

BANK OF LATVIA

FINANCIAL STATEMENTS OF THE BANK OF LATVIA
FOR THE YEAR ENDED 31 DECEMBER 2009
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
ESCB	European System of Central Banks
EU	European Union
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 ¹	2009	2008
FOREIGN ASSETS		3 384 585	2 734 395
Gold	5	134 365	108 998
Special Drawing Rights	6	91 237	187
Convertible foreign currencies	7	3 150 992	2 488 693
Participating interest in the European Central Bank	8	750	743
Participating interest in the Bank for International Settlements	9	1 763	1 763
Other foreign assets	10	5 478	134 011
DOMESTIC ASSETS		175 719	679 200
Loans to credit institutions	11	140 449	639 263
Fixed assets	12, 13	33 232	34 626
Other domestic assets	14, 15	2 038	5 311
TOTAL ASSETS		3 560 304	3 413 595

¹ The accompanying notes set out on pages 9 to 43 are an integral part of these financial statements.


(cont.)


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


LIABILITIES, CAPITAL AND RESERVES	Notes ¹	2009	2008
FOREIGN LIABILITIES		71 469	402 145
Convertible foreign currencies	16	19 006	131 252
International Monetary Fund	6	256	256
Other international institution deposits in lats	17	32 502	6 503
Foreign bank deposits in lats	18	499	247 001
Other foreign liabilities	19	19 206	17 133
LATS IN CIRCULATION	20	788 155	1 018 092
DOMESTIC LIABILITIES		2 412 922	1 751 384
Balances due to credit institutions	21	1 115 677	1 094 295
Balances due to the government	22	1 291 942	638 056
Balances due to other financial institutions		1 948	1 705
Other domestic liabilities	23, 24	3 355	17 328
CAPITAL AND RESERVES		287 758	241 974
Nominal capital	25	25 000	25 000
Reserve capital	25	114 236	95 533
Valuation account	25	74 129	68 004
Profit of the reporting year	25	74 393	53 437
TOTAL LIABILITIES, CAPITAL AND RESERVES		3 560 304	3 413 595
OFF-BALANCE SHEET ACCOUNTS	37		


The financial statements, which are set out on pages 3 to 43, were authorised by the Board of the Bank of Latvia on 16 March 2010.


BOARD OF THE BANK OF LATVIA



Māris Kālis
Chairman of the Board


Reinis Jakovļevs
Deputy Chairman
of the Board


Andris Nīkitins
Member of the Board


Harijs Ozols
Member of the Board


Ilze Bostuma
Member of the Board


Raivo Vanags
Member of the Board

¹ The accompanying notes set out on pages 9 to 43 are an integral part of these financial statements.

PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes ¹	2009	2008
INTEREST INCOME			
Foreign operations	26	59 245	143 646
Interest on securities		51 702	96 553
Interest on deposits with foreign credit institutions and other foreign financial institutions		3 305	11 613
Interest on derivative financial instruments		4 238	35 480
Domestic operations	26	26 925	7 264
Interest on loans to credit institutions		24 696	6 723
Interest on derivative financial instruments		2 229	541
INTEREST EXPENSE			
Foreign operations	26	1 662	11 923
Interest on deposits		93	237
Interest on derivative financial instruments		1 569	11 686
Domestic operations	26	18 515	54 461
Interest on deposits of credit institutions		11 895	39 996
Interest on government deposits		6 592	14 366
Interest on deposits of other financial institutions		28	99
NET INTEREST INCOME	26	65 993	84 526

¹ The accompanying notes set out on pages 9 to 43 are an integral part of these financial statements.

(cont.)

(in thousands of lats)

	Notes ¹	2009	2008
REALISED GAINS/LOSSES (-) FROM FINANCIAL OPERATIONS	27	36 959	34 886
Foreign operations		22 521	23 488
Securities		28 069	3 151
Derivative financial instruments		-5 548	20 337
Foreign currency exchange transactions		14 438	11 398
WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS	28	5 474	38 087
Foreign operations		5 462	37 349
Securities		5 462	30 941
Derivative financial instruments		-	6 408
Foreign currency position		12	738
INCOME FROM PARTICIPATING INTEREST	29	221	206
OTHER OPERATING INCOME	30	4 683	3 433
BANKNOTE PRODUCTION AND COINAGE COSTS	31	4 695	4 046
OTHER OPERATING EXPENSES		23 294	27 481
Remuneration	32	12 643	15 326
Social security costs	32	2 886	3 063
Depreciation and amortisation charges	12, 15	3 373	3 729
Maintenance and operation of information systems		1 510	1 574
Other operating expenses	33	2 882	3 789
PROFIT OF THE REPORTING YEAR		74 393	53 437

¹ The accompanying notes set out on pages 9 to 43 are an integral part of these financial statements.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

(in thousands of lats)

	Notes ¹	2009	2008
REVALUATION	25	27 907	-833
Foreign currency and gold		18 812	733
Interest rate swap contracts		-	-3 145
Securities		9 095	1 579
REALISATION OF ACCUMULATED REVALUATION RESULT	25	-27 256	-3 763
Foreign currency and gold		-1 238	-831
Interest rate swap contracts		-3 263	364
Securities		-22 755	-3 296
WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS	25, 28	5 474	38 087
PROFIT OF THE REPORTING YEAR		74 393	53 437
TOTAL		80 518	86 928

¹ The accompanying notes set out on pages 9 to 43 are an integral part of these financial statements.

CASH FLOW STATEMENT

(in thousands of lats)

	Notes ¹	2009	2008
CASH FLOW FROM OPERATING ACTIVITIES			
Profit of the reporting year		74 393	53 437
Non-cash transaction adjustments	34 (1)	8 850	41 823
Net movements in balance sheet positions	34 (1)	209 535	372 221
Net cash and cash equivalents inflow from operating activities		292 778	467 481
CASH FLOW FROM INVESTING ACTIVITIES			
Increase of participating interest in the European Central Bank	8	-7	-
Dividends on shares of the Bank for International Settlements	29	221	206
Acquisition of fixed assets	12	-1 692	-5 291
Acquisition of intangible assets	15	-50	-55
Net cash and cash equivalents outflow from investing activities		-1 528	-5 140
CASH FLOW FROM FINANCING ACTIVITIES			
Profit appropriated to the state budget	25	-34 734	-15 439
Net cash and cash equivalents outflow from financing activities		-34 734	-15 439
NET CASH AND CASH EQUIVALENTS INFLOW		256 516	446 902
Cash and cash equivalents at the beginning of the year	34 (2)	687 709	240 807
Cash and cash equivalents at the end of the year	34 (2)	944 225	687 709

¹ The accompanying notes set out on pages 9 to 43 are an integral part of these financial statements.

