisory Mechanism (SSM) (see note 25, "Net income/expenses from fees and commissions"), administrative accruals and accruals on financial instruments.

This item also included accrued interest payable to the NCBs for the whole of 2016 in respect of their claims relating to foreign reserves transferred to the ECB (see note 11.1, "Liabilities equivalent to the transfer of foreign reserves"). This amount was settled in January 2017.

| | 2016 € | 2015 € | Change € |
|---|-------------------|-------------------|---------------------|
| Administrative accruals | 20,723,173 | 20,455,723 | 267,450 |
| Financial instruments | 3,621,142 | 2,191,753 | 1,429,389 |
| SSM income collected in advance | 41,089,798 | 18,926,078 | 22,163,720 |
| Foreign reserves transferred to the ECB | 3,611,845 | 17,576,514 | (13,964,669) |
| TARGET2 | - | 36,393,921 | (36,393,921) |
| Total | 69,045,958 | 95,543,989 | (26,498,031) |

12.3 Sundry

In 2016 this item included balances related to swap and forward transactions in foreign currency that were outstanding on 31 December 2016 (see note 19, “Foreign exchange swap and forward transactions”). These balances arose from the conversion of such transactions into their euro equivalents at the respective currency’s average cost on the balance sheet date, compared with the euro values at which the transactions were initially recorded (see “Off-balance-sheet instruments” in the notes on accounting policies).

In addition, this item included the ECB’s net defined benefit liability in respect of the post-employment and other long-term benefits of its staff and the members of the Executive Board, as well as the members of the Supervisory Board employed by the ECB.

*The ECB’s pension plans, other post-employment benefits and other long-term benefits*³⁸

Balance Sheet

The amounts recognised in the Balance Sheet in respect of post-employment and other long-term employee benefits were as follows:

| | 2016 Staff €millions | 2016 Boards €millions | 2016 Total €millions | 2015 Staff €millions | 2015 Boards €millions | 2015 Total €millions |
|--|----------------------------|-----------------------------|----------------------------|----------------------------|-----------------------------|----------------------------|
| Present value of obligation | 1,361.3 | 27.7 | 1,388.9 | 1,116.7 | 24.1 | 1,140.8 |
| Fair value of plan assets | (878.0) | - | (878.0) | (755.3) | - | (755.3) |
| Net defined benefit liability recognised in the Balance Sheet | 483.3 | 27.7 | 510.9 | 361.4 | 24.1 | 385.5 |

In 2016 the present value of the obligation vis-à-vis staff of €1,361.3 million (2015: €1,116.7 million) included unfunded benefits amounting to €187.0 million (2015: €155.9 million) relating to post-employment benefits other than pensions and

³⁸ In all the tables of this section, totals may not add up due to rounding. The columns labelled “Boards” report the amounts in respect of both the Executive Board and the Supervisory Board.

to other long-term benefits. Unfunded arrangements are also in place for the post-employment and other long-term benefits of members of the Executive Board and members of the Supervisory Board.

Profit and Loss Account

The amounts recognised in the Profit and Loss Account in 2016 were as follows:

| | 2016 Staff €millions | 2016 Boards €millions | 2016 Total €millions | 2015 Staff €millions | 2015 Boards €millions | 2015 Total €millions |
|--|----------------------------|-----------------------------|----------------------------|----------------------------|-----------------------------|----------------------------|
| Current service cost | 104.4 | 1.6 | 106.0 | 120.0 | 1.9 | 121.9 |
| Net interest on the net defined benefit liability | 9.7 | 0.6 | 10.3 | 9.5 | 0.5 | 10.0 |
| <i>of which:</i> | | | | | | |
| <i>Cost on the obligation</i> | 29.1 | 0.6 | 29.8 | 22.9 | 0.5 | 23.4 |
| <i>Income on plan assets</i> | (19.5) | - | (19.5) | (13.4) | - | (13.4) |
| Remeasurement (gains)/losses on other long-term benefits | 0.6 | 0.1 | 0.7 | 2.6 | (0.1) | 2.5 |
| Total included in "Staff costs" | 114.6 | 2.4 | 117.0 | 132.1 | 2.3 | 134.4 |

The current service cost decreased in 2016 to €106.0 million (2015: €121.9 million), owing mainly to the increase in the discount rate from 2% in 2014 to 2.5% in 2015.³⁹

