

# **BANK OF LATVIA**

FINANCIAL STATEMENTS OF THE BANK OF LATVIA  
FOR THE YEAR ENDED 31 DECEMBER 2008  
INDEPENDENT AUDITORS' REPORT TO THE COUNCIL  
OF THE BANK OF LATVIA

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## **Abbreviations**

BIS	Bank for International Settlements
EC	European Commission
ECB	European Central Bank
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
FCCM	Financial and Capital Market Commission
GDP	Gross Domestic Product
IMF	International Monetary Fund
JSC	Joint Stock Company
OECD	Organisation for Economic Co-operation and Development
SDR	Special Drawing Rights
US	United States of America

## BALANCE SHEET

(at the end of the year; in thousands of lats)

ASSETS	Notes <sup>1</sup>	2008	2007
FOREIGN ASSETS		<b>2 734 395</b>	2 806 790
Gold	4	108 998	99 130
Special Drawing Rights	6	187	83
Convertible foreign currencies	5	2 488 693	2 687 707
Participating interest in the European Central Bank	7	743	743
Participating interest in the Bank for International Settlements	8	1 763	1 763
Other foreign assets	9	134 011	17 364
DOMESTIC ASSETS		<b>679 200</b>	41 211
Loans to credit institutions	10	639 263	6 850
Fixed assets	11	34 626	32 646
Other domestic assets	12, 13	5 311	1 715
<b>TOTAL ASSETS</b>		<b>3 413 595</b>	2 848 001

<sup>1</sup> The accompanying notes set out on pages 9 to 40 are an integral part of these financial statements.

(cont.)	(at the end of the year; in thousands of lats)		
LIABILITIES, CAPITAL AND RESERVES	Notes	<b>2008</b>	2007
<b>FOREIGN LIABILITIES</b>		<b>402 145</b>	30 825
Convertible foreign currencies	14	131 252	5 330
International Monetary Fund	6	256	254 <sup>1</sup>
Other international institution deposits in lats	15	6 503	6 049
Foreign bank deposits in lats	16	247 001	35
Other foreign liabilities	17	17 133	19 157
<b>LATS IN CIRCULATION</b>	18	<b>1 018 092</b>	1 049 473
<b>DOMESTIC LIABILITIES</b>		<b>1 751 384</b>	1 597 218
Balances due to credit institutions	19	1 094 295	1 416 802
Balances due to the Government	20	638 056	171 241
Balances due to other financial institutions		1 705	4 876
Other domestic liabilities	21, 22	17 328	4 299
<b>CAPITAL AND RESERVES</b>		<b>241 974</b>	170 485
Nominal capital	23	25 000	25 000
Reserve capital	23	95 533	59 508
Valuation account	23	68 004	34 513
Profit of the reporting year	23	53 437	51 464
<b>TOTAL LIABILITIES, CAPITAL AND RESERVES</b>		<b>3 413 595</b>	2 848 001
<b>OFF-BALANCE SHEET ACCOUNTS</b>	35		

The financial statements, which are set out on pages 3 to 40, were authorised by the Board of the Bank of Latvia on 26 February 2009.

#### BOARD OF THE BANK OF LATVIA

M. Kālis  
R. Jakovļevs  
A. Ņikitins  
H. Ozols  
I. Posuma  
R. Vanags

<sup>1</sup> At the end of 2008, Latvia's quota in the IMF and the promissory note issued by the Latvian Government as its security were excluded from the foreign assets and liabilities respectively, and is reported in the financial statements of the Latvian Government.

## PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes	2008	2007
<b>INTEREST INCOME</b>			
Foreign operations	24	<b>143 646</b>	125 829
Interest on securities		96 553	94 921
Interest on deposits with foreign credit institutions and other foreign financial institutions		11 613	10 625
Interest on derivative financial instruments		35 480	20 283
Domestic operations	24	<b>7 264</b>	3 278
Interest on loans to credit institutions		6 723	2 026
Interest on derivative financial instruments		541	1 252
<b>INTEREST EXPENSE</b>			
Foreign operations	24	<b>11 923</b>	24 255
Interest on deposits		237	5
Interest on derivative financial instruments		11 686	24 250
Domestic operations	24	<b>54 461</b>	36 122
Interest on deposits of credit institutions		39 996	24 830
Interest on government deposits		14 366	11 198
Interest on deposits of other financial institutions		99	94
<b>NET INTEREST INCOME</b>	24	<b>84 526</b>	68 730

(cont.)	(in thousands of lats)		
	Notes	2008	2007
<b>REALISED GAINS/LOSSES (-) FROM FINANCIAL OPERATIONS</b>	25	<b>34 886</b>	14 310
Foreign operations		<b>23 488</b>	11 610
Securities		3 151	-4 161 <sup>1</sup>
Derivative financial instruments		20 337	15 771 <sup>2</sup>
Foreign currency exchange transactions		<b>11 398</b>	2 700
<b>WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS</b>	26	<b>38 087</b>	5 862
Foreign operations		<b>37 349</b>	5 504
Securities		30 941	5 504
Derivative financial instruments		6 408	-
Foreign currency position		<b>738</b>	358
<b>INCOME FROM PARTICIPATING INTEREST</b>	27	<b>206</b>	216 <sup>3</sup>
<b>OTHER OPERATING INCOME</b>	28	<b>3 433</b>	1 190
<b>BANKNOTE PRODUCTION AND COINAGE COSTS</b>	29	<b>4 046</b>	3 772 <sup>4</sup>
<b>OTHER OPERATING EXPENSES</b>		<b>27 481</b>	23 348
Remuneration	30	15 326	12 587
Social security costs	30	3 063	2 284
Depreciation and amortisation charges	11, 13	3 729	3 628
Maintenance and operation of information systems		1 574	1 548
Other operating expenses	31	3 789	3 301
<b>PROFIT OF THE REPORTING YEAR</b>		<b>53 437</b>	51 464

<sup>1</sup> Reported in the financial statements of 2007 under the profit and loss statement caption "Gain on investment in debt securities".

<sup>2</sup> Reported in the financial statements of 2007 under the profit and loss statement caption "Gain/losses from derivative financial instruments".

<sup>3</sup> Reported in the financial statements of 2007 under the profit and loss statement caption "Dividends on shares in the Bank for International Settlements".

<sup>4</sup> Reported in the financial statements of 2007 under the profit and loss statement caption "Other operating expenses".

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

		(in thousands of lats)	
	Notes	2008	2007
RESULT ON REVALUATION			
Result on revaluation of foreign currency and gold		-98	3 813
Result on revaluation of interest rate swap contracts		-2 781	-98
Result on revaluation of securities		-1 717	8 494
Write-downs on financial assets and positions		38 087	5 862
NET RESULT ON REVALUATION	23	<b>33 491</b>	18 071
PROFIT OF THE REPORTING YEAR		<b>53 437</b>	51 464
TOTAL		<b>86 928</b>	69 535

## CASH FLOW STATEMENT

		(in thousands of lats)	
	Notes	<b>2008</b>	2007
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
Profit of the reporting year		<b>53 437</b>	51 464
Non-cash transaction adjustments	32 (1)	<b>41 823</b>	9 492
Net movements in balance sheet positions	32 (1)	<b>372 221</b>	60 740
Net cash and cash equivalents inflow from operating activities		<b>467 481</b>	121 696
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>			
Decrease of participating interest in the European Central Bank		–	17
Dividends on shares of the Bank for International Settlements		<b>206</b>	216
Acquisition of fixed assets		<b>–5 291</b>	–3 038
Acquisition of intangible assets		<b>–55</b>	–54
Net cash and cash equivalents outflow from investing activities		<b>–5 140</b>	–2 859
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>			
Profit appropriated to the state budget		<b>–15 439</b>	–1 976
Net cash and cash equivalents outflow from financing activities		<b>–15 439</b>	–1 976
<b>NET CASH AND CASH EQUIVALENTS INFLOW</b>		<b>446 902</b>	116 861
Cash and cash equivalents at the beginning of the year	32 (2)	<b>240 807</b>	123 946
Cash and cash equivalents at the end of the year	32 (2)	<b>687 709</b>	240 807



## NOTES TO THE FINANCIAL STATEMENTS

### 1. PRINCIPAL ACTIVITIES

The Bank of Latvia is the central bank of Latvia. It was established on 31 July 1990 and operates under the Law of the Republic of Latvia "On the Bank of Latvia".

The primary goal of the Bank of Latvia is to maintain price stability in Latvia. Pursuant to the Law "On the Bank of Latvia", its primary tasks are as follows:

- establishment and implementation of monetary policy;
- management of foreign currency and gold reserves;
- issue of the national currency, both banknotes and coins;
- organisation and management of the interbank payment system and promotion of a smooth functioning of the payment system in Latvia;
- compiling and publishing financial statistics and Latvia's balance of payments;
- representation of Latvia in foreign central banks and international financial institutions;
- acting as a financial agent for the Latvian Government.

On 1 January 2008, the Credit Register of the Bank of Latvia was launched. It has been developed pursuant to the provisions of the Law "On Credit Institutions" and other legal acts.

In the execution of its tasks and control in accordance with the Law "On the Bank of Latvia" and the Law "On Credit Institutions", the Bank of Latvia neither seeks nor takes instructions from the Government or any other institution. The Bank of Latvia is independent in setting and implementing policy under its legal mandate. The Bank of Latvia is supervised by the Parliament (Saeima) of the Republic of Latvia.

The Bank of Latvia does not engage in any commercial activity, and its operation related to the execution of its tasks is mainly financed from income received from foreign currency and gold reserves management.

The Head Office of the Bank of Latvia is situated in Riga, K. Valdemāra Street 2A. The Bank of Latvia manages the storage, processing and circulation of cash through its Riga Branch and the regional branches in Daugavpils, Liepāja and Rēzekne.

### 2. RISK MANAGEMENT

The main risks associated with the Bank of Latvia's activities are financial and operational risks. Therefore, the Board of the Bank of Latvia has established a risk management framework under the principles and guidelines set forth by the Council of the Bank of Latvia, which is continuously improved in line with the developments in financial markets and the Bank of Latvia's operations. Management of the Bank of Latvia's financial and operational risk is reviewed by the Internal Audit Department and is monitored by the Security Supervision Commission and Audit Committee of the Bank of Latvia, each of which is comprised of members of the Council of the Bank of Latvia.

#### FINANCIAL RISKS

Market (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks to which the Bank of Latvia is exposed in its daily activities.

The Bank of Latvia manages financial risks related to foreign currency and gold reserves (hereinafter, foreign reserves) in accordance with the "Guidelines for Managing the Bank of Latvia's Foreign Reserves" (hereinafter, the Guidelines), as approved by the Council of the Bank of Latvia. Managing of foreign reserves is conducted in compliance with the basic principles set out in the Guidelines, including preserving the value of foreign reserves, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting to the Bank of Latvia's monetary policy objectives.

Foreign reserves are managed by classifying them into different investment portfolios. Portfolios of borrowed funds include foreign reserves which correspond to the Bank of Latvia's liabilities in foreign currencies to other institutions. Separate investment portfolios exist for gold reserves, foreign currency reserves managed by the Bank of Latvia, and foreign currency reserves managed by external asset managers.