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.

The Bank of Latvia ensures the operation of the Credit Register as of 1 January 2008. The Bank of Latvia also issues licences to legal persons listed in the Republic of Latvia Register of Enterprises, except credit institutions, for the purchase and sale of foreign currency as a commercial activity, and controls compliance with the procedure it has established for effecting foreign currency purchase and sales transactions.

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 (hereinafter, foreign 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 risk (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 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 foreign reserves managers.

Parameters for a benchmark portfolio reflecting the acceptable level of financial risks, return target as well as the target structure of investments are set out for each portfolio type in the Guidelines. For foreign reserves portfolios (except for the gold reserves portfolio, portfolios of borrowed funds, and asset-backed security portfolios) the benchmark portfolio is pledged to the weighted 1–3 year government securities index of the euro area countries, US and Japan and denominated in euro, eliminating the currency risk. 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. 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. Once every two months the Market Operations Department informs the Council and the Board of the Bank of Latvia about the results of management of foreign reserves.

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 is exposed to interest rate risk primarily due to investing in foreign debt securities and interest rate derivatives that are subject to interest rate fluctuations and used within the course of foreign reserve management. The Bank of Latvia manages the interest rate risk by using a modified duration limit set individually for each investment portfolio.

Bank of Latvia's exposure to currency risk is determined by the structure of its foreign currency and gold reserves, which cannot be formed in compliance with the Bank of Latvia's liability parameters. 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 the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the 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. In order to achieve the compliance of open foreign currency positions with the limits, the Bank of Latvia hedges the risk of fluctuations in gold reserves market value and foreign exchange rates by concluding forward exchange rate and currency future contracts.

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 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 2009 and 2008) is provided in Notes 39 and 40.

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, including short-term cash and gold deposits, 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, including short-term cash and gold deposits, 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. The Bank of Latvia is allowed to invest in securities of the OECD countries, whose long-term credit rating in foreign currencies is at least A-/A-/A3. 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 2009 and 2008) is provided in Notes 42 to 44.

LIQUIDITY RISK

Liquidity risk is associated with a failure to meet liabilities timely. Bank of Latvia's exposure to liquidity risk arises mainly from the need to ensure foreign currency for conducting interventions and repaying deposits of the Latvian government and other institutions. 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 34. The liquidity profile of the Bank of Latvia's assets and liabilities as at the end of 2009 and 2008 is provided in Note 41.

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 threats to the employees of the Bank of Latvia, its information, information systems and technical resources, or material values.

The basic principles of the Bank of Latvia's operational risk management are determined by the Council of the Bank of Latvia. The Bank of Latvia's operational risk management is implemented by the Board of the Bank of Latvia. In addition, the Board of the Bank of Latvia has established the Committee for Managing the Bank of Latvia's Operational Risks which coordinates, on a daily basis, the activities under the operational risk management process and provides support to the Board of the Bank of Latvia on operational risk management issues. The Committee is presided by a member of the Board of the Bank of Latvia and includes the Risk Management Officer, Operational Continuity Officer, Information Security Officer, Information Systems Security Officer, Data Privacy Officer, and the Head of Security Department.

In 2009, the Bank of Latvia amended "The Regulation for Managing Operational Risks of the Bank of Latvia", which covers identification, analysis and assessment of risks as well as planning, implementation, supervision, revision, and informing of risk mitigation activities. Risk management is conducted by the Bank of Latvia employees who are responsible for Bank of Latvia processes, department heads who are involved in the processes, project managers and other employees of the Bank of Latvia.

In order to minimise operational risks with respect to information systems, the Bank of Latvia has established the Committee for Managing Information Systems of the Bank of Latvia which assesses the information system governance on a regular basis. In order to ensure confidentiality of information, authorised access and integrity, information systems are classified under the internal control system. The Bank of Latvia has appointed the owners of information who are responsible for risk analysis, protection and determination of access rights and application procedures of relevant information systems. The Bank of Latvia conducts, on a regular basis, the analysis of information system security risks and improves security measures and tools.

In 2009, the Bank of Latvia amended "The Procedure for Managing the Continuity of the Bank of Latvia's Operation", which sets out the procedure for organising the operational continuity management at the Bank of Latvia, delegation of responsibilities in the area of operational continuity management and critical processes. "The Procedure for Managing Incidents and Emergency Situations at the Bank of Latvia" sets out the procedures for managing and reporting incidents and emergency situations and informing the employees of the Bank of Latvia in the event of an incident or emergency situation. In order to provide for a uniform reporting of incidents and emergency situations and to improve the collection and analysis of relevant information, the Bank of Latvia established a single register of incidents and emergency situations in 2009.

The Bank of Latvia conducts, on a regular basis, educational sessions for employees on information and information systems security, risk management and management of operational continuity.

Under the total operational risk minimisation system, the Bank of Latvia is insured against certain types of operational risks.

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 interest rate derivatives and currency futures contracts, which are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 3 under "Financial derivatives". The reconciliation of the book value and fair value of these instruments is provided in Note 37.

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 assets and liabilities, 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 lats 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 calculation of 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 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 2009 and the year ended 31 December 2008 are as follows:

	(at the end of the year)		
	2009	2008	Changes (%)
Euro (EUR)	0.702804	0.702804	0.0
US dollar (USD)	0.489	0.495	-1.2
Japanese yen (JPY)	0.00533	0.00547	-2.6
Gold (XAU)	540.256	438.259	23.27
Special Drawing Rights (XDR)	0.766	0.764	0.3

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 instruments is determined by the Bank of Latvia using quoted prices in active market, other financial market information sources or discounted cash flows. The discounted cash flows are modelled using quoted market prices of financial instruments and money market interest rates. Note 7 discloses the determination of fair value of investments in securities.

Fair value of the Bank of Latvia's financial assets and financial liabilities does not differ materially from the reported book value of the respective assets and liabilities, if not specified otherwise in particular notes to the financial statements.

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 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 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 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. Equity instruments which do not have a quoted price in an active market and whose fair value cannot be reliably measured 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.