Changes in the defined benefit obligation, plan assets and remeasurement results

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

| | 2016 Staff €millions | 2016 Boards €millions | 2016 Total €millions | 2015 Staff €millions | 2015 Boards €millions | 2015 Total €millions |
|---|----------------------------|-----------------------------|----------------------------|----------------------------|-----------------------------|----------------------------|
| Opening defined benefit obligation | 1,116.7 | 24.1 | 1,140.8 | 1,087.1 | 24.5 | 1,111.6 |
| Current service cost | 104.4 | 1.6 | 106.0 | 120.0 | 1.9 | 121.9 |
| Interest cost on the obligation | 29.1 | 0.6 | 29.8 | 22.9 | 0.5 | 23.4 |
| Contributions paid by plan participants | 19.5 | 0.2 | 19.8 | 21.7 | 0.2 | 21.9 |
| Benefits paid | (8.6) | (0.8) | (9.5) | (7.5) | (0.8) | (8.3) |
| Remeasurement (gains)/losses | 100.2 | 1.9 | 102.1 | (127.5) | (2.2) | (129.7) |
| Closing defined benefit obligation | 1,361.3 | 27.7 | 1,388.9 | 1,116.7 | 24.1 | 1,140.8 |

The total remeasurement losses of €102.1 million for 2016 on the defined benefit obligation arose primarily owing to the reduction in the discount rate from 2.5% in 2015 to 2% in 2016.

³⁹ The current service cost is estimated using the discount rate that applied in the previous year.

Changes in 2016 in the fair value of plan assets in the defined benefit pillar relating to staff were as follows:

| | 2016 € millions | 2015 € millions |
|--|--------------------|--------------------|
| Opening fair value of plan assets | 755.3 | 651.9 |
| Interest income on plan assets | 19.5 | 13.4 |
| Remeasurement gains | 44.7 | 26.8 |
| Contributions paid by employer | 45.0 | 46.9 |
| Contributions paid by plan participants | 19.5 | 21.7 |
| Benefits paid | (6.0) | (5.4) |
| Closing fair value of plan assets | 878.0 | 755.3 |

Remeasurement gains on plan assets in both 2016 and 2015 reflected the fact that actual returns on the fund units were higher than the estimated interest income on plan assets.

In 2016, as a follow-up to a funding valuation of the staff pension plan carried out by the ECB's actuaries as at 31 December 2015, the Governing Council decided, inter alia, to (a) discontinue the ECB's annual supplementary contributions of €6.8 million, and (b) to increase from September 2016 the contributions made by the ECB to the staff pension plan from 19.5% to 20.7% of basic salary.⁴⁰ These decisions resulted in a net reduction in the total contributions paid by the ECB in 2016 despite the increase in the number of plan members (see note 28, "Staff costs").

Changes in 2016 in the remeasurement results (see note 14, "Revaluation accounts") were as follows:

| | 2016 € millions | 2015 € millions |
|---|--------------------|--------------------|
| Opening remeasurement gains/(losses) | (148.4) | (305.6) |
| Contributions by NCBs joining the Eurosystem ⁴¹ | 0.0 | (1.8) |
| Gains on plan assets | 44.7 | 26.8 |
| Gains/(losses) on obligation | (102.1) | 129.7 |
| Losses recognised in the Profit and Loss Account | 0.7 | 2.5 |
| Closing remeasurement losses included under "Revaluation accounts" | (205.1) | (148.4) |

Key assumptions

In preparing the valuations referred to in this note, the actuaries have used assumptions which the Executive Board has accepted for the purposes of accounting and disclosure. The principal assumptions used for the purposes of calculating the benefits scheme liability are as follows:

⁴⁰ In addition, the Governing Council decided to increase the contribution rate paid by ECB staff from 6.7% to 7.4% of basic salary.

⁴¹ Upon the adoption of the single currency by Lithuania, Lietuvos bankas contributed to the balances of all the revaluation accounts of the ECB with effect from 1 January 2015. The outstanding remeasurement losses that were included in the revaluation accounts as at 31 December 2014 resulted in a reduction in the contributions by Lietuvos bankas.

| | 2016 % | 2015 % |
|---|-----------|-----------|
| Discount rate | 2.00 | 2.50 |
| Expected return on plan assets ⁴² | 3.00 | 3.50 |
| General future salary increases ⁴³ | 2.00 | 2.00 |
| Future pension increases ⁴⁴ | 1.40 | 1.40 |

Furthermore, voluntary contributions made by staff in a defined contribution pillar in 2016 amounted to €133.2 million (2015: €123.3 million). These contributions are invested in the plan assets but also give rise to a corresponding obligation of equal value.

13 Provisions

This item consists mainly of a provision for foreign exchange rate, interest rate, credit and gold price risks.