Parameters for a benchmark portfolio reflecting the return target and acceptable level of financial risks, as well as the target structure of investments are set out for each portfolio type in the Guidelines. On a business day basis, the Risk Management Division of the Market Operations Department monitors the compliance of foreign reserves with the requirements set out in the Guidelines.

For the purpose of financial risk management, the Investment Committee of the Bank of Latvia that develops the investment management strategy, approves tactical decisions and sets detailed limits for financial risks in accordance with the Guidelines. The Investment Committee of the Bank of Latvia reviews the investment strategy once a quarter, and on a weekly basis receives and reviews reports and forecasts for developments in financial markets, which are prepared by foreign reserves investment portfolio managers, and approves the investment management tactical decisions for the forthcoming week.

### *MARKET RISK*

Market risk is exposure to losses due to adverse changes in financial markets (for example, movements in interest rates or exchange rates). The Bank of Latvia manages interest rate risk inherent mainly in financial instruments sensitive to interest rate fluctuations by using a modified duration limit set individually for each investment portfolio. The Bank of Latvia incurs interest rate risk mainly from investment in foreign debt securities and interest rate financial derivatives that are used within the framework of foreign reserves management.

The Bank of Latvia monitors the currency risk by determining open currency position limits. In accordance with the exchange rate policy of the Bank of Latvia for foreign reserves portfolios, except for portfolios of borrowed funds, the benchmark portfolio currency is euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with parameters of respective liabilities. Deviations from the benchmark currency structure give rise to the open currency position. Pursuant to the Guidelines, substantial deviation from the benchmark position is not permissible.

Every business day, the Risk Management Division of the Market Operations Department monitors the compliance of the modified duration limits and open currency positions with the Guidelines and the related resolutions passed by the Investment Committee of the Bank of Latvia.

In addition, the aggregate market risk of foreign reserves portfolios, except for portfolios of borrowed funds, is managed by determining the portfolio tracking error limit. It is calculated as the annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark portfolio.

The Bank of Latvia manages interest rate risk arising from foreign reserves by investing only in financial instruments denominated in the currencies of the OECD countries which have been assigned a definite credit rating.

The Bank of Latvia does not hedge interest rate risk related to domestic financial assets in order to avoid a conflict with the monetary policy objectives pursued by the Bank.

Exposure of the Bank of Latvia to market risk (as at the end of 2008 and 2007) is provided in Notes 37 and 38.

### *CREDIT RISK*

Credit risk is exposure to losses resulting from counterparty default. The Bank of Latvia's exposure to credit risk results mainly from investments in foreign financial instruments and short-term lending to domestic credit institutions.

The Bank of Latvia manages exposure to credit risk related to investments made in foreign financial instruments by establishing limits on investments of different credit quality in the Guidelines. Credit quality is evaluated on the basis of ratings assigned by the international rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's. Limits are set also on the maximum investment in financial instruments of the same class and counterparty, as well as in financial instruments of one issuer. In order to monitor the Bank's exposure to credit risk associated with its foreign operations, the Risk Management Division of the Market Operations Department is involved in monitoring of the Bank of Latvia's compliance with the Guidelines on a business day basis.

Short-term loans granted to domestic credit institutions are secured by collateral of Latvian Government securities (hereinafter, government securities) and such private sector debt securities, according to the requirements established by the Council of the Bank of Latvia. The Market Operations Department reviews the compliance of ratings assigned to issuers of securities with the requirements of the Council of the Bank of Latvia and monitors the adequacy of collateral on a regular basis. Exposure of the Bank of Latvia to credit risk (as at the end of 2008 and 2007) is provided in Notes 40 to 42.

### *LIQUIDITY RISK*

Liquidity risk is associated with a failure to meet liabilities timely. The Bank of Latvia manages liquidity risk by investing foreign exchange reserves in liquid debt securities and other financial instruments issued by international institutions, foreign governments and the corporate sector, while investing its gold reserves in short-term deposits with foreign financial institutions. Investments are made so as to ensure timely meeting of the Bank of Latvia's liabilities. The structure of the Bank of Latvia's cash and its equivalents is provided in Note 32. The liquidity profile of the Bank of Latvia's assets and liabilities as at the end of 2008 and 2007 is provided in Note 39.

The Bank of Latvia manages liquidity risk also by setting limits on the maximum investment in financial instruments of the same class and in financial instruments of the same issuer.

## OPERATIONAL RISKS

Operational risk is exposure to financial and non-financial losses resulting from an unexpected interruption of operation, unauthorised use of information or physical threats to the employees of the Bank of Latvia, its information, information systems and technical resources, or material values.

The goal and basic principles of the Bank of Latvia's security policy are determined by the Council of the Bank of Latvia. "The Security Policy of the Bank of Latvia", approved by the Council, covers risk management, management of operational continuity, security of information and information systems, and physical security; it also lays down regulations for uninterrupted and secure execution of the Bank of Latvia's tasks.

The Board of the Bank of Latvia determines the procedure for Bank of Latvia's risk management. "The Regulation for Managing the Bank of Latvia's Risks" covers the procedure for identifying, documenting, assessing and minimising risks. The management of the Bank of Latvia's operational risks is coordinated by the Head of Risk Management. In order to improve the risk management procedures, in 2008 the Bank of Latvia specified the risk management improvement areas, and the set and scope of activities to be undertaken.

To minimise the operational risks related to security and information systems, the Operational Risk Expert Group whose main task is to provide opinion to the Board of the Bank of Latvia on operational risks identified and initiate activities that would minimise these risks, and the Committee for Managing the Bank of Latvia's Information Systems to review, on a regular basis, the operational risk management system related to information systems, have been established at the Bank of Latvia.

In order to ensure confidentiality, authorised accessibility and integrity, information and relevant technical resources are classified under the internal control system. The Bank of Latvia has appointed owners of information and information systems who are responsible for classification, risk analysis and protection of relevant information or information systems, as well as determination of access rights and their application procedure. In 2008, the methodological improvement of the internal risk analysis based on the methods and tools developed by *Information Security Forum Limited* began.

"The Procedure for Managing the Continuity of the Bank of Latvia's Operation" approved by the Bank of Latvia's Council sets out general procedure for managing Bank of Latvia's operational continuity. An operational continuity management system to ensure timely identification of incidents and emergency situations and their prevention, to develop proposals for prevention of incidents and emergency situations in the future, to organise education and training of employees, to test and update action plans for ensuring operational continuity has been established at the Bank of Latvia. The Bank of Latvia's Board is responsible for the management of incidents and emergency situations at the Bank of Latvia. "The Procedure for Managing Incidents and Emergency Situations at the Bank of Latvia" approved by the Board covers timely identification of incidents and emergency situations and provides for coordinated and effective activities of the Bank of Latvia's departments in the event of an incident or emergency situation.

The Bank of Latvia has specified the functions whose discontinuity may cause emergency; specified also are the maximum permissible periods of forced discontinuity and the critical resources used in the implementation of these functions. On a regular basis, the Bank of Latvia's Board revises and evaluates the specified functions and critical resources as well as reviews the adequacy and availability of the resources for ensuring the continuity of the Bank's operations in case of emergency.

In order to improve the organisation of the Bank of Latvia's operational activities and to mitigate operational risks, the Bank of Latvia has designed and is continuously developing a quality management system in compliance with the quality management system standard ISO 9001:2000.

Within the framework of measures for managing total operational risks, the Bank of Latvia has been insured against certain types of operational risk.

## UNCERTAIN FINANCIAL MARKETS

In 2008 the stresses on the global financial system, which had been sparked by losses incurred by financial institutions on securities backed by US sub-prime mortgages, intensified further. Tensions in the financial sector have increasingly spilled over to the real economy. As uncertainty grew about the global economic outlook, risk aversion among financial market participants rose, with most financial asset prices falling as a result. Financial market liquidity and funding conditions deteriorated markedly, and securitisation became inactive. In the conditions of persistent liquidity stresses, financial institutions were facing mounting challenges in accessing short-term funding and capital markets. These and other factors have had an adverse effect on Latvia's financial sector and the real economy. The financial turmoil has affected, and may continue to affect, the financial position and financial performance of the Bank of Latvia. The Bank of Latvia's transactions have been affected by the restrained operation of the interbank market in the fourth quarter of 2008, which resulted in a substantial increase in the Bank of Latvia's short-term lending to credit institutions and the demand for euro due to which the Bank of Latvia sold a part of its foreign currency reserves in the fourth quarter of 2008. The income of the Bank of Latvia has been determined by the changes in interest rates and financial instrument liquidity. The impact of the respective developments and also other factors on the financial position and financial performance of the Bank of Latvia is reported in the notes to the financial statements dealing with the Bank of Latvia's

exposure to financial risks and also in Notes 23–26. The future developments in financial markets may differ from the assessment of the Bank of Latvia's management.

### 3. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by the Bank of Latvia in the preparation of these financial statements is set out below.

#### BASIS OF PRESENTATION

These financial statements have been prepared in accordance with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, and the Law "On the Bank of Latvia".

The "Financial Accounting Policy of the Bank of Latvia" requires that events and financial transactions of the Bank of Latvia relating to the implementation of monetary policy and management of foreign reserves are accounted for in accordance with the principal accounting policies established by the ECB Guideline of 10 November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2006/16).

#### BASIS OF MEASUREMENT

These financial statements have been prepared in accordance with the historical cost basis of accounting except gold, debt securities and derivatives, which are accounted for at fair value.

#### USE OF ESTIMATES

Estimates and assumptions have been made in the preparation of the financial statements that affect the amounts of certain assets, liabilities and contingent liabilities reported in the financial statements. Future events may affect the above mentioned estimates and assumptions. The effect of a change in such estimates and assumptions is reported in the financial statements of the reporting period and each particular future period to which it refers.

#### FOREIGN CURRENCY TRANSLATION

Transactions denominated in foreign currencies are recorded in lats at the exchange rates quoted by the Bank of Latvia for the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the exchange rates set by the Bank of Latvia at the end of the reporting period. Non-monetary items, measured at cost or amortised cost, are translated into lats at the exchange rate for the respective foreign currency set by the Bank of Latvia on the day of the transaction. Taking into account the lat's peg to the euro, the Bank of Latvia sets the exchange rates for other currencies on the basis of the exchange rate of euro against the US dollar and the exchange rates of the US dollar against other currencies as quoted in the information system *Reuters*.

Transactions in foreign currencies are included in the net foreign currency position of the respective currency. The transactions in foreign currencies reducing the respective currency position result in realised gains or losses. Any gain or loss arising from revaluation of transactions in foreign currencies and currency positions are credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on the financial instruments".