DERIVATIVE FINANCIAL INSTRUMENTS

The Bank of Latvia enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements, and interest rate and currency 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 derivative financial instruments are reported in the balance sheet at fair value.

Interest on derivative financial instruments, 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 and currency 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 derivative financial instruments 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 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:

	(%)	
	2009	2008
Buildings		
– structures	1	1
– outer finishing	5	5
– interior decorations	5–20	5–20
– engineering communications	5	5
– other components	10–14	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.

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. 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 reflecting 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 liabilities, 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 GAINS OR LOSSES ON FINANCIAL INSTRUMENTS

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

- (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 FINANCIAL OPERATIONS

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 the right to receive payment is established.

BANKNOTE PRODUCTION AND COINAGE COSTS

Banknote production and coinage costs, except gold circulation coin production costs, are charged to the profit and loss statement at the moment of acquisition.

OTHER EXPENSE AND INCOME

Bank's other operating expense and income is recognised in the profit and loss statement on an accrual basis. The amount of accrued expense and income for the reporting period is calculated in accordance with the volume of services received or rendered in the reporting period. Lease payments are recognised in the profit and loss statement proportionally over the term of the respective agreement.

4. SUMMARY OF THE BANK OF LATVIA'S FINANCIAL POSITION AND FINANCIAL PERFORMANCE

FINANCIAL POSITION

In 2009, the Bank of Latvia assets grew by 146.7 million lats, on account of an increase in foreign assets.

Convertible foreign currencies posted a 662.3 million lats increase, mainly due to the loan to the Latvian government granted by the EC, IMF and other international lenders, which has been deposited on the Treasury accounts with the Bank of Latvia. A decreasing effect resulted from repaying funds to foreign financial institutions for the funding received under foreign exchange swaps and securities repurchase agreements in 2008 which also caused a 330.7 million lats decrease in liabilities reported under the Bank of Latvia balance sheet captions "Convertible foreign currencies" and "Foreign bank deposits in lats". In order to ensure stability of the exchange rate of the lats against the euro, in the first half of 2009, the Bank of Latvia sold part of its foreign currency reserves as a result of interventions in the foreign exchange market; in the second half of 2009, however, opposite interventions were made as the Bank of Latvia purchased euro mostly from the Treasury of the Republic of Latvia (in 2009, foreign currency sales amounted to 690.9 million lats). As a result of interventions in the foreign exchange market, the Bank of Latvia sold euro in exchange for lats in the net amount of 55.8 million lats in the reporting year.

The increase in foreign assets was also affected by the allocation of SDRs received from the IMF in the amount of 72.3 million lats, allocated to all IMF members, including Latvia, to provide liquidity to the global economy. IMF members were also assigned an additional allocation of SDRs (Latvia's share amounted to 20.5 million lats) with the aim of balancing the uneven distribution of SDRs as more than one fifth of member countries had not received any SDR allocations since they joined the IMF after 1981. Latvia received such allocation for the first time.

A fall of 128.5 million lats in other foreign assets was mostly on account of changes in the volume and valuation of non-traded financial derivative contracts concluded with foreign financial institutions.

With the situation in the Latvian financial system stabilising and due to excess liquidity of the lats, credit institutions' demand for the liquidity offered by the Bank of Latvia gradually moderated in 2009, and the caption "Loans to credit institutions" on the asset side of the balance sheet recorded a 498.8 million lats decrease.

With the demand for cash contracting, the amount of currency in circulation shrank in 2009. As a result, a decrease of 229.9 million lats was reported on the Bank of Latvia balance sheet caption "Lats in circulation".

The Bank of Latvia's capital and reserves increased by 45.8 million lats on account of profit earned in 2009 and change in valuation of financial instruments. The transfer of profit to the state budget in the amount of 34.7 million lats had a decreasing effect.

FINANCIAL PERFORMANCE

In 2009, the Bank of Latvia earned 74.4 million lats in profit. Although net interest income in 2009 decreased by 18.5 million lats year-on-year, the drop was offset by positive changes in other profit and loss statement items. With interest rates in the euro area and Japan falling, the market value of securities held by the

Bank of Latvia increased. Hence, the Bank of Latvia's realised gains from securities disposal grew and write-downs on financial assets and positions decreased by 32.6 million lats in comparison with 2008. The investment decisions also had a positive impact on income, resulting in a considerably higher return on foreign reserves in comparison with that on the benchmark portfolio.

The fall in net interest income was mostly a consequence of a decrease in foreign reserves of the Bank of Latvia at the end of 2008 and in the first half of 2009, due to the sales of foreign currency by the Bank of Latvia as a result of interventions in the foreign exchange market, as well as the low levels of interest rates in the US and the euro area.

The narrowing spread between the euro and US dollar short-term interest rates also resulted in lower net interest income on financial derivatives, used by the Bank of Latvia mostly for hedging currency risk exposure.

In 2009, the Bank of Latvia's lending to credit institutions gradually moderated; nevertheless, the average outstanding balance of loans considerably exceeded those granted in 2008 and resulted in a 18.0 million lats rise in interest income.

As a result of lowering deposit interest rates and a decrease in the amount of the credit institution minimum reserve requirements held with the Bank of Latvia, the interest expense on credit institution deposits, including remuneration for holding the minimum reserves, fell by 28.1 million lats. Lower lats interest rates and smaller amount of funds in lats deposited by the Latvian government also accounted for a 7.8 million lats drop in interest expense on the government deposits.

In the first half of 2009, following a decrease in the foreign currency reserves as a result of interventions, the Bank of Latvia disposed of a part of securities it had purchased, realising the securities revaluation result of 22.8 million lats, accumulated on the valuation account earlier. The realised gains/losses from financial operations were negatively affected by the negative result on currency future contracts concluded for the purpose of hedging currency risk exposure, as the positive result on revaluation of the hedged balance sheet items has been reported in the balance sheet caption "Valuation account".

With the Bank of Latvia cutting its administrative expense in 2009, including remuneration of employees, the Bank of Latvia's other operating expense decreased by 4.2 million lats year-on-year. In 2010, following changes in the market, the Bank of Latvia implements further decrease in the remuneration expenses.

The uncertainty of the Bank of Latvia's financial performance in 2010 is mostly related to interest rate developments in the US and euro area financial markets since the Bank of Latvia is exposed to the interest rate risk. In view of the historically low levels of interest rates, a further interest rate fall is potentially negligible in comparison with a potential rise; thus, the expected pickup in interest rates in the foreign financial market may negatively affect the income on the fixed income securities.