The provision for foreign exchange rate, interest rate, credit and gold price risks will be used to the extent deemed necessary by the Governing Council to offset future realised and unrealised losses, in particular valuation losses exceeding the respective revaluation accounts. The size of and continuing requirement for this provision is reviewed annually, based on the ECB's assessment of its exposure to these risks and taking a range of factors into account. Its size, together with any amount held in the general reserve fund, may not exceed the value of the ECB's capital paid up by the euro area NCBs.

As at 31 December 2016 the provision for foreign exchange rate, interest rate, credit and gold risks amounted to €7,619,884,851, unchanged from 2015. This amount corresponds to the value of the ECB's capital paid up by the euro area NCBs as at that date.

14 Revaluation accounts

This item consists mainly of revaluation balances arising from unrealised gains on assets, liabilities and off-balance-sheet instruments (see "Income recognition", "Gold and foreign currency assets and liabilities", "Securities" and "Off-balance-sheet instruments" in the notes on accounting policies). It also includes the remeasurements of the ECB's net defined benefit liability in respect of post-

⁴² These assumptions were used for calculating the part of the ECB's defined benefit obligation which is funded by assets with an underlying capital guarantee.

⁴³ In addition, allowance is made for prospective individual salary increases of up to 1.8% per annum, depending on the age of the plan participants.

⁴⁴ In accordance with the ECB's pension plan rules, pensions will be increased annually. If general salary adjustments for ECB employees are below price inflation, any increase in pensions will be in line with the general salary adjustments. If the general salary adjustments exceed price inflation, they will be applied to determine the increase in pensions, provided that the financial position of the ECB's pension plans permits such an increase.

employment benefits (see “The ECB’s pension plans, other post-employment benefits and other long-term benefits” in the notes on accounting policies and note 12.3, “Sundry”).

| | 2016 € | 2015 € | Change € |
|--|-----------------------|-----------------------|----------------------|
| Gold | 13,926,380,231 | 11,900,595,095 | 2,025,785,136 |
| Foreign currency | 14,149,471,665 | 12,272,562,352 | 1,876,909,313 |
| Securities and other instruments | 755,494,021 | 808,078,836 | (52,584,815) |
| Net defined benefit liability in respect of post-employment benefits | (205,078,109) | (148,413,109) | (56,665,000) |
| Total | 28,626,267,808 | 24,832,823,174 | 3,793,444,634 |

The increase in the size of the revaluation accounts is due to the depreciation of the euro against gold, the US dollar and Japanese yen in 2016.

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

| Exchange rates | 2016 | 2015 |
|-----------------------------|-----------|---------|
| US dollars per euro | 1.0541 | 1.0887 |
| Japanese yen per euro | 123.40 | 131.07 |
| Euro per SDR | 1.2746 | 1.2728 |
| Euro per fine ounce of gold | 1,098.046 | 973.225 |

15 Capital and reserves

15.1 Capital

The subscribed capital of the ECB is €10,825,007,069. The capital paid up by euro area and non-euro area NCBs amounts to €7,740,076,935.

The euro area NCBs have fully paid up their share of subscribed capital which since 1 January 2015 has amounted to €7,619,884,851, as shown in the table.⁴⁵

⁴⁵ Individual amounts are shown rounded to the nearest euro. Consequently, totals in the tables of this note may not add up due to rounding.

| | Capital key since 1 January 2015 ⁴⁶ % | Paid-up capital since 1 January 2015 € |
|--|---|---|
| Nationale Bank van België/ Banque Nationale de Belgique | 2.4778 | 268,222,025 |
| Deutsche Bundesbank | 17.9973 | 1,948,208,997 |
| Eesti Pank | 0.1928 | 20,870,614 |
| Central Bank of Ireland | 1.1607 | 125,645,857 |
| Bank of Greece | 2.0332 | 220,094,044 |
| Banco de España | 8.8409 | 957,028,050 |
| Banque de France | 14.1792 | 1,534,899,402 |
| Banca d'Italia | 12.3108 | 1,332,644,970 |
| Central Bank of Cyprus | 0.1513 | 16,378,236 |
| Latvijas Banka | 0.2821 | 30,537,345 |
| Lietuvos bankas | 0.4132 | 44,728,929 |
| Banque centrale du Luxembourg | 0.2030 | 21,974,764 |
| Central Bank of Malta | 0.0648 | 7,014,605 |
| De Nederlandsche Bank | 4.0035 | 433,379,158 |
| Oesterreichische Nationalbank | 1.9631 | 212,505,714 |
| Banco de Portugal | 1.7434 | 188,723,173 |
| Banka Slovenije | 0.3455 | 37,400,399 |
| Národná banka Slovenska | 0.7725 | 83,623,180 |
| Suomen Pankki – Finlands Bank | 1.2564 | 136,005,389 |
| Total | 70.3915 | 7,619,884,851 |