The principal exchange rates of foreign currencies and gold set by the Bank of Latvia and used in the preparation of the balance sheet for the year ended 31 December 2008 and the year ended 31 December 2007 are as follows:

	(at the end of the year)		
	2008	2007	Changes (%)
Euro (EUR)	<b>0.702804</b>	0.702804	–
US dollar (USD)	<b>0.495</b>	0.484	2.3
Japanese yen (JPY)	<b>0.00547</b>	0.00424	29.0
Gold (XAU)	<b>438.259</b>	398.591	9.95
Special Drawing Rights (XDR)	<b>0.764</b>	0.759	0.7

#### RECOGNITION AND DERECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

Financial assets and financial liabilities are recognised in the balance sheet when the Bank of Latvia becomes a contractual party in the respective financial transaction. A regular way purchase or sale of financial assets is recognised and derecognised on the settlement day.

A financial asset is derecognised when the contractual rights to cash flows arising from the respective financial asset expire or are transferred, hereby risks and rewards related to the particular asset are transferred, and the Bank of Latvia does not retain control over the asset. Financial liabilities are derecognised when the respective obligations are settled.

#### FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair value is the estimated amount at which financial assets could be exchanged, or financial liabilities settled in a transaction on an arm's length basis between knowledgeable and willing parties.

Fair value of financial assets and financial liabilities is obtained from quoted market prices or discounted cash flows. Discounted cash flows are modelled on the basis of financial instruments' quoted market prices and money market interest rates.

Fair value of the Bank of Latvia's financial assets and financial liabilities at the end of 2008 and 2007 did not differ materially from the reported book value of the respective assets and liabilities.

#### OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets and financial liabilities are offset and the net amount in the financial statements reported only in cases when there is a legally enforceable right to set off the recognised amounts, and there is an intention to settle on a net basis, or dispose the asset and settle the liability simultaneously.

#### GOLD

Gold reserves are recorded at market value in the balance sheet.

Any gain or loss arising from the revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on the financial instruments".

#### SECURITIES

Securities are stated at fair value in the balance sheet.

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income. Gain or loss arising from transactions in securities and revaluation are credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on the financial instruments".

#### REVERSE REPURCHASE AGREEMENTS

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not included in the Bank of Latvia's balance sheet. The related funding provided to the counterparty is included in the Bank of Latvia's balance sheet at nominal value as claims on domestic credit institutions or foreign credit institutions and other foreign financial institutions, as appropriate.

The difference between the purchase and resale price of securities is recognised as interest income in the profit and loss statement over the term of the agreement.

#### REPURCHASE AGREEMENTS

Repurchase agreements are accounted for as financing transactions. Securities sold under repurchase agreements are retained in the Bank of Latvia's balance sheet along with other securities that are not involved in these transactions. Funding received from such sales is included in the balance sheet at nominal value as a liability to the counterparty.

The difference between the sale and repurchase price of securities is recognised as interest expense in the profit and loss statement over the term of the agreement.

#### LOANS TO CREDIT INSTITUTIONS, DEPOSITS AND SIMILAR FINANCIAL CLAIMS AND FINANCIAL LIABILITIES

Loans granted to credit institutions, deposits and similar financial claims and liabilities are recorded at nominal value in the balance sheet.

#### PARTICIPATING INTEREST

Participating interest includes long-term investments of the Bank of Latvia in equity instruments. The Bank of Latvia has no control or significant influence in any institution, therefore participating interest is not accounted for as an investment in a subsidiary or an associate. As these equity instruments do not have a market price quoted in an active market and their fair value cannot be reliably measured, they are reported in the balance sheet at cost. An increase or decrease in participating interest due to acquisition or sale of new equity instruments is recognised considering the historical cost basis.

## FINANCIAL DERIVATIVES

The Bank of Latvia enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements, and interest rate future contracts, which are reported in off-balance sheet accounts at their contract or notional amount. Forward exchange rate contracts and currency swap arrangements are included in the net position of the respective currency on transaction day at the spot rate of the transaction and are recorded in the balance sheet in lats at the exchange rate of the respective currency set by the Bank of Latvia at the end of the reporting period. Other financial derivatives are reported in the balance sheet at fair value.

Interest on financial derivatives, including the spot and forward interest rate spread of forward exchange rate contracts and currency swap arrangements, are recognised in the profit and loss statement as interest income or interest expense. Any gain or loss arising from a change in fair value of interest rate future contracts is included in the profit and loss statement upon settlement. Any gain or loss arising from a change in fair value of other financial derivatives is credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on the financial instruments".

## ACCRUED INTEREST INCOME AND EXPENSE

Accrued interest income on securities is included in the carrying amount of the respective interest bearing securities. Accrued interest income and expense on other financial instruments are reported under relevant balance sheet captions of other assets or other liabilities.

## FIXED ASSETS

Fixed assets are tangible long-term investments with the useful life over one year. These assets are used in the provision of services as well as in the maintenance of other fixed assets and to ensure the Bank of Latvia's operation.

Fixed assets are recorded at cost less accumulated depreciation and impairment, if any.

Depreciation is recognised using the straight-line method over the estimated useful life of the asset. Assets under construction or development, land and works of art are not depreciated.

The following depreciation rates have been applied on an annual basis:

	(%)	
	2008	2007
Buildings		
– structures	1	1
– outer finishing	5	5
– interior decorations	5–20	5–20
– engineering communications	5	5
– other components	10–20	10–20
Improvement of territory	10	10
Transport vehicles	10	10
Office furniture	10	10
Computer equipment	20–33	20–33
Other office equipment	20	20
Cash processing equipment	10–20	10–20
Tools	50	50
Other fixed assets	7–20	7–20

In accordance with generally accepted principles for hedge accounting, the cost of individual fixed assets includes an effective result arising from financial instruments designated as hedges of exchange risk associated with development of the respective fixed assets.

Costs associated with the maintenance and repairs of fixed assets are recognised in the profit and loss statement when incurred.

Pursuant to the Law "On Disposal of the State and Local Government Property", the Bank of Latvia disposes of fixed assets to the state and local government institutions without charge. Loss on disposal of fixed assets is determined on the basis of the carrying amount of the fixed assets as at the time of disposal and is reported under the profit and loss statement caption "Other operating expenses".

#### INTANGIBLE ASSETS

Intangible assets are long-term investments without physical substance with a useful life of over one year. Intangible assets include software application rights and other rights.

Intangible assets are reported in the balance sheet at cost less accumulated amortisation and impairment, if any.

Acquisition costs of intangible assets are amortised over the useful life of the relevant assets using the straight-line method; however, this period may not exceed 10 years.

Costs related to software development by the Bank of Latvia are recognised in the profit and loss statement when incurred.

#### IMPAIRMENT OF ASSETS

An asset is impaired when its carrying amount exceeds its recoverable amount. With a view to detecting any indications of impairment of an asset, the Bank of Latvia's organisational units assess the quality of the Bank of Latvia's assets that have not been recognised at their fair value on a regular basis. Upon detecting any indications of impairment of an asset, the recoverable amount of the respective asset is estimated. If the recoverable amount is less than the carrying amount of the respective asset, adequate allowances for the relevant asset are made. Such allowances are recognised in the profit and loss statement with a respective reduction in the asset's carrying amount.

#### LATS IN CIRCULATION

Lats banknotes and coins in circulation issued by the Bank of Latvia, except for gold circulation coins and collector coins, are included in the balance sheet caption "Lats in circulation" at nominal value. The balance sheet caption "Lats in circulation" reports the Bank of Latvia's liabilities to holders of the respective banknotes and coins.

#### GOLD CIRCULATION COINS

Gold circulation coins (fineness .999) held in the vaults of the Bank of Latvia are included in the balance sheet caption "Other domestic assets", as their value is directly supported by their content of gold. These coins are stated in the balance sheet at the market value of their content of gold.

When gold circulation coins are issued, they are excluded from the balance sheet caption "Other domestic assets". The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", as their value is directly supported by their content of gold.

#### COLLECTOR COINS

Collector coins sold are not included in the balance sheet caption "Lats in circulation", as the repurchasing probability of those coins is low or the value of precious metals of which the coins are made exceeds repurchase value. Proceeds from sales of collector coins are recognised in the profit and loss statement when incurred.

#### PROVISIONS

Provisions are recognised in the financial statements when the Bank of Latvia has incurred a present legal or constructive obligation arising from a past event or transaction and a reliable estimate can be made of the obligation and it can be expected to result in a cash outflow from the Bank of Latvia.

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents recorded in the cash flow statement include convertible foreign currency in cash, demand deposits and deposits with an original maturity up to 5 business days made with foreign credit institutions, and other foreign financial institutions.

#### RECOGNITION OF PROFIT OR LOSS ON FINANCIAL INSTRUMENTS

Gains or losses on financial instruments are recognised in accordance with the following principles:

- (a) realised gains and losses shall be recorded in the profit and loss statement;
- (b) unrealised gains shall be recognised in the balance sheet caption "Valuation account";
- (c) unrealised losses recognised in the balance sheet caption "Valuation account" at the end of the reporting year shall be transferred to the profit and loss statement if they exceed previous revaluation gain on the respective financial instrument, foreign currency or gold holding;

(d) unrealised losses recognised in the profit and loss statement at the end of the reporting year shall not be reversed and offset by unrealised gains of the respective financial instrument, foreign currency or gold holding in the subsequent years;

(e) there shall be no netting of unrealised losses in a financial instrument, foreign currency or gold holding against unrealised gains in other financial instrument, foreign currency or gold holding.

The average cost method shall be used to calculate realised and unrealised gains and losses of financial instrument, foreign currency or gold holding. The average cost of financial instrument, foreign currency or gold holding shall be increased or reduced by unrealised losses that are recognised in the profit and loss statement at year-end.

#### INTEREST INCOME AND EXPENSE

Interest income and expense are recognised in the profit and loss statement on an accrual basis.

Interest income includes interest on acquired securities, deposits, loans granted, forward exchange rate contracts, and currency and interest rate swap arrangements. Interest on acquired securities also includes premium and discount, which is amortised over the remaining life of the respective securities using the straight-line method.

Interest expense includes interest on deposits received from the Latvian Government, domestic credit institutions and other financial institutions, as well as forward exchange rate contracts, and currency and interest rate swap arrangements.

#### REALISED GAINS OR LOSSES FROM INVESTMENT IN FINANCIAL INSTRUMENTS

Realised gains or losses from investment in financial instruments are recognised in the profit and loss statement at the time of disposal of financial instrument or at the moment of settlement.

Realised gains or losses from investment in financial instruments include realised gains or losses of foreign exchange transactions, disposal of debt securities, and derivative financial instruments.

#### INCOME FROM PARTICIPATING INTEREST

Dividends on participating interest are recognised in the profit and loss statement when received.

#### BANKNOTE PRODUCTION AND COINAGE COSTS

Banknote production and coinage costs, except gold circulation coin production costs, are charged to the profit and loss statement when incurred.

#### OTHER EXPENSE AND INCOME

Bank's other operational expense and income is recognised in the profit and loss statement on an accrual basis. Lease payments are recognised in the profit and loss statement proportionally over the term of the respective agreement.