5. GOLD

Movements in gold reserves in 2009 and 2008 were as follows:

	Troy ounces	in thousands of lats
As at 31 December 2007	248 701	99 130
During 2008		
Increase in gold market value	x	9 866
Net change resulting from gold depositing and deposit withdrawal	6	2
As at 31 December 2008	248 707	108 998
During 2009		
Increase in gold market value	x	25 367
As at 31 December 2009	248 707	134 365

The Bank of Latvia hedges the risk related to fluctuations in gold reserves market value by entering into forward exchange rate and currency future contracts (see also Note 39). Revaluation of gold reserves and forward exchange rate contracts is recognised in the balance sheet caption "Valuation account", whereas revaluation of currency future contracts is recognised in the profit and loss statement caption "Realised gains/losses from financial operations".

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. Latvia's quota in the IMF is 126 800 thousand XDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in lats and IMF allocations. On 28 August 2009, the IMF made general allocations to all IMF members in the amount of 74.13% in proportion to their existing quotas in the IMF, including 93 998 thousand XDR for Latvia, to boost liquidity of the global economy. A special allocation of 26 824 thousand XDR was made on 9 September 2009. The special allocation aims at making SDR allocations more equitable and correcting the fact that more than one fifth of all members that joined the IMF after 1981 had never received an SDR allocation. Latvia received such allocation for the first time.

At the end of 2009, the claims on the IMF in SDR as recorded on the Bank of Latvia's balance sheet were equivalent to 91 237 thousand lats (at the end of 2008 – 187 thousand lats), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 256 thousand lats (at the end of 2008 – 256 thousand lats) held on its accounts No. 1 and No. 2.

At the end of 2009 and 2008, Latvia's net claims and liabilities to the IMF were as follows:

	(in thousands of lats)		(in thousands of XDR)	
	2009	2008	2009	2008
Latvia's quota in the IMF	97 129	96 875	126 800	126 800
IMF holdings in lats	-643 865	-505 850	-840 554	-662 106
Promissory notes of the Latvian government	-643 609	-505 594	-840 220	-661 772
Account No. 1	-243	-242	-317	-317
Account No. 2	-13	-14	-17	-17
Stand-by Arrangement for Latvia	546 765	409 003	713 792	535 344
Reserve position in IMF	42	42	55	55
SDR	91 237	187	119 108	245
General allocation	-72 002	-	-93 998	-
Special allocation	-20 547	-	-26 824	-
Latvia's net claims/liabilities (-) to the IMF	-1 270	229	-1 659	300

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. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency assets of the Bank of Latvia are invested primarily in debt securities of high liquidity and short-term deposits.

The carrying amount of interest bearing debt securities includes accrued interest income (16 947 thousand lats at the end of 2009 and 28 568 thousand lats at the end of 2008).

At the end of 2009 and 2008, the balance sheet asset caption "Convertible foreign currencies" was comprised of the following assets:

	(in thousands of lats)	
	2009	2008
Debt securities of foreign governments, financial institutions and non-financial corporations	2 012 260	1 800 987
Demand deposits with foreign central banks, credit institutions and international institutions	805 403	661 741
Time deposits with foreign credit institutions and other foreign financial institutions	313 986	19 679
Foreign currency in cash	19 343	6 286
Total	3 150 992	2 488 693

The breakdown of fair value of Bank of Latvia's investments in debt securities of foreign governments, financial institutions and non-financial corporations is determined using the following hierarchy:

- quoted price. The price in this group of securities is determined using quoted prices for identical instruments in active markets;
- observable data. The price in this group of securities is determined using quoted prices for similar instruments in active markets, quoted prices for similar or identical instruments in inactive markets or using models where all significant inputs are observable;
- non-observable data. The price in this group of securities is determined using models where significant inputs are not observable.

At the end of 2009 and 2008, Bank of Latvia's investments in debt securities were generally valued on the basis of quoted prices for identical instruments in active markets. With financial market liquidity improving, the proportion of securities classified in this fair value assessment group increased in 2009. At the end of 2009 and 2008, the breakdown of Bank of Latvia's investments in debt securities of foreign governments, financial institutions and non-financial corporations according to the fair value hierarchy was as follows:

	(in thousands of lats)	
	2009	2008
Quoted price	1 796 323	1 414 545
Observable data	215 937	311 773
Non-observable data	–	74 669
Total	2 012 260	1 800 987

The average market prices on the last trading day of the reporting year are obtained from the electronic information systems *Bloomberg* and *Interactive Data*. Where the above price for a financial instrument is inaccessible or absent in the electronic information systems, the latest available market price or the price determined by applying the discounted cash flow approach is used for evaluating the financial instrument. Where the fair value of securities is based on the information provided by market participants, the securities are included in the assessment group of non-observable data.

8. 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.

Until 1 January 2009, 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). On 1 January 2009, the ECB capital shares held by the national central banks were adjusted in compliance with the Statute of the ESCB and the ECB; as a result, the share of the Bank of Latvia in the ECB's capital increased to 0.2837%, which corresponds to 16 343 thousand euro (11 486 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 1 144 thousand euro or 750 thousand lats (743 thousand lats at the end of 2008; see also Note 38).

Participating interest in the ECB's capital has been reported at cost in the balance sheet of the Bank of Latvia. ECB's capital shares are not traded in the public securities market, and the share of the Bank of Latvia in the ECB's capital can be increased or decreased only in the cases referred to in this Note.

9. PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2009 and 2008, the Bank of Latvia owned 1 070 shares in the BIS, which correspond to approximately 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 XDR (the nominal value per share is 5 thousand XDR), paid up in the amount of 25% or 1 338 thousand XDR (see also Note 38). The deemed cost of this holding as at 31 December 2009 and 31 December 2008 is reported in the Bank of Latvia's balance sheet in the amount of 1 763 thousand lats (see also Note 29).

BIS shares are not traded in the public securities market. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. The fair value of BIS shares, defined as 70% of the Bank of Latvia's share in the BIS net assets¹, differs from their book value and was 14 409 thousand lats at the end of 2009 (13 729 thousand lats at the end of 2008).