The non-euro area NCBs are required to pay up 3.75% of their subscribed capital as a contribution to the operational costs of the ECB. This contribution amounted to a total of €120,192,083 at the end of 2016, unchanged from 2015. The non-euro area NCBs are not entitled to receive any share of the distributable profits of the ECB, including income arising from the allocation of euro banknotes within the Eurosystem, nor are they liable to fund any loss of the ECB.

The non-euro area NCBs have paid up the following amounts:

⁴⁶ The shares of the individual NCBs in the key for subscription to the ECB's capital were last changed on 1 January 2014. However, on 1 January 2015, owing to the entry of Lithuania into the euro area, the total capital key weight of the euro area NCBs in the ECB's overall capital increased, whereas the total capital key weight of the non-euro area NCBs decreased. No changes took place in 2016.

| | Capital key since 1 January 2015 % | Paid-up capital since 1 January 2015 € |
|--|---|---|
| Българска народна банка (Bulgarian National Bank) | 0.8590 | 3,487,005 |
| Česká národní banka | 1.6075 | 6,525,450 |
| Danmarks Nationalbank | 1.4873 | 6,037,512 |
| Hrvatska narodna banka | 0.6023 | 2,444,963 |
| Magyar Nemzeti Bank | 1.3798 | 5,601,129 |
| Narodowy Bank Polski | 5.1230 | 20,796,192 |
| Banca Națională a României | 2.6024 | 10,564,124 |
| Sveriges Riksbank | 2.2729 | 9,226,559 |
| Bank of England | 13.6743 | 55,509,148 |
| Total | 29.6085 | 120,192,083 |

Off-balance-sheet instruments

16 Securities lending programmes

As part of the management of the ECB's own funds, the ECB has a securities lending programme agreement in place, whereby a specialised institution enters into securities lending transactions on behalf of the ECB.

In addition, in accordance with the Governing Council's decisions, the ECB has made available for lending its holdings of securities purchased under the first, second and third covered bond purchase programmes, as well as its holdings of securities purchased under the PSPP and those purchased under the SMP that are also eligible for purchase under the PSPP.⁴⁷

If no cash collateral remains uninvested at the year-end, the related securities lending operations are recorded in off-balance sheet accounts.⁴⁸ Such securities lending operations, with a value of €10.9 billion (2015: €4.5 billion), were outstanding as at 31 December 2016. Of this amount, €3.9 billion (2015: €0.3 billion) related to the lending of securities held for monetary policy purposes.

17 Interest rate futures

As at 31 December 2016 the following foreign currency transactions, presented at year-end market rates, were outstanding:

| Foreign currency interest rate futures | 2016 Contract value € | 2015 Contract value € | Change € |
|--|-----------------------------|-----------------------------|---------------|
| Purchases | 558,770,515 | 694,406,172 | (135,635,657) |
| Sales | 2,258,798,975 | 690,554,100 | 1,568,244,875 |

These transactions were conducted in the context of the management of the ECB's foreign reserves.

18 Interest rate swaps

Interest rate swap transactions with a notional value of €378.3 million (2015: €274.5 million), presented at year-end market rates, were outstanding as at 31 December 2016. These transactions were conducted in the context of the management of the ECB's foreign reserves.

⁴⁷ The ECB does not purchase securities under the CSPP and consequently has no related holdings available for lending.

⁴⁸ If cash collateral remains uninvested at the year-end, these transactions are recorded in on-balance-sheet accounts (see note 8, "Other liabilities to euro area credit institutions denominated in euro", and note 10, "Liabilities to non-euro area residents denominated in euro").

19 Foreign exchange swap and forward transactions

Management of foreign reserves

Foreign exchange swap and forward transactions were conducted in 2016 in the context of the management of the ECB's foreign reserves. Claims and liabilities resulting from these transactions that were outstanding as at 31 December 2016 are presented at year-end market rates as follows:

| Foreign exchange swap and forward transactions | 2016 € | 2015 € | Change € |
|--|---------------|---------------|-------------|
| Claims | 3,123,544,615 | 2,467,131,004 | 656,413,611 |
| Liabilities | 2,855,828,167 | 2,484,517,472 | 371,310,695 |

Liquidity-providing operations

US dollar-denominated claims and liabilities with a settlement date in 2017 arose in connection with the provision of US dollar liquidity to Eurosystem counterparties (see note 10, "Liabilities to non-euro area residents denominated in euro").