### 4. GOLD

Movements in gold reserves in 2008 and 2007 were as follows:

	Troy ounces	Amount in thousands of lats
As at 31 December 2006	248 701	83 668
Increase in gold market value	x	15 462
As at 31 December 2007	248 701	99 130
Increase in gold market value	x	9 866
Net change resulting from gold depositing and deposit withdrawal	6	2
<b>As at 31 December 2008</b>	<b>248 707</b>	<b>108 998</b>

The Bank of Latvia hedges the risk related to fluctuations in gold reserves market value by entering into forward exchange rate contracts (see also Note 37).

### 5. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency assets of the Bank of Latvia are invested primarily in debt securities of high liquidity.



The carrying amount of interest bearing debt securities includes both interest income purchased at the date of acquisition and interest income accrued subsequent to the date of acquisition of securities (28 568 thousand lats at the end of 2008 and 24 658 thousand lats at the end of 2007).

At the end of 2008 and 2007, the balance sheet asset caption "Convertible foreign currencies" was comprised of the following assets:

	(in thousands of lats)	
	2008	2007
Debt securities of foreign governments, financial institutions and non-financial corporations	<b>1 800 987</b>	2 398 148
Demand deposits with foreign central banks, credit institutions and international institutions	<b>661 741</b>	223 530
Time deposits with foreign credit institutions and other foreign financial institutions	<b>19 679</b>	63 564
Foreign currency in cash	<b>6 286</b>	2 465
<b>Total</b>	<b>2 488 693</b>	2 687 707

## 6. INTERNATIONAL MONETARY FUND

Pursuant to the Law "On the Republic of Latvia Joining the International Monetary Fund" the Bank of Latvia serves as a depository for the IMF and services the IMF accounts in the member state currency without compensation. The IMF holdings in lats comprise promissory notes issued by the Latvian Government, Account No. 1 used for financial transactions with the IMF, and Account No. 2 used for the IMF administrative expenditure and receipts.

Latvia's claims on the IMF include SDR and Latvia's quota in the IMF. SDR is an international reserve asset created by the IMF and used in transactions between the IMF and its members. The quota in the IMF reflects the subscription in the IMF of respective members. Latvia's quota in the IMF is secured by the Latvian Government promissory note issued to the IMF and is recorded as an asset denominated in SDR. The Latvian quota in the IMF is 126 800 thousand SDR.

In 2008, the Bank of Latvia changed its balance sheet reporting of assets and liabilities relating to the IMF. Latvia's quota in the IMF and the Latvian Government promissory note have been excluded from the foreign assets and liabilities respectively and are reported in the financial statements of the Latvian Government. There was no impact on the Bank of Latvia's financial performance of this decision.

At the end of 2008, the liabilities to the IMF reported on the Bank of Latvia's balance sheet consisted of the funds at the disposal of the IMF in the amount of 256 thousand lats (254 thousand lats at the end of 2007) held on its accounts No. 1 and No. 2.

At the end of 2008 and 2007, Latvia's net claims on the IMF were as follows:

	(in thousands of lats)		(in thousands of SDR)	
	2008	2007	2008	2007
Latvian quota in the IMF	<b>96 875</b>	96 241	<b>126 800</b>	126 800
IMF holdings in lats	<b>-505 850</b>	-96 212	<b>-662 106</b>	-126 762
Promissory notes of the Latvian Government	<b>-505 594</b>	-95 958	<b>-661 772</b>	-126 428
Account No. 1	<b>-242</b>	-241	<b>-317</b>	-317
Account No. 2	<b>-14</b>	-13	<b>-17</b>	-17
Stand-by Arrangement for Latvia	<b>409 003</b>	-	<b>535 344</b>	-
Reserve position in IMF	<b>42</b>	42	<b>55</b>	55
Special Drawing Rights	<b>187</b>	83	<b>245</b>	109
<b>Latvia's net claims on IMF</b>	<b>229</b>	125	<b>300</b>	164

The reserve position in the IMF is the difference between the total Latvian quota in the IMF and the IMF holdings in lats, excluding the balance on Account No. 2 and adding the amount of the IMF loan.

Claims on and liabilities to the IMF are expressed in lats at the SDR exchange rate set by the Bank of Latvia at the end of the year.

## 7. PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, the Bank of Latvia became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and the ECB, the share of the Bank of Latvia in the ECB's capital was calculated on the basis of the EU states' population and GDP data and is adjusted every five years or at shorter intervals depending on changes in the number of the EU Member States.

On 31 December 2008, the share of the Bank of Latvia in the ECB's capital was 0.2813% which corresponds to 16 205 thousand euro (11 389 thousand lats). As Latvia does not participate in the euro area, pursuant to the transitional provisions of the Statute of the ESCB and the ECB, the Bank of Latvia has paid up a minimum 7% contribution of its total subscribed capital in the ECB amounting to 1 134 thousand euro or 743 thousand lats (see also Note 36).

## 8. PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2008 and 2007, the Bank of Latvia owned 1 070 shares in the BIS, which correspond to 0.20% of the total subscribed and paid-up BIS capital.

The nominal value of the Bank of Latvia's shareholding in the BIS is 5 350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 25% or 1 338 thousand SDR (see also Note 36). The deemed cost of this holding as at 31 December 2008 and 31 December 2007 is reported in the Bank of Latvia's balance sheet in the amount of 1 763 thousand lats (see also Note 27).

## 9. OTHER FOREIGN ASSETS

At the end of 2008 and 2007, other foreign assets consisted of the following items:

	(in thousands of lats)	
	2008	2007
Non-traded financial derivative contracts with foreign financial institutions	133 551	16 523
Prepaid expense	392	250
Advance payment for delivered goods	–	325
Interest accrued on deposits	27	217
Other	41	49
Total	134 011	17 364

## 10. LOANS TO CREDIT INSTITUTIONS

At the end of 2008, loans to domestic credit institutions included the main refinancing operations, the marginal lending facility and other short-term loans in the amount of 639 263 thousand lats (6 850 thousand lats at the end of 2007). In the fourth quarter of 2008, due to tensions in the financial system impaired functioning of the interbank market was observed; hence, the Bank of Latvia granted a considerably larger amount of short-term loans than in 2007, providing liquidity support to credit institutions that had difficulty in accessing funding on the interbank market.

Loans granted to domestic credit institutions are secured by collateral of Latvian Government securities and private sector debt securities with the fair value of 678 027 thousand lats at the end of 2008 (6 970 thousand lats at the end of 2007; see also the section "Credit risk" in Note 2).

## 11. FIXED ASSETS

The following changes in fixed assets took place in 2008 and 2007:

	(in thousands of lats)					
	Buildings, improvement of territory, and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
<b>As at 31 December 2006</b>						
Cost	31 245	6 885	4 240	1 113	4 650	48 133
Accumulated depreciation	-3 802	-4 711	-2 393	-731	-3 733	-15 370
Net book value	27 443	2 174	1 847	382	917	32 763
<b>During 2007</b>						
Additions	971	478	1 225	47	317	3 038
Disposals	-	-514	-24	-128	-182	-848
Net change in cost	971	-36	1 201	-81	135	2 190
Depreciation charge	-1 766	-658	-247	-72	-410	-3 153
Accumulated depreciation on disposals	-	513	24	128	181	846
Net change in accumulated depreciation	-1 766	-145	-223	56	-229	-2 307
<b>As at 31 December 2007</b>						
Cost	32 216	6 849	5 441	1 032	4 785	50 323
Accumulated depreciation	-5 568	-4 856	-2 616	-675	-3 962	-17 677
Net book value	26 648	1 993	2 825	357	823	32 646
<b>During 2008</b>						
Additions	3 833	361	254	279	564	5 291
Change in classification	2	-9	9	-1	-1	-
Disposals	-	-405	-1 061	-23	-234	-1 723
Net change in cost	3 835	-53	-798	255	329	3 568
Depreciation charge	-1 945	-587	-379	-71	-322	-3 304
Change in classification	-1	2	-2	1	-	-
Accumulated depreciation on disposals	-	400	1 061	23	232	1 716
Net change in accumulated depreciation	-1 946	-185	680	-47	-90	-1 588
<b>As at 31 December 2008</b>						
Cost	36 051	6 796	4 643	1 287	5 114	53 891
Accumulated depreciation	-7 514	-5 041	-1 936	-722	-4 052	-19 265
<b>Net book value</b>	<b>28 537</b>	<b>1 755</b>	<b>2 707</b>	<b>565</b>	<b>1 062</b>	<b>34 626</b>

At the end of 2008, the total cadastral value of land under the ownership and possession of the Bank of Latvia was 3 171 thousand lats (724 thousand lats at the end of 2007). Land is reported in the balance sheet of the Bank of Latvia at cost (264 thousand lats at the end of 2008 and 2007).

During the year, the Bank of Latvia acquired additional building premises for 3 200 thousands lats for operational needs to ensure expansion of the cash processing function and customer servicing area in preparation

for the euro changeover. Part of the building is currently leased to another entity under an operating lease until 2011.

## 12. OTHER DOMESTIC ASSETS

At the end of 2008 and 2007, other domestic assets consisted of the following items:

	(in thousands of lats)	
	2008	2007
Accrued interest on loans to credit institutions	2 714	5 <sup>1</sup>
Intangible assets	1 001	1 371
Non-traded financial derivative contracts with domestic credit institutions	211	2 <sup>1</sup>
Tax claims	209	–
Prepaid expense	183	135
Other	993	202
<b>Total</b>	<b>5 311</b>	<b>1 715</b>

## 13. INTANGIBLE ASSETS

The following changes in intangible assets took place in 2008 and 2007:

	(in thousands of lats)	
As at 31 December 2006		
Cost		4 311
Accumulated amortisation		–2 479
Net book value		1 832
During 2007		
Additions		54
Derecognised assets		–615
Net change in cost		–561
Amortisation charge		–475
Accumulated amortisation on disposals		575
Net change in accumulated amortisation		100
As at 31 December 2007		
Cost		3 750
Accumulated amortisation		–2 379
Net book value		1 371
<b>During 2008</b>		
Additions		55
Derecognised assets		–85
Net change in cost		–30
Amortisation charge		–425
Accumulated amortisation on derecognised assets		85
Net change in accumulated amortisation		–340

<sup>1</sup> In the financial statements for 2007, reported in item "Other" under "Other domestic assets".

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**As at 31 December 2008**

Cost	3 720
Accumulated amortisation	-2 719
<b>Net book value</b>	<b>1 001</b>

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**14. CONVERTIBLE FOREIGN CURRENCIES**

Convertible foreign currency liabilities consist of repurchase agreements (*repos*) concluded with foreign financial institutions and funds on the EC account, as well as other liabilities. The EC account is used by the EC for the distribution of EU budgetary funds (see also Note 15).

At the end of 2008 and 2007, convertible foreign currency liabilities consisted of the following items:

	(in thousands of lats)	
	<b>2008</b>	2007
Repurchase agreements	123 953	–
European Commission demand deposits	6 230	5 330
Other liabilities	1 069	–
<b>Total</b>	<b>131 252</b>	5 330

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**15. OTHER INTERNATIONAL INSTITUTION DEPOSITS IN LATS**

Deposits of other international institutions in lats consist of funds on the EC account for settlements in lats, which is used for effecting Latvian Government payments to the EU budget (see also Note 14) and liabilities to other international institutions.