10. OTHER FOREIGN ASSETS

At the end of 2009 and 2008, other foreign assets consisted of the following items:

	(in thousands of lats)	
	2009	2008
Non-traded financial derivative contracts with foreign financial institutions	5 056	133 551
Prepaid expense	326	392
Interest accrued on deposits	17	27
Other	79	41
Total	5 478	134 011

11. LOANS TO CREDIT INSTITUTIONS

At the end of 2009, loans to domestic credit institutions included short-term loans in the amount of 140 449 thousand lats (639 263 thousand lats at the end of 2008). With the tensions in the financial system moderating in 2009, credit institutions' liquidity increased; hence the amount of short-term loans granted by the Bank of Latvia decreased considerably at the end of 2009.

Loans granted to domestic credit institutions are secured by collateral of Latvian government securities and private sector debt securities with the fair value of 211 501 thousand lats at the end of 2009 (678 027 thousand lats at the end of 2008; see also the section "Credit risk" in Note 2).

¹ The BIS applies this valuation method for calculating the price of its shares; the International Court at the Hague has recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS.

12. FIXED ASSETS

The following changes in fixed assets took place in 2009 and 2008:

	(in thousands of lats)					
	Buildings, improvement of territory, and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
As at 31 December 2007						
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
During 2008						
Additions	3 833	361	254	279	564	5 291
Change in classification	2	-9	9	-1	-1	-
Disposals and write-offs	-	-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 and write-offs	-	400	1 061	23	232	1 716
Net change in accumulated depreciation	-1 946	-185	680	-47	-90	-1 588
As at 31 December 2008						
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
Net book value	28 537	1 755	2 707	565	1 062	34 626
During 2009						
Additions	1 107	241	15	128	201	1 692
Change in classification	-	9	-	-	-9	-
Disposals and write-offs	-1	-701	-29	-130	-123	-984
Net change in cost	1 106	-451	-14	-2	69	708
Depreciation charge	-1 806	-545	-387	-96	-249	-3 083
Change in classification	-	-12	-	-	12	-
Accumulated depreciation on disposals and write-offs	1	698	29	130	123	981
Net change in accumulated depreciation	-1 805	141	-358	34	-114	-2 102
As at 31 December 2009						
Cost	37 157	6 345	4 629	1 285	5 183	54 599
Accumulated depreciation	-9 319	-4 900	-2 294	-688	-4 166	-21 367
Net book value	27 838	1 445	2 335	597	1 017	33 232

At the end of 2009, the total cadastral value of land under the ownership and possession of the Bank of Latvia was 3 168 thousand lats (3 171 thousand lats at the end of 2008). Land is reported in the balance sheet of

the Bank of Latvia at cost (1 669 thousand lats at the end of 2009 and 264 thousand lats at the end of 2008). Changes in the historical cost of land in 2009 are related to a change in the classification of the real estate components.

13. LEASING

The Bank of Latvia's assets subject to leases are buildings, land, and equipment. In the balance sheet they are reported as fixed assets. All lease agreements where the Bank of Latvia acts as a lessor are operating leases. Lease payments, except those that are directly transferred to the state budget, are recognised in the profit and loss statement proportionally over the term of the respective agreement. The depreciation of the leased assets is calculated on the basis of the depreciation policy described in Note 3 under "Fixed assets" and reported in the profit and loss statement as depreciation charges. Carrying amount of leased assets at the end of 2009 and 2008 was as follows:

	(in thousands of lats)
As at 31 December 2008	
Cost	2 504
Accumulated depreciation	-416
Net book value	2 088
As at 31 December 2009	
Cost	1 086
Accumulated depreciation	-381
Net book value	705

14. OTHER DOMESTIC ASSETS

At the end of 2009 and 2008, other domestic assets consisted of the following items:

	(in thousands of lats)	
	2009	2008
Accrued interest on loans to credit institutions	763	2 714
Intangible assets	761	1 001
Non-traded financial derivative and spot exchange rate contracts with domestic institutions	147	211
Tax claims	-	209
Prepaid expense	160	183
Other	207	993
Total	2 038	5 311

15. INTANGIBLE ASSETS

The following changes in intangible assets took place in 2009 and 2008:

	(in thousands of lats)	
As at 31 December 2007		
Cost		3 750
Accumulated amortisation		-2 379
Net book value		1 371
During 2008		
Additions		55
Derecognised assets		-85
Net change in cost		-30
Amortisation charge		-425
Accumulated amortisation on disposals		85
Net change in accumulated amortisation		-340
As at 31 December 2008		
Cost		3 720
Accumulated amortisation		-2 719
Net book value		1 001
During 2009		
Additions		50
Derecognised assets		-1
Net change in cost		49
Amortisation charge		-290
Accumulated amortisation on derecognised assets		1
Net change in accumulated amortisation		-289
As at 31 December 2009		
Cost		3 769
Accumulated amortisation		-3 008
Net book value		761

16. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency liabilities consist of funds on the EC account for settlements in euro. The EC account is used by the EC for the distribution of EU budgetary funds (see also Note 17).

At the end of 2009 and 2008, convertible foreign currency liabilities consisted of the following items:

	(in thousands of lats)	
	2009	2008
Repurchase agreements	-	123 953
EC demand deposits	19 006	6 230
Other liabilities	-	1 069
Total	19 006	131 252

17. 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 16) and liabilities to other international institutions.

At the end of 2009 and 2008, the breakdown of deposits of other international institutions in lats was as follows:

	(in thousands of lats)	
	2009	2008
EC demand deposits	32 252	6 273
Other deposits	250	230
Total	32 502	6 503

18. FOREIGN BANK DEPOSITS IN LATS

Decrease in foreign bank deposits in lats resulted from repaying short term deposits of *Sveriges Riksbank* and *Danmarks Nationalbank* resulting from the exchange of the lats to the euro under foreign currency swaps in 2008.