20 Administration of borrowing and lending operations

In 2016 the ECB continued to be responsible for the administration of the borrowing and lending operations of the EU under the medium-term financial assistance facility, the European Financial Stabilisation Mechanism, the European Financial Stability Facility and the European Stability Mechanism (ESM), as well as for the loan facility agreement for Greece. In 2016 the ECB processed payments related to these operations, as well as payments in the form of member subscriptions to the ESM's authorised capital stock.

21 Contingent liabilities from pending lawsuits

Four lawsuits have been filed against the ECB and other EU institutions by a number of depositors, shareholders and bondholders of Cypriot credit institutions. The applicants alleged that they had suffered financial losses as a result of acts that they deemed to have led to the restructuring of these credit institutions in the context of the financial assistance programme for Cyprus. The General Court of the EU found twelve similar cases inadmissible in their entirety in 2014. Appeals were brought against eight of these verdicts and in 2016 the Court of Justice of the European Union either confirmed the inadmissibility of the cases or ruled in favour of the ECB in these appeals. The ECB's involvement in the process leading up to the conclusion of the financial assistance programme was limited to the provision of technical advice, pursuant to the Treaty establishing the European Stability Mechanism, acting in liaison with the European Commission, as well as the issuance of a non-binding

opinion on the Cypriot draft resolution law. It is therefore considered that no losses will be incurred by the ECB as a result of these cases.

Notes on the Profit and Loss Account

22 Net interest income

22.1 Interest income on foreign reserve assets

This item includes interest income, net of interest expense, in respect of the ECB's net foreign reserve assets, as follows:

| | 2016 € | 2015 € | Change € |
|--|--------------------|--------------------|-------------------|
| Interest income on current accounts | 1,499,288 | 552,459 | 946,829 |
| Interest income on money market deposits | 18,095,835 | 6,306,443 | 11,789,392 |
| Interest income/(expense) on repurchase agreements | (34,017) | 38,311 | (72,328) |
| Interest income on reverse repurchase agreements | 12,745,338 | 2,920,201 | 9,825,137 |
| Interest income on securities | 304,958,993 | 261,121,900 | 43,837,093 |
| Interest income/(expense) on interest rate swaps | 19,080 | (861,355) | 880,435 |
| Interest income on forward and swap transactions in foreign currencies | 33,157,253 | 13,127,982 | 20,029,271 |
| Interest income on foreign reserve assets (net) | 370,441,770 | 283,205,941 | 87,235,829 |

The overall increase in net interest income in 2016 was due mainly to higher interest income generated on the US dollar portfolio.

22.2 Interest income arising from the allocation of euro banknotes within the Eurosystem

This item consists of the interest income relating to the ECB's 8% share of the total euro banknote issue (see "Banknotes in circulation" in the notes on accounting policies and note 5.1, "Claims related to the allocation of euro banknotes within the Eurosystem"). Despite a 4.7% increase in the average value of banknotes in circulation, there was a decrease in income in 2016 owing to the fact that the average rate on the main refinancing operations was lower than in 2015 (at 0.01% in 2016, compared with 0.05% in 2015).

22.3 Remuneration of NCBs' claims in respect of foreign reserves transferred

Remuneration paid to euro area NCBs on their claims in respect of the foreign reserve assets transferred to the ECB (see note 11.1, "Liabilities equivalent to the transfer of foreign reserves") is disclosed under this heading. The decrease in this remuneration in 2016 reflected the fact that the average rate on the main refinancing operations was lower than in 2015.

22.4 Other interest income; and other interest expense⁴⁹

In 2016 these items comprised mainly net interest income of €1.0 billion (2015: €0.9 billion) on the securities purchased by the ECB for monetary policy purposes. Of this amount, €0.5 billion (2015: €0.6 billion) related to net interest income on securities purchased under the SMP and €0.4 billion (2015: €0.2 billion) related to net interest income on securities purchased under the APP.

The remainder of these items consisted mainly of interest income and expense on the ECB's own funds portfolio (see note 6.2, "Other financial assets") and on other miscellaneous interest-bearing balances.