At the end of 2008 and 2007, the breakdown of deposits of other international institutions in lats was as follows:

	(in thousands of lats)	
	<b>2008</b>	2007
European Commission demand deposits	<b>6 273</b>	5 819
Other deposits	<b>230</b>	230
<b>Total</b>	<b>6 503</b>	6 049

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**16. FOREIGN BANK DEPOSITS IN LATS**

Foreign bank deposits in lats comprise short term deposits of *Sveriges Riksbank* and *Danmarks Nationalbank* resulting from the exchange of the lats to the euro under foreign currency swaps.

**17. OTHER FOREIGN LIABILITIES**

At the end of 2008 and 2007, other foreign liabilities consisted of the following items:

	(in thousands of lats)	
	<b>2008</b>	2007
Non-traded financial derivative contracts and spot exchange rate contracts with foreign financial institutions	<b>16 292</b>	18 874
Accrued expense	<b>304</b>	244
Other	<b>537</b>	39
<b>Total</b>	<b>17 133</b>	19 157

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## 18. LATS IN CIRCULATION

At the end of 2008 and 2007, the following units of lats (LVL) and santims (s) were in circulation:

Nominal	Amount (in thousands of lats)		Number (in thousands of units)		Percentage (%)	
	2008	2007	2008	2007	2008	2007
<b>Banknotes</b>						
LVL 500	<b>110 872</b>	143 413	<b>222</b>	287	<b>10.9</b>	13.7
LVL 100	<b>145 212</b>	170 275	<b>1 452</b>	1 703	<b>14.3</b>	16.2
LVL 50	<b>73 889</b>	68 481	<b>1 478</b>	1 370	<b>7.3</b>	6.5
LVL 20	<b>485 292</b>	458 353	<b>24 265</b>	22 918	<b>47.7</b>	43.9
LVL 10	<b>73 773</b>	79 128	<b>7 377</b>	7 913	<b>7.2</b>	7.5
LVL 5	<b>70 781</b>	73 922	<b>14 156</b>	14 784	<b>6.9</b>	7.0
Total banknotes	<b>959 819</b>	993 572	<b>x</b>	x	<b>94.3</b>	94.8
<b>Coins</b>						
LVL 100	<b>405</b>	404	<b>4</b>	4	<b>0</b>	0
LVL 10	<b>145</b>	145	<b>15</b>	14	<b>0</b>	0
LVL 2	<b>8 673</b>	8 811	<b>4 337</b>	4 405	<b>0.9</b>	0.8
LVL 1	<b>28 345</b>	26 997	<b>28 345</b>	26 997	<b>2.8</b>	2.6
50 s	<b>7 744</b>	7 374	<b>15 489</b>	14 747	<b>0.8</b>	0.7
20 s	<b>4 376</b>	4 168	<b>21 881</b>	20 842	<b>0.4</b>	0.4
10 s	<b>2 723</b>	2 596	<b>27 224</b>	25 961	<b>0.3</b>	0.2
5 s	<b>2 082</b>	1 966	<b>41 638</b>	39 329	<b>0.2</b>	0.2
2 s	<b>2 166</b>	1 940	<b>108 294</b>	97 001	<b>0.2</b>	0.2
1 s	<b>1 614</b>	1 500	<b>161 425</b>	149 985	<b>0.1</b>	0.1
Total coins	<b>58 273</b>	55 901	<b>x</b>	x	<b>5.7</b>	5.2
Total lats in circulation	<b>1 018 092</b>	1 049 473	<b>x</b>	x	<b>100.0</b>	100.0

At the end of 2008, the total nominal value of gold circulation coins (fineness .999) issued, with the denomination of LVL 100, was 1 988 thousand lats (1 988 thousand lats at the end of 2007). The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", since their nominal value is directly supported by their content of gold.

As at the end of 2008, collector coins with the total nominal value of 1 449 thousand lats had been issued (1 346 thousand lats at the end of 2007). These coins are not included in the balance sheet caption "Lats in circulation".

### 19. BALANCES DUE TO CREDIT INSTITUTIONS

Balances due to credit institutions include balances on the settlement accounts of domestic credit institutions opened with the Bank of Latvia, as well as deposit facility and time deposits in lats received from the above financial institutions. The respective credit institutions place their funds with the Bank of Latvia in order to comply with its minimum reserve requirement, as well as to effect interbank and customer payments, the Bank of Latvia's monetary policy operations and other settlements in the Bank of Latvia's payment systems.

At the end of 2008 and 2007, balances due to domestic credit institutions consisted of the following items:

	(in thousands of lats)	
	2008	2007
Current account balances in lats	1 071 869	1 407 539
Current account balances in euro	22 426	9 263
Total	1 094 295	1 416 802

### 20. BALANCES DUE TO THE GOVERNMENT

Latvian Government deposits consist of the Treasury of the Republic of Latvia demand deposits and time deposits in lats and foreign currencies received by the Bank of Latvia acting as the financial agent of the Latvian Government.

At the end of 2008 and 2007, the breakdown of Latvian Government deposits was as follows:

	(in thousands of lats)	
	2008	2007
Demand deposits in foreign currencies	467 188	43 744
Time deposits in lats	170 868	75 646
Time deposits in foreign currencies	–	51 851
Total	638 056	171 241

### 21. OTHER DOMESTIC LIABILITIES

At the end of 2008 and 2007, other domestic liabilities consisted of the following items:

	(in thousands of lats)	
	2008	2007
Money in transit	11 192	498
Accrued expense and similar liabilities	3 148	2 192
Accrued interest expense	600	728
Non-traded currency swap arrangements with domestic credit institutions	403	101
Tax liabilities	–	170
Other	1 985	610
Total	17 328	4 299

## 22. TAX

In 2008 and 2007, the Bank of Latvia calculated and paid the following taxes:

(in thousands of lats)

	Personal income tax	Compul- sory social security contribu- tions (by employer)	Compul- sory social security contribu- tions (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2006	0	7	3	0	35	0	45
<b>During 2007</b>							
Calculated	2 631	2 285	886	144	437	2	6 385
Decrease in deferred liabilities	–	70	–	–	–	–	70
Paid	–2 631	–2 356	–887	–144	–310	–2	–6 330
Liabilities as at 31 December 2007	0	6	2	0	162	0	170
<b>During 2008</b>							
Calculated	3 015	3 063	1 065	88	309	1	7 541
Increase in deferred liabilities	–	–230	–	–	–	–	–230
Recalculation of liabilities	–	–	–	–	–362	–	–362
Paid	–3 015	–2 839	–1 067	–88	–318	–1	–7 328
<b>Claims as at 31 December 2008</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>–209</b>	<b>0</b>	<b>–209</b>

In addition to the tax payments indicated herein, the Bank of Latvia transfers 30% of the profit for the reporting year, including the payment for the usage of state capital (15 439 thousand lats in 2008; 1 976 thousand lats in 2007; see also Notes 23 and 33) to the state budget. The Bank of Latvia is not subject to corporate income tax.



### 23. CAPITAL AND RESERVES

In 2008 and 2007, changes in the Bank of Latvia's capital and reserves were as follows:

	(in thousands of lats)					
	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	EU grant	Capital and reserves
As at 31 December 2006	25 000	54 898	16 442	6 586	533	103 459
<b>During 2007</b>						
Net result on revaluation	x	x	18 071	x	x	18 071
Profit appropriated to the state budget	x	x	x	-1 976	x	-1 976
Profit transferred to the reserve capital	x	4 610	x	-4 610	x	-
Decrease in EU grant	x	x	x	x	-533	-533
Profit of the reporting year	x	x	x	51 464	x	51 464
As at 31 December 2007	25 000	59 508	34 513	51 464	-	170 485
<b>During 2008</b>						
Net result on revaluation	x	x	33 491	x	x	33 491
Profit appropriated to the state budget	x	x	x	-15 439	x	-15 439
Profit transferred to the reserve capital	x	36 025	x	-36 025	x	-
Profit of the reporting year	x	x	x	53 437	x	53 437
<b>As at 31 December 2008</b>	<b>25 000</b>	<b>95 533</b>	<b>68 004</b>	<b>53 437</b>	<b>x</b>	<b>241 974</b>

The capital of the Bank of Latvia is comprised of the nominal capital, reserve capital and the balance sheet item "Valuation account", as well as the undistributed profit. The Bank of Latvia does not take decisions affecting the formation of the nominal capital, reserve capital, and the profit distribution as they are provided for by the Law "On the Bank of Latvia". The balance sheet item "Valuation account" comprises the positive result on revaluation of the financial instruments. The accounting policies described in Note 3 stipulate that the realised gains are recognised in the profit and loss statement only after the disposal of a financial instrument while unrealised gains are recorded under the balance sheet item "Valuation account", thus facilitating the preservation of the capital under the impact of unfavourable financial instrument price, interest rate and exchange rate fluctuations.

No external capital adequacy requirements have been stipulated for the Bank of Latvia capital; nevertheless, it should be adequate to promote credibility of the monetary policy implemented by the Bank of Latvia, and to ensure implementation of its operations and financial independence when performing the tasks set forth by the Law "On the Bank of Latvia". The Bank of Latvia does not hedge financial risks where a conflict with the policy objectives pursued by it could arise. The implementation of the monetary policy as well as exposure to other financial and operational risks may adversely affect the Bank of Latvia income or cause losses to be covered from the capital of the Bank of Latvia.

The nominal capital of the Bank of Latvia is comprised of the State-allotted resources and the Bank of Latvia's profit allocations. The authorised and paid-up nominal capital of the Bank of Latvia amounts to 25 million lats as prescribed by the Law "On the Bank of Latvia".

The Law "On the Bank of Latvia" establishes that a part of the Bank of Latvia's profit of the reporting year, calculated by applying the same percentage as the tax rate set for resident corporate entities of Latvia by the Law "On Corporate Income Tax", together with a payment in the amount of 15% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget. At the end of 2008 and 2007, the corporate income tax rate applicable to residents of Latvia was 15%. Therefore, 30% of the Bank of Latvia's profit of the reporting year shall be transferred to the state budget within 15 days following the approval of the annual report by the Council of the Bank of Latvia.

The Bank of Latvia's profit remaining after making the above deductions shall be transferred to the reserve capital. The reserve capital shall be formed to cover potential losses.