19. OTHER FOREIGN LIABILITIES

At the end of 2009 and 2008, other foreign liabilities consisted of the following items:

	(in thousands of lats)	
	2009	2008
Non-traded financial derivative contracts and spot exchange rate contracts with foreign financial institutions	18 826	16 292
Accrued expense	332	304
Other	48	537
Total	19 206	17 133

20. LATS IN CIRCULATION

At the end of 2009 and 2008, the following units of lats (LVL) and santims (s) were in circulation:

Nominal	Amount		Number		Percentage	
	(in thousands of lats)	(in thousands of units)	(in thousands of units)	(in thousands of units)	(%)	(%)
	2009	2008	2009	2008	2009	2008
Banknotes						
LVL 500	62 842	110 872	126	222	8.0	10.9
LVL 100	94 337	145 212	943	1 452	12.0	14.3
LVL 50	61 163	73 889	1 223	1 478	7.8	7.3
LVL 20	388 305	485 292	19 415	24 265	49.3	47.7
LVL 10	63 321	73 773	6 332	7 377	8.0	7.2
LVL 5	61 313	70 781	12 263	14 156	7.7	6.9
Total banknotes	731 281	959 819	x	x	92.8	94.3
Coins						
LVL 100	405	405	4	4	0.1	0
LVL 10	145	145	15	15	0	0
LVL 2	7 985	8 673	3 993	4 337	1.0	0.9
LVL 1	27 936	28 345	27 937	28 345	3.5	2.8
50 s	7 677	7 744	15 353	15 489	1.0	0.8
20 s	4 287	4 376	21 435	21 881	0.5	0.4
10 s	2 638	2 723	26 375	27 224	0.3	0.3
5 s	2 018	2 082	40 352	41 638	0.3	0.2
2 s	2 163	2 166	108 159	108 294	0.3	0.2
1 s	1 620	1 614	161 959	161 425	0.2	0.1
Total coins	56 874	58 273	x	x	7.2	5.7
Total lats in circulation	788 155	1 018 092	x	x	100.0	100.0

At the end of 2009 and 2008, the total nominal value of gold circulation coins (fineness .999) issued, with the denomination of LVL 100, was 1 988 thousand lats. 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 2009, collector coins with the total nominal value of 1 480 thousand lats had been issued (1 449 thousand lats at the end of 2008). These coins are not included in the balance sheet caption "Lats in circulation".

21. 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 overnight deposits (deposit facility) 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.

At the end of 2009 and 2008, balances due to domestic credit institutions consisted of the following items:

	(in thousands of lats)	
	2009	2008
Current account balances in lats	835 761	1 069 279
Deposit facility	260 020	2 590
Current account balances in euro	19 896	22 426
Total	1 115 677	1 094 295

22. 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. In 2009, a rise in the Latvian government deposits in foreign currency is mostly a result of inflows of funds received under the international loan agreements.

At the end of 2009 and 2008, the breakdown of Latvian government deposits was as follows:

	(in thousands of lats)	
	2009	2008
Time deposits in foreign currencies	1 063 849	–
Demand deposits in foreign currencies	197 870	467 188
Demand deposits in lats	30 223	–
Time deposits in lats	–	170 868
Total	1 291 942	638 056

23. OTHER DOMESTIC LIABILITIES

At the end of 2009 and 2008, other domestic liabilities consisted of the following items:

	(in thousands of lats)	
	2009	2008
Accrued expense and similar liabilities	1 689	3 148
Accrued interest expense	252	600
Tax liabilities	18	–
Money in transit	–	11 192
Non-traded currency swap arrangements with domestic credit institutions	–	403
Other	1 396	1 985
Total	3 355	17 328

24. TAX

In 2009 and 2008, 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 2007	0	6	2	0	162	0	170
During 2008							
Calculated	3 015	3 063	1 065	88	309	1	7 541
Decrease in deferred liabilities	–	–230	–	–	–	–	–230
Recalculation of liabilities	–	–	–	–	–362	–	–362
Paid	–3 015	–2 839	–1 067	–88	–318	–1	–7 328
Claims as at 31 December 2008	0	0	0	0	–209	0	–209
During 2009							
Calculated	2 477	2 886	1 142	93	247	1	6 846
Increase in deferred liabilities	0	146	0	0	0	0	146
Paid	–2 477	–3 032	–1 142	–93	–20	–1	–6 765
Liabilities as at 31 December 2009	0	0	0	0	18	0	18

In addition to the tax payments indicated herein, the Bank of Latvia transfers 65% of the profit for the reporting year (30% in 2008), including the payment for the usage of state capital (34 734 thousand lats in 2009; 15 439 thousand lats in 2008; see also Notes 25 and 35) to the state budget. The Bank of Latvia is not subject to corporate income tax.

25. CAPITAL AND RESERVES

In 2009 and 2008, 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	Capital and reserves
As at 31 December 2007	25 000	59 508	34 513	51 464	170 485
During 2008					
Revaluation, realisation, and write-downs	x	x	33 491	x	33 491
Profit appropriated to the state budget	x	x	x	-15 439	-15 439
Profit transferred to the reserve capital	x	36 025	x	-36 025	-
Profit of the reporting year	x	x	x	53 437	53 437
As at 31 December 2008	25 000	95 533	68 004	53 437	241 974
During 2009					
Revaluation, realisation, and write-downs	x	x	6 125	x	6 125
Profit appropriated to the state budget	x	x	x	-34 734	-34 734
Profit transferred to the reserve capital	x	18 703	x	-18 703	-
Profit of the reporting year	x	x	x	74 393	74 393
As at 31 December 2009	25 000	114 236	74 129	74 393	287 758

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 or settlement while unrealised gains are recorded under the balance sheet item "Valuation account", thus facilitating the preservation of the capital under the impact of 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 interest rate risk related to domestic financial assets 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 50% of the profit of the reporting year for the usage of state capital (15% in 2008) shall be transferred to the state budget. At the end of 2009 and 2008, the corporate income tax rate applicable to residents of Latvia was 15%. Therefore, 65% 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 of 2009 by the Council of the Bank of Latvia. In 2010, the Bank of Latvia will transfer 48 355 thousand lats from its profit earned in 2009 to the state budget.

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 2009 and 2008, changes in the balance sheet caption "Valuation account" were as follows:

(in thousands of lats)

	2009	Write-downs	Revaluation	Realisation	2008	Write-downs	Revaluation	Realisation	2007
Initial valuation account	24 283	x	x	216	24 067	x	x	3 352	20 715
Deferred result on revaluation of foreign currencies and gold	24 018	x	x	–	24 018	x	x	–	24 018
Deferred result on revaluation of non-traded interest rate swap arrangements	–	x	x	–	–	x	x	545	–545
Deferred result on revaluation of securities	265	x	x	216	49	x	x	2 807	–2 758
Result on revaluation of foreign currencies and gold	21 477	12	18 812	–1 238	3 891	738	733	–831	3 251
Result on revaluation of non-traded interest rate swap arrangements	–	–	–	–3 263	3 263	6 408	–3 145	–181	181
Result on revaluation of securities	28 369	5 462	9 095	–22 971	36 783	30 941	1 579	–6 103	10 366
Total	74 129	5 474	27 907	–27 256	68 004	38 087	–833	–3 763	34 513

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 2009 is related to the recognition of the profit or loss or result on revaluation from disposal of the financial instruments of the Bank of Latvia in the reporting year in the amount of 216 thousand lats (3 352 thousand lats in 2008) outstanding at the end of 2006. At the end of 2009, 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 year has been recognised in the caption "Write-downs on financial assets and positions" of the profit and loss statement; see also Note 3).