23 Realised gains/losses arising from financial operations

Net realised gains arising from financial operations in 2016 were as follows:

| | 2016 € | 2015 € | Change € |
|---|--------------------|--------------------|-------------------|
| Net realised price gains | 159,456,244 | 175,959,137 | (16,502,893) |
| Net realised exchange rate and gold price gains | 65,085,498 | 38,474,593 | 26,610,905 |
| Net realised gains arising from financial operations | 224,541,742 | 214,433,730 | 10,108,012 |

Net realised price gains included realised gains and losses on securities, interest rate futures and interest rate swaps. The decrease in net realised price gains in 2016 was due mainly to lower realised price gains generated on securities in the US dollar portfolio.

The overall increase in net realised exchange rate and gold price gains was due mainly to outflows in SDR holdings in the context of the two-way SDR buying and selling arrangement with the IMF (see note 2.1, "Receivables from the IMF").

24 Write-downs on financial assets and positions

Write-downs on financial assets and positions in 2016 were as follows:

⁴⁹ With effect from 2016 interest income and interest expense arising from securities held for monetary policy purposes is reported on a net basis under either "Other interest income" or "Other interest expense", depending on whether the net amount is positive or negative (see "Reclassifications" in the notes on accounting policies).

| | 2016 € | 2015 € | Change € |
|--|----------------------|---------------------|---------------------|
| Unrealised price losses on securities | (148,159,250) | (63,827,424) | (84,331,826) |
| Unrealised price losses on interest rate swaps | - | (223,892) | 223,892 |
| Unrealised exchange rate losses | (12,760) | (1,901) | (10,859) |
| Total write-downs | (148,172,010) | (64,053,217) | (84,118,793) |

The higher write-downs compared with 2015 were mainly due to the higher market yields of the securities held in the US dollar portfolio alongside the overall decrease in their market value.

25 Net income/expense from fees and commissions

| | 2016 € | 2015 € | Change € |
|---|--------------------|--------------------|--------------------|
| Income from fees and commissions | 382,191,051 | 277,324,169 | 104,866,882 |
| Expenses relating to fees and commissions | (10,868,282) | (8,991,908) | (1,876,374) |
| Net income from fees and commissions | 371,322,769 | 268,332,261 | 102,990,508 |

In 2016 income under this heading consisted mainly of supervisory fees. Expenses consisted mainly of custody fees, as well as fees payable to the external asset managers conducting purchases of eligible asset-backed securities on explicit instructions from, and on behalf of, the Eurosystem.

Income and expenses related to supervisory tasks

On November 2014 the ECB assumed its supervisory tasks in accordance with Article 33 of Council Regulation 1024/2013/EU of 15 October 2013. In order to recover its expenditure incurred for performing these tasks the ECB levies annual fees on supervised entities. The ECB announced in April 2016 that the annual supervisory fees in 2016 would amount to €404.5 million.⁵⁰ This amount was based on an estimated annual expenditure for 2016 amounting to €423.2 million, after adjustments for (i) the surplus supervisory fees of €18.9 million charged in 2015; (ii) the amounts refunded in relation to changes in the number or status of supervised entities⁵¹ (€0.3 million); and (iii) interest of €0.1 million charged for late payments in 2015.

Based on the actual expenditure of the ECB on its banking supervisory tasks, the supervisory fee income for 2016 stood at €382.2 million.

⁵⁰ This amount was invoiced in October 2016 with a due date of 18 November 2016.

⁵¹ Based on Article 7 of the ECB Regulation on supervisory fees (ECB/2014/41), in cases where (i) a supervised entity or a supervised group is supervised for only part of the fee period or (ii) the status of a supervised entity or a supervised group changes from significant to less significant, or vice versa, the individual supervisory fees are amended. Any such amounts received or refunded are taken into account for the calculation of the total annual supervisory fees to be levied in subsequent years.

| | 2016 € | 2015 € | Change € |
|---|--------------------|--------------------|--------------------|
| Supervisory fees | 382,151,355 | 277,086,997 | 105,064,358 |
| <i>of which:</i> | | | |
| <i>Fees allocated to significant entities or significant groups</i> | 338,418,328 | 245,620,964 | 92,797,364 |
| <i>Fees allocated to less significant entities or less significant groups</i> | 43,733,027 | 31,466,033 | 12,266,994 |
| Total income from banking supervision tasks | 382,151,355 | 277,086,997 | 105,064,358 |

The surplus of €41.1 million arising from the difference between the estimated expenditure (€423.2 million) and the actual expenditure (€382.2 million) for 2016 is shown under the heading “Accruals and income collected in advance” (see note 12.2, “Accruals and income collected in advanced”). It will reduce the supervisory fees to be levied in 2017.