In 2008 and 2007, changes in the balance sheet caption "Valuation account" were as follows:

(in thousands of lats)

	2008	Other changes	Write-offs	2007	Other changes	Write-offs	Valuation differences	Reclassification	2006
Initial valuation account	24 067	–	3 352	20 715	–	4 070	203	16 442	x
Deferred result on revaluation of foreign currencies and gold	24 018	–	–	24 018	717	–	203	23 098	x
Deferred result on revaluation of non-traded interest rate swap arrangements	–	–	545	–545	–557	278	x	–266	x
Deferred result on revaluation of securities	49	–	2 807	–2 758	–160	3 792	x	–6 390	x
Result on revaluation of foreign currencies and gold	3 891	–98	738	3 251	2 893	358	x	–23 098	23 098
Result on revaluation of non-traded interest rate swap arrangements	3 263	–3 326	6 408	181	181	–	x	266	–266
Result on revaluation of securities	36 783	–4 524	30 941	10 366	4 862	5 504	x	6 390	–6 390
<b>Total</b>	<b>68 004</b>	<b>–7 948</b>	<b>41 439</b>	<b>34 513</b>	<b>7 936</b>	<b>9 932</b>	<b>203</b>	<b>0</b>	<b>16 442</b>

The initial valuation account was established by transferring thereto the result on revaluation prior to the change in the accounting policies on 1 January 2007. The change in the balance of the initial valuation account in 2008 is related to the recognition of the profit or loss or result on revaluation of the financial instruments of the Bank of Latvia in the amount of 3 352 thousand lats (4 070 thousand lats in 2007) outstanding at the end of 2006. At the end of 2008, balances of other items comprise the positive result on revaluation of the respective financial instruments, calculated from the beginning of 2007 (the negative result on revaluation at the end of 2008 has been recognised in the caption "Write-downs on financial assets and positions" of the profit and loss statement; see also Note 3).

#### 24. NET INTEREST INCOME

In 2008, the Bank of Latvia's net interest income amounted to 84 526 thousand lats (68 730 thousand lats in 2007). The income was mainly derived from investing foreign currency reserves.

Interest income from foreign operations increased by 17 817 thousand lats while interest expense decreased by 12 332 thousand lats in comparison with 2007. Net interest income grew mostly on account of interest on forward exchange rate contracts and currency swap arrangements concluded by the Bank of Latvia for the purpose of hedging currency risk exposure, and the excess of interest income over the expenditure resulted from higher euro interest rates in comparison with those of other foreign currencies included in the foreign currency reserves and gold in 2008.

In comparison with 2007, interest income from domestic operations increased by 3 986 thousand lats in 2008 on account of larger amounts of loans granted to domestic credit institutions.

Interest expense on domestic operations (54 461 thousand lats; 36 122 thousand lats in 2007) was largely comprised of interest on deposits of domestic credit institutions and the Latvian Government. Interest expense on credit institution deposits increased by 15 166 thousand lats as the Bank of Latvia raised its deposit facility rate from 2% to 3% and the average balance of credit institution deposits grew. The Bank of Latvia also received a larger amount of Latvian Government funds as deposits than in 2007; moreover, interest paid on these deposits rose, therefore interest expense on Government deposits increased by 3 168 thousand lats in 2008.

#### 25. REALISED GAINS/ LOSSES FROM FINANCIAL OPERATIONS

Realised gains or losses on investment in financial instruments comprises the realised gains and losses on exchange rate contracts, gains and losses from the disposal of securities as well as realised gains and losses on financial derivatives.

The increase in profit on foreign exchange rate contracts mostly resulted from the interventions conducted in the foreign exchange market in the amount of 1 027 million lats in October, November and December 2008. Profit from investment in financial instruments resulted from the interest rate drop in the US and euro area, positively affecting both the result on disposal of foreign debt securities and interest rate future contracts.

## 26. WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS

The unrealised negative result on the revaluation of several securities positions as well as other financial instruments at the end of the reporting year was primarily produced by a fall in the financial instrument liquidity related to the adverse developments on the global financial market and hence also by a drop in the market value. The unrealised negative result on the revaluation of financial instruments has been recognised as a write-down on financial instruments in the profit and loss statement while the positive result on the revaluation of other financial instruments, mostly foreign government bonds, has been reported in the balance sheet caption "Valuation account" (see also Note 23).

## 27. INCOME FROM PARTICIPATING INTEREST

Income from participating interest in the amount of 206 thousand lats (216 thousand lats in 2007) comprises the dividends received from the participating interest in the BIS (see also Note 8).

## 28. OTHER OPERATING INCOME

Other operating income in 2008 and 2007 was as follows:

	(in thousands of lats)	
	2008	2007
Income from sale of collector coins	1 113	776
Income from payment and securities settlement services	317	205
Other	2 003	209
Total	3 433	1 190

## 29. BANKNOTE PRODUCTION AND COINAGE COSTS

The breakdown of banknote production and coinage costs in 2008 and 2007 was as follows:

	(in thousands of lats)	
	2008	2007
Banknote production	1 612	2 191
Coinage of circulation coins	1 612	1 214
Coinage of collector coins	822	367
Total	4 046	3 772

## 30. REMUNERATION AND SOCIAL SECURITY COSTS

Remuneration and social security costs in 2008 and 2007 were as follows:

	(in thousands of lats)	
	2008	2007
Remuneration		
Remuneration of members of the Council and the Board	1 470	1 261
Remuneration of other personnel	13 856	11 326
Total remuneration	15 326	12 587
Social security costs	3 063	2 284
Total remuneration and social security costs	18 389	14 871

Remuneration of those members of the Bank of Latvia's Board who are also Heads of Departments of the Bank of Latvia includes remuneration for performance of operational duties.

The number of employees in 2008 and 2007 was as follows:

	<b>2008</b>	2007
Number of employees at the end of the year		
Members of the Council and the Board	<b>14</b>	14
Other personnel	<b>630</b>	629
Total at the end of the year	<b>644</b>	643
Average number of employees per period	<b>649</b>	635

### **31. OTHER OPERATING EXPENSES**

Other operating expenses in 2008 and 2007 were as follows:

	(in thousands of lats)	
	<b>2008</b>	2007
Municipal services	<b>534</b>	414
Maintenance of buildings, territory and equipment	<b>475</b>	447
Personnel training	<b>331</b>	314
Business travel	<b>288</b>	317
Telecommunications services and system maintenance	<b>265</b>	279
Information and public relations	<b>251</b>	303
Risk insurance	<b>250</b>	266
Acquisition of low value office supplies	<b>215</b>	178
Transport provision	<b>172</b>	149
Tax on real estate	<b>86</b>	138
Audit, advisory and legal services	<b>47</b>	49
Other	<b>875</b>	447
Total	<b>3 789</b>	3 301

The audit, advisory and legal services expenses also comprise the remuneration in the amount of 28 thousand lats (33 thousand lats in 2007) to *KPMG Baltics SIA* for the audit of 2008 financial statements and the internal audit quality assessment costs in the amount of 9 thousand lats.

### 32. CASH FLOW STATEMENT

(1) Reconciliation of profit before appropriation to net cash and cash equivalents inflow arising from operating activities

	(in thousands of lats)	
	2008	2007
Profit before appropriation	53 437	51 464
Non-cash transaction adjustments		
Depreciation of fixed assets and amortisation of intangible assets	3 729	3 628
Losses on disposal of fixed assets	7	2
Write-downs on financial assets and positions	38 087	5 862
Net change in balance sheet items		
Net increase in gold	-2	-
Net increase in Special Drawing Rights	-103	-3
Net increase (-)/decrease in foreign debt securities and other foreign investments	511 732	-220 942
Net increase in loans to domestic credit institutions	-632 413	-6 850
Net increase in other assets	-3 376	-263
Net increase/decrease (-) in foreign convertible currency liabilities	125 922	-15 828
Net increase in foreign bank and other international institution deposits in lats	247 420	4 288
Net decrease in lats in circulation	-31 381	-24 378
Net increase/decrease (-) in time deposits of domestic credit institutions	-322 507	204 539
Net increase in Latvian Government time deposits	466 815	121 423
Net decrease in time deposits of other financial institutions	-3 171	-1 432
Net increase in other liabilities	13 285	186
Net cash and cash equivalents inflow arising from operating activities	467 481	121 696

## (2) Analysis of balances and movements in cash and cash equivalents

(at the end of year; in thousands of lats)

	2008	Change	2007	Change	2006
Convertible foreign currencies in cash	<b>6 286</b>	3 821	2 465	2 321	144
Demand deposits with foreign credit institutions and other foreign financial institutions	<b>661 741</b>	438 211	223 530	107 232	116 298
Time deposits with foreign credit institutions and other foreign financial institutions with original maturity up to 5 business days	<b>19 682</b>	4 870	14 812	7 308	7 504
<b>Total cash and cash equivalents</b>	<b>687 709</b>	446 902	240 807	116 861	123 946

**33. TRANSACTIONS WITH THE LATVIAN GOVERNMENT**

The Bank of Latvia is wholly owned by the Republic of Latvia and carries out transactions with the Treasury of the Republic of Latvia, acting as the financial agent of the Latvian Government. Performing this function, the Bank of Latvia services the Treasury's accounts in lats and foreign currency, as well as conducts foreign exchange transactions. The Bank of Latvia conducts government securities transactions in the secondary securities market in order to implement monetary policy. In the above transactions, the Bank of Latvia is not subject to the decisions and orders of the Government or its institutions, and is independent in making its own decisions.

The interest rates and foreign exchange rates used in the transactions with the Latvian Government are market-based. No commission fees are applied to transactions with the Latvian Government.

At the end of 2008 and 2007, the breakdown of the Bank of Latvia claims on and liabilities to the Latvian Government and the respective interest rates were as follows:

	Amount (in thousands of lats)		Yield (%)	
	2008	2007	2008	2007
Claims (-)/liabilities				
Demand deposits	<b>467 188</b>	43 744	<b>0.01–2.10</b>	3.22–3.89
Time deposits	<b>170 868</b>	127 497	<b>5.53</b>	3.99–5.81
Tax claims (-)/liabilities	<b>-209</b>	190	<b>x</b>	x
Accrued interest expense	<b>52</b>	114	<b>x</b>	x
<b>Total net liabilities</b>	<b>637 899</b>	171 545	<b>x</b>	x

In 2008 and 2007, the breakdown of the Bank of Latvia's income and expense related to the Latvian Government, as well as the Bank of Latvia's profit appropriated to the state budget in 2008 and 2007 was as follows (see also Note 24):

	(in thousands of lats)	
	2008	2007
Expense and the Bank of Latvia's profit appropriated to the state budget		
Interest on government deposits	<b>14 366</b>	11 198
Taxes	<b>7 541</b>	6 385
Bank of Latvia's profit appropriated to the state budget	<b>15 439</b>	1 976
<b>Total expense and the Bank of Latvia's profit appropriated to the state budget</b>	<b>37 346</b>	19 559

**34. PLEDGED ASSETS**

Securities and other financial instruments with the market value of 180 840 thousand lats, as at the end of 2008 (7 409 thousand lats at the end of 2007), have been sold in repurchase agreements (*repos*) or pledged to provide collateral for interest rate future contract and other transactions. These financial instruments are included in the balance sheet asset caption "Convertible foreign currencies".

### 35. OFF-BALANCE SHEET ACCOUNTS

The Bank of Latvia enters into forward and spot exchange rate contracts, interest rate swap arrangements and interest rate future contracts in order to manage interest rate and exchange exposure associated with the Bank of Latvia foreign reserves. As part of its monetary policy, the Bank of Latvia also engages in currency swap arrangements. The Bank of Latvia enters into forward and spot exchange rate contracts with the Treasury of the Republic of Latvia in order to manage the foreign exchange exposure of Latvian Government funds.