26. NET INTEREST INCOME

In 2009, the Bank of Latvia's net interest income amounted to 65 993 thousand lats (84 526 thousand lats in 2008). The income was mainly derived from investing foreign currency reserves and from loans to credit institutions. The fall in net interest income was mostly on account of a decrease in foreign currencies at the end of 2008 and in the first half of 2009 as the Bank of Latvia sold euro as a result of interventions in the foreign exchange market, with the low levels of interest rates in the US and the euro area also contributing to it.

Interest income from foreign operations shrank by 84 401 thousand lats in comparison with 2008, and interest expense contracted by 10 261 thousand lats year-on-year.

In 2009, interest income from domestic operations increased by 19 661 thousand lats due to a higher average outstanding balance of loans granted to domestic credit institutions in comparison with 2008.

Interest expense on domestic operations (18 515 thousand lats; 54 461 thousand lats in 2008) was largely comprised of interest on deposits of domestic credit institutions and the Latvian government. Interest expense on credit institution deposits decreased by 28 101 thousand lats as a result of lowering the deposit facility rate and a decrease in the amount of the credit institution minimum reserve requirements held with the Bank of Latvia. The Bank of Latvia received a smaller amount of Latvian government funds as deposits than in 2008; moreover, interest paid on these deposits also fell, therefore interest expense on government deposits decreased by 7 774 thousand lats in 2009.

27. REALISED GAINS/LOSSES FROM FINANCIAL OPERATIONS

Realised gains/losses from financial operations 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, selling foreign currency in the amount of 690 946 thousand lats. Realised

gains/losses from financial operations were positively affected by the interest rate fall in the euro area and Japan as it increased profits gained from securities disposal. Disposing of a part of securities it had purchased, the Bank of Latvia also realised the positive securities revaluation result of 22.8 million lats, accumulated on the valuation account in previous reporting years. The realised gains/losses from financial operations were negatively affected by negative result on currency future contracts that had been concluded for the purpose of hedging currency risk exposure, as the positive revaluation result of the hedged balance sheet items has been reported in the balance sheet caption "Valuation account".

28. WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS

The revaluation result of several securities and foreign currency positions at the end of 2009 was negative, and it has been recognised as write-downs on financial assets and positions in the profit and loss statement while the positive result on the revaluation of securities and foreign currency positions has been reported in the balance sheet caption "Valuation account" (see also Note 25).

29. INCOME FROM PARTICIPATING INTEREST

Income from participating interest in the amount of 211 thousand lats (206 thousand lats in 2008) comprises the dividends received from the participating interest in the BIS (see also Note 9).

30. OTHER OPERATING INCOME

Other operating income in 2009 and 2008 was as follows:

	(in thousands of lats)	
	2009	2008
Income from sale of collector coins	525	1 113
Income from payment and securities settlement services	301	317
Other	3 857	2 003
Total	4 683	3 433

31. BANKNOTE PRODUCTION AND COINAGE COSTS

The breakdown of banknote production and coinage costs in 2009 and 2008 was as follows:

	(in thousands of lats)	
	2009	2008
Banknote production	3 322	1 612
Coinage of circulation coins	842	1 612
Coinage of collector coins	531	822
Total	4 695	4 046

32. REMUNERATION AND SOCIAL SECURITY COSTS

Remuneration and social security costs in 2009 and 2008 were as follows:

	(in thousands of lats)	
	2009	2008
Remuneration		
Remuneration of members of the Council and the Board	1 106	1 470
Remuneration of other personnel	11 537	13 856
Total remuneration	12 643	15 326
Social security costs	2 886	3 063
Total remuneration and social security costs	15 529	18 389

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 2009 and 2008 was as follows:

	2009	2008
Number of employees at the end of the year		
Members of the Council and the Board	14	14
Other personnel	604	630
Total at the end of the year	618	644
Average number of employees per period	634	649

33. OTHER OPERATING EXPENSES

Other operating expenses in 2009 and 2008 were as follows:

	(in thousands of lats)	
	2009	2008
Municipal services	565	534
Maintenance of buildings, territory and equipment	415	475
Risk insurance	291	250
Personnel training	240	331
Business travel	235	288
Telecommunications services and system maintenance	228	265
Information and public relations	222	251
Acquisition of low value office supplies	197	215
Transport provision	147	172
Tax on real estate	91	86
Audit, advisory and legal services	26	47
Other	225	875
Total	2 882	3 789

The audit, advisory and legal services expenses also comprise the remuneration in the amount of 22 thousand lats paid to *Deloitte Audits Latvia SIA* for the audit of 2009 financial statements (remuneration of 28 thousand lats to *KPMG Baltics SIA* for the audit of 2008 financial statements – in 2008).

34. CASH FLOW STATEMENT

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

	(in thousands of lats)	
	2009	2008
Profit before appropriation	74 393	53 437
Non-cash transaction adjustments		
Depreciation of fixed assets and amortisation of intangible assets	3 373	3 729
Losses on disposal of fixed assets	3	7
Write-downs on financial assets and positions	5 474	38 087
Net non-cash transaction adjustments	8 850	41 823
Change in balance sheet items		
Net increase in gold	–	–2
Net increase in Special Drawing Rights	–91 050	–103
Net increase (–)/decrease in foreign debt securities and other foreign investments	–300 030	511 732
Net increase (–)/decrease in loans to domestic credit institutions	498 814	–632 413
Net increase (–)/decrease in other assets	3 007	–3 376
Net increase/decrease (–) in foreign convertible currency liabilities	–112 246	125 922
Net increase/decrease (–) in foreign bank and other international institution deposits in lats	–220 503	247 420
Net decrease in lats in circulation	–229 937	–31 381
Net increase/decrease (–) in deposits of domestic credit institutions	21 382	–322 507
Net increase in Latvian government deposits	653 886	466 815
Net increase/decrease (–) in deposits of other financial institutions	243	–3 171
Net increase/decrease (–) in other liabilities	–14 031	13 285
Net change in balance sheet items	209 535	372 221
Net cash and cash equivalents inflow arising from operating activities	292 778	467 481