Furthermore, the ECB is entitled to impose fines or periodic penalty payments on undertakings for failure to comply with obligations under its regulations and decisions. No such fines or penalties were imposed in 2016.

The SSM-related expenditure results from the direct supervision of significant entities, the oversight of the supervision of less significant entities and the performance of horizontal tasks and specialised services. It also includes expenditure arising from support areas, including premises, human resources management, administrative services, budgeting and controlling, accounting, legal, internal audit, statistical and information technology services needed to fulfil the ECB’s supervisory responsibilities.

For 2016 this expenditure is broken down under the following headings:

| | 2016 € | 2015 € | Change € |
|---|--------------------|--------------------|--------------------|
| Salaries and benefits | 180,655,666 | 141,262,893 | 39,392,773 |
| Rent and building maintenance | 58,103,644 | 25,513,220 | 32,590,424 |
| Other operating expenditure | 143,392,045 | 110,310,884 | 33,081,161 |
| Total expenditure related to banking supervision tasks | 382,151,355 | 277,086,997 | 105,064,358 |

The increase in the total number of staff working in ECB Banking Supervision, the relocation to new premises and the provision of statistical and IT infrastructure for the performance of supervisory tasks contributed to the rise in total SSM expenditure for 2016.

26 Income from equity shares and participating interests

Dividends received on shares which the ECB holds in the BIS (see note 6.2, “Other financial assets”) are shown under this heading.

27 Other income

Other miscellaneous income during 2016 mainly arose from the accrued contributions of the euro area NCBs to the costs incurred by the ECB in connection with joint Eurosystem projects.

28 Staff costs

The higher average number of staff employed by the ECB in 2016 has led to an overall increase in staff costs. This increase was partially offset by a decrease in the net expense related to post-employment benefits and other long-term benefits.

Salaries, allowances, staff insurance and other miscellaneous costs of €349.5 million (2015: €306.4 million) are included under this heading. Also included in this item is an amount of €117.0 million (2015: €134.4 million) recognised in connection with the ECB's pension plans, other post-employment benefits and other long-term benefits (see note 12.3, "Sundry").

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

Members of the Executive Board and the members of the Supervisory Board employed by the ECB receive a basic salary, while part-time members of the Supervisory Board employed by the ECB receive additional remuneration based on the number of meetings attended. Furthermore, the members of the Executive Board and the full-time members of the Supervisory Board employed by the ECB receive additional allowances for residence and representation. In the case of the President, an official residence owned by the ECB is provided in lieu of a residence allowance. Subject to the Conditions of Employment for Staff of the European Central Bank, members of both boards are entitled to household, child and education allowances, depending on their individual circumstances. Salaries are subject to a tax for the benefit of the European Union, as well as to deductions in respect of contributions to the pension, medical and accident insurance schemes. Allowances are non-taxable and non-pensionable.

In 2016 the basic salaries of the members of the Executive Board and members of the Supervisory Board employed by the ECB (i.e. excluding representatives of national supervisors) were as follows:⁵²

⁵² Amounts are presented gross, i.e. before any tax deductions for the benefit of the European Union.

| | 2016 € | 2015 € |
|--|------------------|------------------|
| Mario Draghi (President) | 389,760 | 385,860 |
| Vitor Constâncio (Vice-President) | 334,080 | 330,744 |
| Peter Praet (Board Member) | 277,896 | 275,604 |
| Benoît Cœuré (Board Member) | 277,896 | 275,604 |
| Yves Mersch (Board Member) | 277,896 | 275,604 |
| Sabine Lautenschläger (Board Member) | 277,896 | 275,604 |
| Total Executive Board | 1,835,424 | 1,819,020 |
| Total Supervisory Board (members employed by the ECB) ⁵³ | 631,254 | 635,385 |
| <i>of which:</i> | | |
| <i>Danièle Nouy (Chair of the Supervisory Board)</i> | 277,896 | 275,604 |
| Total | 2,466,678 | 2,454,405 |

Furthermore, the additional remuneration of the part-time members of the Supervisory Board amounted to €343,341 (2015: €352,256).

The total allowances paid to members of both boards and the ECB's contributions to the medical and accident insurance schemes on their behalf amounted to €807,475 (2015: €625,021). In December 2015 the Governing Council decided that, for staff members and Board members who bear the full cost of private medical insurance coverage, the ECB would pay an amount equivalent to the contribution it would make if the individuals were members of the ECB's medical scheme. Furthermore, the rule includes a retroactive clause for medical insurance payments from 1 January 2013. Due to this clause, allowance payments in 2017 are expected to be lower than in 2016.