At the end of 2008 and 2007, the Bank of Latvia's off-balance sheet account profile was as follows:

	(in thousands of lats)					
	Contract or notional amount		Book value			
	2008	2007	Assets		Liabilities	
	2008	2007	2008	2007	2008	2007
Non-traded financial derivative contracts with foreign financial institutions						
Forward exchange rate contracts and currency swap arrangements	<b>1 468 024</b>	1 814 172	<b>127 451</b>	15 332	<b>7 141</b>	17 782
Gold interest rate swap arrangements	<b>28 049</b>	25 510	<b>27</b>	317	<b>72</b>	8
Other interest rate swap arrangements	<b>248 292</b>	70 280	<b>5 648</b>	874	<b>8 437</b>	1 084
<b>Total</b>	<b>x</b>	x	<b>133 126</b>	16 523	<b>15 650</b>	18 874
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	<b>1 329 814</b>	1 710 251	<b>6 276</b>	-6 014	<b>-2 909</b>	188
Non-traded financial derivative contracts with domestic credit institutions						
Currency swap arrangements	<b>60 403</b>	10 101	<b>211</b>	2	<b>403</b>	101
<b>Total</b>	<b>x</b>	x	<b>211</b>	2	<b>403</b>	101
Other transactions						
Agreements concluded on a regular way placement and receipt of time deposits	-	4 920	<b>x</b>	x	<b>x</b>	x
Contracted commitments related to acquisition of fixed assets	<b>136</b>	174	<b>x</b>	x	<b>x</b>	x

As at the end of 2008 and 2007, the book value and the fair value of non-traded contracts concluded by the Bank of Latvia were not materially different. At the end of 2008 and 2007, the comparison of the book value of the off-balance sheet instruments and their net fair value was as follows:

(in thousands of lats)						
	Net fair value		Net book value		Difference	
	2008	2007	2008	2007	2008	2007
Non-traded financial derivative contracts with foreign financial institutions						
Forward exchange rate contracts and currency swap arrangements	119 326	-2 900	120 310	-2 450	-984	-450
Gold interest rate swap arrangements	-45	309	-45	309	0	0
Other interest rate swap arrangements	-2 789	-210	-2 789	-210	0	0
<b>Total</b>	<b>116 492</b>	<b>-2 801</b>	<b>117 476</b>	<b>-2 351</b>	<b>-984</b>	<b>-450</b>
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	3 367	-6 202	3 367	-6 202	0	0
Non-traded financial derivative contracts with domestic credit institutions						
Currency swap arrangements	-173	-98	-192	-99	19	1
<b>Total</b>	<b>-173</b>	<b>-98</b>	<b>-192</b>	<b>-99</b>	<b>19</b>	<b>1</b>

### 36. CONTINGENT LIABILITIES AND COMMITMENTS

In May 2005, the company *BDO Invest Rīga* being the liquidator of the bankrupt JSC *Banka Baltija* filed a claim against the Bank of Latvia on behalf of the creditors of JSC *Banka Baltija* in the Riga Regional Court for the recovery of losses in the amount of 185.6 million lats. The claimant alleges that the Bank of Latvia, as the institution in charge of banking supervision at that time, is responsible for losses arising from the bankruptcy of JSC *Banka Baltija* in 1995. The Bank of Latvia is confident that the claim is without merits; therefore no provision is recognised in the financial statements. The final ruling on the case is expected no earlier than in 2010.

The Bank of Latvia has not paid up 93% of the Bank of Latvia's share in the ECB subscribed capital, which is payable following the decision of the General Council of the ECB. At the end of 2008, the Bank of Latvia's unpaid share in the ECB subscribed capital was 15 070 thousand euro (10 592 thousand lats).

The Bank of Latvia's uncalled portion of the BIS shares is 75% of their nominal value. These shares are callable following the decision of the BIS Board. At the end of 2008, the uncalled portion of the BIS share holding was 4 013 thousand SDR (3 230 thousand lats).

At the end of 2008, the Bank of Latvia had issued collector coins in the nominal value of 1 449 thousand lats (1 346 thousand lats at the end of 2007) and gold circulation coins with a nominal value of 1 988 thousand lats (1 988 thousand lats at the end of 2007). These coins may be represented to the Bank of Latvia in exchange for lats at a nominal value. In the opinion of management, the probability that the Bank of Latvia will be required to repurchase these coins from their holders is considered minimal and no provisions have been made.



### 37. CURRENCY PROFILE

At the end of 2008 and 2007, the currency profile of the Bank of Latvia's assets, liabilities and off-balance sheet accounts was as follows:

	(in thousands of lats)							
	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
<b>As at 31 December 2008</b>								
Foreign assets								
Gold	–	–	–	–	–	108 998	–	108 998
Special Drawing Rights	–	187	–	–	–	–	–	187
Convertible foreign currencies	–	–	782 303	1 541 784	160 427	–	4 179	2 488 693
Participating interest in the								
European Central Bank	–	–	–	743 <sup>1</sup>	–	–	–	743
Participating interest in the								
Bank for International Settlements	–	1 763 <sup>1</sup>	–	–	–	–	–	1 763
Other foreign assets	129 913	–	3 880	86	98	28	6	134 011
Domestic assets								
Loans to credit institutions	435 450	–	–	203 813	–	–	–	639 263
Fixed assets	34 626	–	–	–	–	–	–	34 626
Other domestic assets	4 994	–	–	273	–	–	44	5 311
<b>TOTAL ASSETS</b>	<b>604 983</b>	<b>1 950</b>	<b>786 183</b>	<b>1 746 699</b>	<b>160 525</b>	<b>109 026</b>	<b>4 229</b>	<b>3 413 595</b>
Foreign liabilities								
Convertible foreign								
currencies	–	–	6 019	125 233	–	–	–	131 252
International Monetary								
Fund	256 <sup>2</sup>	–	–	–	–	–	–	256
Other international								
institution deposits in lats	6 503	–	–	–	–	–	–	6 503
Foreign bank deposits in lats	247 001	–	–	–	–	–	–	247 001
Other foreign liabilities	13 475	–	3 171	410	–	41	36	17 133
Lats in circulation	1 018 092	–	–	–	–	–	–	1 018 092
Domestic liabilities								
Balances due to credit								
institutions	1 071 869	–	–	22 426	–	–	–	1 094 295
Balances due to the								
Government	170 868	187	978	466 014	9	–	–	638 056
Balances due to other financial								
institutions	1 685	–	18	2	–	–	–	1 705
Other domestic liabilities	15 512	–	776	1 040	–	–	–	17 328
<b>TOTAL LIABILITIES</b>	<b>2 545 261</b>	<b>187</b>	<b>10 962</b>	<b>615 125</b>	<b>9</b>	<b>41</b>	<b>36</b>	<b>3 171 621</b>

<sup>1</sup> The respective assets are recorded in the balance sheet at cost and the Bank of Latvia is not exposed to currency risk related to these assets.

<sup>2</sup> The Bank of Latvia is exposed to the SDR currency risk related to IMF holdings in lats based on changes in the underlying SDR balances determined in accordance with the exchange rate set by the IMF.

(in thousands of lats)

	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
Net position on balance sheet	-1 940 278	1 763	775 221	1 131 574	160 516	108 985	4 193	241 974
Net position on financial instruments' off-balance sheet accounts	266 672	-	-776 975	900 383	-158 494	-111 872	-2 430	117 284
Net position on balance sheet and off-balance sheet accounts	-1 673 606	1 763	-1 754	2 031 957	2 022	-2 887	1 763	359 258
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	-256 <sup>1</sup>	-1 754	2 031 214	2 022	-2 887	1 763	2 030 102
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	-0.01	-0.09	100.05	0.10	-0.14	0.09	100.00
Benchmark currency structure (%)	x	0	0	100.00	0	0	0	100.00
As at 31 December 2007								
TOTAL ASSETS	54 446	1 846	1 288 173	1 145 798	239 104	99 165	19 469	2 848 001
TOTAL LIABILITIES	2 565 167	83	3 299	108 900	6	8	53	2 677 516
Net position on balance sheet	-2 510 721	1 763	1 284 874	1 036 898	239 098	99 157	19 416	170 485
Net position on financial instruments' off-balance sheet accounts	10 002	-	-1 284 008	1 622 463	-236 783	-98 893	-15 231	-2 450
Net position on balance sheet and off-balance sheet accounts	-2 500 719	1 763	866	2 659 361	2 315	264	4 185	168 035
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	-215	866	2 658 618	2 315	264	4 185	2 666 033
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	-0.01	0.03	99.72	0.09	0.01	0.16	100.00
Benchmark currency structure (%)	x	0	0	100.00	0	0	0	100.00

<sup>1</sup> Net XDR position on balance sheet and off-balance sheet accounts exposed to currency risk comprises liabilities to the IMF (256 thousand lats) and does not include participating interest in BIS (1 763 thousand lats).

### 38. REPRICING MATURITY AND TRACKING ERROR

The table below reflects the sensitivity of the Bank of Latvia's assets, liabilities off-balance sheet accounts to a change in interest rates. Items reported in this table are stated at carrying amounts, except for traded interest rate future contracts that are stated at notional amounts and included in off-balance sheet accounts. A nearest contractual interest repricing or residual maturity date to 31 December of the reporting year is used for categorising items reported in this table.

	Interest bearing					Non- interest bearing	Total
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
(in thousands of lats)							
<b>As at 31 December 2008</b>							
Foreign assets							
Gold	–	–	–	–	–	108 998	108 998
Special Drawing Rights	187	–	–	–	–	–	187
Convertible foreign currencies	901 594	81 187	122 809	864 863	508 813	9 427	2 488 693
Participating interest in the European Central Bank	–	–	–	–	–	743	743
Participating interest in the Bank for International Settlements	–	–	–	–	–	1 763	1 763
Other foreign assets	2 550	–	–	–	–	131 461	134 011
Domestic assets							
Loans to credit institutions	639 263	–	–	–	–	–	639 263
Fixed assets	–	–	–	–	–	34 626	34 626
Other domestic assets	2 714	–	–	–	–	2 597	5 311
<b>TOTAL ASSETS</b>	<b>1 546 308</b>	<b>81 187</b>	<b>122 809</b>	<b>864 863</b>	<b>508 813</b>	<b>289 615</b>	<b>3 413 595</b>
Foreign liabilities							
Convertible foreign currencies	123 953	–	–	–	–	7 299	131 252
International Monetary Fund	–	–	–	–	–	256	256
Other international institution deposits in lats	–	–	–	–	–	6 503	6 503
Foreign bank deposits in lats	–	–	–	–	–	247 001	247 001
Other foreign liabilities	2 326	–	–	–	–	14 807	17 133
Lats in circulation	–	–	–	–	–	1 018 092	1 018 092
Domestic liabilities							
Balances due to credit institutions	1 071 869	–	–	–	–	22 426	1 094 295
Balances due to the Government	638 055	–	–	–	–	1	638 056
Balances due to other financial institutions	1 006	–	–	–	–	699	1 705
Other domestic liabilities	600	–	–	–	–	16 728	17 328
<b>TOTAL LIABILITIES</b>	<b>1 837 809</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>1 333 812</b>	<b>3 171 621</b>

(in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
Net position on balance sheet	-291 501	81 187	122 809	864 863	508 813	x	x
Assets on financial instruments' off-balance sheet accounts	1 868 363	2 559	-	1 383 681	5 174	x	x
Liabilities on financial instruments' off-balance sheet accounts	2 941 077	-	11 069	4 094	186 253	x	x
Net position on balance sheet and off-balance sheet accounts	-1 364 215	83 746	111 740	2 244 450	327 734	x	x
As at 31 December 2007							
TOTAL ASSETS	1 026 297	76 252	318 624	726 027	592 211	108 590	2 848 001
TOTAL LIABILITIES	1 583 293	-	-	-	-	1 094 223	2 677 516
Net position on balance sheet	-556 996	76 252	318 624	726 027	592 211	x	x
Assets on financial instruments' off-balance sheet accounts	2 009 520		75 315	1 533 964	10 828	x	x
Liabilities on financial instruments' off-balance sheet accounts	3 445 667	59 165	38 159	19 844	69 242	x	x
Net position on balance sheet and off-balance sheet accounts	-1 993 143	17 087	355 780	2 240 147	533 797	x	x

The exposure of foreign reserves portfolios to credit risk and aggregated market risk, except for the gold portfolio and portfolios of borrowed funds can be characterised by the tracking error, which is measured as the annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark portfolio. For foreign reserves portfolios, except for the gold portfolio and portfolios of borrowed funds, the benchmark portfolio is pledged to the weighted 1–3 year government securities index of the euro area countries, US and Japan in euro, eliminating the currency risk.

In 2008 and 2007, the average weighted tracking error of the Bank of Latvia's foreign reserves portfolios, except for the gold portfolio and portfolios of borrowed funds, was 50 and 28 basis points respectively, and lay within the following basis points intervals during the year:

Tracking error (in basis points)	Number of business days	
	2008	2007
10–20	7	48
20–30	52	91
30–40	9	79
40–50	26	25
50–60	88	5
60–70	40	–
70–85	25	–
Total	247	248

### 39. LIQUIDITY PROFILE

At the end of 2008 and 2007, the liquidity profile of the Bank of Latvia's assets and liabilities was as follows:

(in thousands of lats)						
	2008			2007		
	Up to 3 months	No fixed maturity	Total	Up to 3 months	No fixed maturity	Total
<b>Assets</b>						
Foreign assets	2 731 466	2 929	<b>2 734 395</b>	2 803 659	3 131	2 806 790
Domestic assets	643 135	36 065	<b>679 200</b>	6 980	34 231	41 211
<b>TOTAL ASSETS</b>	<b>3 374 601</b>	<b>38 994</b>	<b>3 413 595</b>	<b>2 810 639</b>	<b>37 362</b>	<b>2 848 001</b>
<b>Liabilities</b>						
Foreign liabilities	402 112	33	<b>402 145</b>	30 786	39	30 825
Lats in circulation	–	1 018 092	<b>1 018 092</b>	–	1 049 473	1 049 473
Domestic liabilities	1 750 741	643	<b>1 751 384</b>	1 597 218	–	1 597 218
<b>TOTAL LIABILITIES</b>	<b>2 152 853</b>	<b>1 018 768</b>	<b>3 171 621</b>	<b>1 628 004</b>	<b>1 049 512</b>	<b>2 677 516</b>
Net position on balance sheet	1 221 748	–979 774	<b>x</b>	1 182 635	–1 012 150	<b>x</b>

### 40. SECTORAL PROFILE OF ASSETS

The sectoral profile of the Bank of Latvia's assets at the end of 2008 and 2007 was as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2008	2007	2008	2007
<b>Claims</b>				
Foreign central governments and other governmental institutions	<b>1 148 514</b>	1 318 772	<b>33.6</b>	46.3
Foreign local governments	<b>79 057</b>	19 992	<b>2.3</b>	0.7
Foreign central banks and credit institutions	<b>1 149 663</b>	882 651	<b>33.7</b>	31.0
Other foreign financial institutions	<b>365 159</b>	517 398	<b>10.7</b>	18.2
Foreign non-financial corporations	<b>9 967</b>	33 683	<b>0.3</b>	1.2
International institutions	<b>42 674</b>	34 280	<b>1.3</b>	1.2
Latvian central government	<b>589 843</b>	6 893	<b>17.3</b>	0.2
Domestic credit institutions	<b>836</b>	40	<b>0</b>	0
Unclassified assets	<b>27 882</b>	34 292	<b>0.8</b>	1.2
<b>Total</b>	<b>3 413 595</b>	<b>2 848 001</b>	<b>100.0</b>	<b>100.0</b>

For the purposes of credit risk analysis, loans issued to domestic credit institutions and secured by pledged securities are classified herein according to the issuer of the security.

#### 41. FOREIGN ASSETS BY THEIR LOCATION OR THE COUNTERPARTY'S DOMICILE

At the end of 2008 and 2007, the Bank of Latvia's foreign assets broken down by their location or the counterparty's domicile were as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2008	2007	2008	2007
Euro area	<b>1 415 730</b>	1 027 351	<b>51.8</b>	36.6
Other EU countries	<b>378 361</b>	353 419	<b>13.8</b>	12.6
US	<b>579 994</b>	849 142	<b>21.2</b>	30.3
Japan	<b>175 362</b>	256 734	<b>6.4</b>	9.1
Other countries	<b>142 274</b>	285 865	<b>5.2</b>	10.2
International institutions	<b>42 674</b>	34 279	<b>1.6</b>	1.2
Total	<b>2 734 395</b>	2 806 790	<b>100.0</b>	100.0

#### 42. ASSETS BY CREDIT RATINGS ASSIGNED TO THE COUNTERPARTY

At the end of 2008 and 2007, the Bank of Latvia's assets broken down by categories of credit ratings assigned to the counterparty were as follows:

	Credit rating	Amount (in thousands of lats)		Percentage (%)	
		2008	2007	2008	2007
<b>FOREIGN ASSETS</b>					
Gold	AAA	<b>108 998</b>	25 754	<b>3.2</b>	0.9
	AA	–	73 376	<b>0</b>	2.6
Special Drawing Rights	AAA	<b>187</b>	83	<b>0</b>	0
Foreign debt securities	AAA	<b>1 310 234</b>	1 526 129	<b>38.4</b>	53.6
	AA+	<b>123 443</b>	115 141	<b>3.6</b>	4.0
	AA	<b>19 019</b>	208 368	<b>0.6</b>	7.3
	AA–	<b>199 854</b>	183 680	<b>5.9</b>	6.4
	A+	<b>64 241</b>	304 369	<b>1.9</b>	10.7
	A	<b>62 777</b>	57 656	<b>1.8</b>	2.0
	A–	<b>1 366</b>	2 169	<b>0</b>	0.1
	BBB	<b>12 766</b>	–	<b>0.4</b>	–
	BBB–	–	316	–	0
	BB	<b>7 287</b>	–	<b>0.2</b>	–
	B	–	320	–	0
	Deposits with foreign financial institutions	AAA	<b>589 371</b>	183 401	<b>17.3</b>
AA+		<b>1 353</b>	1 586	<b>0</b>	0.1
AA		<b>14 122</b>	26 009	<b>0.4</b>	0.9
AA–		<b>46 945</b>	11 995	<b>1.4</b>	0.4
A+		–	53 208	–	1.9
A		<b>29 629</b>	3 669	<b>0.9</b>	0.1
A–		–	7 226	–	0.3
Foreign currency in cash	AAA	<b>6 286</b>	2 465	<b>0.2</b>	0.1
Participating interest in the European Central Bank	AAA	<b>743</b>	743	<b>0</b>	0
Participating interest in the Bank for International Settlements	AAA	<b>1 763</b>	1 763	<b>0.1</b>	0.1
Derivative financial instruments	AAA	<b>11 139</b>	591	<b>0.3</b>	0
	AA	<b>9 395</b>	3 345	<b>0.3</b>	0.1
	AA–	<b>57 112</b>	7 969	<b>1.6</b>	0.3
	A+	<b>31 698</b>	3 921	<b>0.9</b>	0.2
	A	<b>20 732</b>	697	<b>0.6</b>	0
	A–	<b>3 475</b>	–	<b>0.1</b>	–
Accrued interest income	Different	<b>27</b>	217	<b>0</b>	0
Other foreign assets	Different	<b>443</b>	624	<b>0</b>	0
<b>DOMESTIC ASSETS</b>					
Loans to credit institutions	Different	<b>639 263</b>	6 850	<b>18.7</b>	0.2
Other	Different	<b>39 937</b>	34 361	<b>1.2</b>	1.2
<b>TOTAL</b>		<b>3 413 595</b>	2 848 001	<b>100.0</b>	100.0

At the end of 2008 and 2007, the Bank of Latvia's foreign assets broken down by major categories of credit ratings assigned to the counterparty were as follows:

	Credit rating category	Amount (in thousands of lats)		Percentage (%)	
		2008	2007	2008	2007
Foreign assets	AAA	<b>2 028 722</b>	1 740 929	<b>74.2</b>	62.1
	AA	<b>471 242</b>	631 469	<b>17.2</b>	22.5
	A	<b>213 918</b>	432 915	<b>7.8</b>	15.4
	BBB	<b>12 766</b>	316	<b>0.5</b>	0
	BB	<b>7 287</b>	–	<b>0.3</b>	–
	B	–	320	–	0
	Different	<b>460</b>	841	<b>0</b>	0
<b>Total</b>		<b>2 734 395</b>	2 806 790	<b>100.0</b>	100.0

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above tables show the breakdown of the Bank of Latvia's assets as at the end of the reporting period. The rating "AAA" is the highest possible long-term creditworthiness rating, which indicates an extremely strong capacity of the counterparty to meet its financial commitments. The rating "AA" confirms the counterparty's very strong capacity and the rating "A" – the counterparty's strong capacity to meet its financial commitments in the long term. Ratings below "AAA" are modified by marks "+" or "-" to show the relative standing within the major categories of an international agency's ratings.



# INDEPENDENT AUDITORS' REPORT TO THE COUNCIL OF THE BANK OF LATVIA

## REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Bank of Latvia ("the Bank"), which comprise the balance sheet as at 31 December 2008, and the related statements of profit and loss, total recognised gains and losses and cash flow for the year then ended, and a summary of principal accounting policies and other explanatory notes to the financial statements, as set out on pages 3 to 40.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, and the law "On the Bank of Latvia". This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

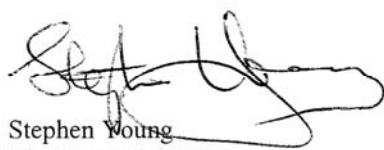
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, and the law "On the Bank of Latvia".

KPMG Baltics SIA  
Licence No 55



Stephen Young  
Chairman of the Board  
Riga, Latvia  
26 February 2009

The State Audit Office  
of the Republic of Latvia



Inguna Sudraba  
Auditor General  
Riga, Latvia  
26 February 2009