Transitional payments may be made to former members of the Executive Board and the Supervisory Board for a limited period after the end of their terms of office. No such payments were made in 2016. Pension payments, including related allowances, to former board members or their dependents and contributions to the medical and accident insurance schemes amounted to €834,668 (2015: €783,113).

At the end of 2016 the actual full-time equivalent number of staff holding contracts with the ECB was 3,171,⁵⁴ including 320 with managerial positions. The change in the number of staff during 2016 was as follows:

⁵³ This total excludes the salary of Sabine Lautenschläger, which is reported with those of the other members of the Executive Board.

⁵⁴ Staff on unpaid leave are excluded. This number includes staff with permanent, fixed or short-term contracts and the participants in the ECB's Graduate Programme. Staff on maternity or long-term sick leave are also included.

| | 2016 | 2015 |
|--|--------------|--------------|
| Total staff as at 1 January (excluding new starters on 1 January) | 2,871 | 2,577 |
| Newcomers/change of contractual status | 725 | 648 |
| Resignations/end of contract | (380) | (299) |
| Net increase/(decrease) due to changes in part-time working patterns | (45) | (55) |
| Total staff as at 31 December | 3,171 | 2,871 |
| Average number of staff employed | 3,007 | 2,722 |

29 Administrative expenses

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

30 Banknote production services

This expense arises predominantly owing to the cross-border transportation of euro banknotes between banknote printing works and NCBs, for the delivery of new banknotes, and between NCBs, for the compensation of shortages with surplus stocks. These costs are borne centrally by the ECB.

President and Governing Council
of the European Central Bank
Frankfurt am Main

8 February 2017

Independent auditor's report

Opinion

We have audited the financial statements of the European Central Bank, which comprise the balance sheet as at 31 December 2016, the profit and loss account for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements of the European Central Bank give a true and fair view of the financial position of the European Central Bank as at 31 December 2016 and of the results of its operations for the year then ended, in accordance with the principles established by the Governing Council, which are laid down in Decision (EU) 2016/2247 of the ECB of 3 November 2016 on the annual accounts of the ECB (ECB/2016/35).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the European Central Bank in accordance with the German ethical requirements that are relevant to our audit of the financial statements, which are consistent with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the European Central Bank's Executive Board and Those Charged with Governance for the Financial Statements

The Executive Board is responsible for the preparation and fair presentation of the financial statements in accordance with the principles established by the Governing Council, which are laid down in Decision (EU) 2016/2247 of the ECB of 3 November 2016 on the annual accounts of the ECB (ECB/2016/35), and for such internal control as the Executive Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Executive Board is responsible for using the going concern basis of accounting in accordance with Article 4 of the applicable Decision (ECB/2016/35).

Those charged with governance are responsible for overseeing the European Central Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

Yours sincerely,

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft



Claus-Peter Wagner
Wirtschaftsprüfer



Victor Veger
Certified Public Accountant

Note on profit distribution/allocation of losses

This note is not part of the financial statements of the ECB for the year 2016.

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

- (a) an amount to be determined by the Governing Council, which may not exceed 20% of the net profit, shall be transferred to the general reserve fund, subject to a limit equal to 100% of the capital; and
- (b) the remaining net profit shall be distributed to the shareholders of the ECB in proportion to their paid-up shares.⁵⁵

In the event of a loss incurred by the ECB, the shortfall may be offset against the general reserve fund of the ECB and, if necessary, following a decision by the Governing Council, against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the NCBs in accordance with Article 32.5 of the Statute of the ESCB.⁵⁶

The ECB's net profit for 2016 was €1,193.1 million. Following a decision by the Governing Council, an interim profit distribution, amounting to €966.2 million, was paid out to the euro area NCBs on 31 January 2017. Furthermore, the Governing Council decided to distribute the remaining profit of €226.9 million to the euro area NCBs.

| | 2016 € | 2015 € |
|--|---------------|---------------|
| Profit for the year | 1,193,108,250 | 1,081,790,763 |
| Interim profit distribution | (966,234,559) | (812,134,494) |
| Profit after the interim profit distribution | 226,873,691 | 269,656,269 |
| Distribution of the remaining profit | (226,873,691) | (269,656,269) |
| Total | 0 | 0 |

⁵⁵ Non-euro area NCBs are not entitled to receive any share of the ECB's distributable profits, nor are they liable to fund any loss of the ECB.

⁵⁶ Under Article 32.5 of the Statute of the ESCB, the sum of the NCBs' monetary income shall be allocated to the NCBs in proportion to their paid-up shares in the capital of the ECB.

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