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

	(at the end of year; in thousands of lats)				
	2009	Change	2008	Change	2007
Convertible foreign currencies in cash	19 343	13 057	6 286	3 821	2 465
Demand deposits with foreign credit institutions and other foreign financial institutions	805 403	143 662	661 741	438 211	223 530
Time deposits with foreign credit institutions and other foreign financial institutions with original maturity up to 5 business days	119 479	99 797	19 682	4 870	14 812
Total cash and cash equivalents	944 225	256 516	687 709	446 902	240 807

35. 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 2009 and 2008, 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)		Interest rate (%)	
	2009	2008	2009	2008
Liabilities/claims (–)				
Time deposits in foreign currencies	1 063 849	–	0.17–0.38	–
Demand deposits in foreign currencies	197 870	467 188	0.00–0.05	0.01–2.10
Demand deposits in lats	30 223	–	1.18	–
Time deposits in lats	–	170 868	–	5.53
Spot exchange rate contracts	–105	–	x	x
Tax liabilities/claims (–)	18	–209	x	x
Accrued interest expense	4	52	x	x
Total net liabilities	1 291 859	637 899	x	x

In 2009 and 2008, 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 was as follows (see also Note 26):

	(in thousands of lats)	
	2009	2008
Expense and the Bank of Latvia's profit appropriated to the state budget		
Interest on government deposits	6 592	14 366
Taxes	6 846	7 541
Profit appropriated to the state budget	34 734	15 439
Total expense and the Bank of Latvia's profit appropriated to the state budget	48 172	37 346

36. PLEDGED ASSETS

Securities and other financial instruments with the market value of 14 905 thousand lats, as at the end of 2009 (180 840 thousand lats at the end of 2008), 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".

37. OFF-BALANCE SHEET ACCOUNTS

The Bank of Latvia enters into forward and spot exchange rate contracts, interest rate swap arrangements and interest rate and currency future contracts in order to manage interest rate and currency risk associated with the Bank of Latvia's 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 currency risk associated with Latvian government funds.

At the end of 2009 and 2008, the Bank of Latvia's off-balance sheet account profile was as follows:

(in thousands of lats)

	Contract or notional amount		Book value			
			Assets		Liabilities	
	2009	2008	2009	2008	2009	2008
Non-traded financial derivative and spot exchange rate contracts with foreign financial institutions						
Forward exchange rate contracts and currency swap arrangements	1 365 021	1 421 228	4 676	127 451	18 216	6 227
Spot exchange rate contracts	68 664	46 736	–	–	137	914
Gold interest rate swap arrangements	–	28 049	–	27	–	72
Other interest rate swap arrangements	–	248 292	–	5 648	–	8 437
Total	x	x	4 676	133 126	18 353	15 650
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	1 307 220	1 329 814	–668	6 276	1 971	–2 909
Currency future contracts	210 230	–	–1 241	–	6 745	–
Total	x	x	–1 909	6 276	8 716	–2 909
Non-traded financial derivative and spot exchange rate contracts with domestic institutions						
Currency swap arrangements	–	60 403	–	211	–	403
Spot exchange rate contracts	14 654	–	147	–	–	–
Total	x	x	147	211	–	403
Other transactions						
Agreements concluded on a regular way placement and receipt of time deposits	520 045	9 839	x	x	x	x
Forward transactions in securities	123 547	203 461	380	655	467	464
Contracted commitments related to acquisition of fixed assets	79	136	x	x	x	x

As at the end of 2009 and 2008, 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 2009 and 2008, 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	
	2009	2008	2009	2008	2009	2008
Non-traded financial derivative contracts with foreign financial institutions and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	-13 552	120 240	-13 540	121 224	-12	-984
Spot exchange rate contracts	-137	-914	-137	-914	0	0
Gold interest rate swap arrangements	-	-45	-	-45	-	0
Other interest rate swap arrangements	-	-2 789	-	-2 789	-	0
Total	-13 689	116 492	-13 677	117 476	-12	-984
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	1 303	3 367	1 303	3 367	0	0
Currency futures contracts	5 504	-	5 504	-	0	-
Total	6 807	3 367	6 807	3 367	0	0
Non-traded financial derivative contracts with domestic credit institutions						
Currency swap arrangements	-	-173	-	-192	-	19
Spot exchange rate contracts	147	-	147	-	0	-
Total	147	-173	147	-192	0	19

38. CONTINGENT LIABILITIES AND COMMITMENTS

In 2005, 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 the amount of which was increased to 238.3 million lats in February 2010 (the amount of claim was 185.6 million lats at the end of 2009). 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 2009, the Bank of Latvia's unpaid share in the ECB subscribed capital was 15 199 thousand euro (10 682 thousand lats; at the end of 2008 – 15 070 thousand euro or 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 2009, the uncalled portion of the BIS share holding was 4 013 thousand XDR (3 074 thousand lats; at the end of 2008 – 4 013 thousand XDR or 3 066 thousand lats).

At the end of 2009, the Bank of Latvia had issued collector coins in the nominal value of 1 480 thousand lats (1 449 thousand lats at the end of 2008) and gold circulation coins with a nominal value of 1 988 thousand lats (1 988 thousand lats at the end of 2008). 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 low and no provisions have been made.

39. CURRENCY PROFILE

At the end of 2009 and 2008, 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
As at 31 December 2009								
Foreign assets								
Gold	–	–	–	–	–	134 365	–	134 365
Special Drawing Rights	–	91 237	–	–	–	–	–	91 237
Convertible foreign currencies	–	–	930 978	2 056 297	160 841	–	2 876	3 150 992
Participating interest in the European Central Bank	–	–	–	750 ¹	–	–	–	750
Participating interest in the Bank for International Settlements	–	1 763 ¹	–	–	–	–	–	1 763
Other foreign assets	4 699	–	625	97	22	–	35	5 478
Domestic assets								
Loans to credit institutions	140 449	–	–	–	–	–	–	140 449
Fixed assets	33 232	–	–	–	–	–	–	33 232
Other domestic assets	2 007	–	–	31	–	–	–	2 038
TOTAL ASSETS	180 387	93 000	931 603	2 057 175	160 863	134 365	2 911	3 560 304
Foreign liabilities								
Convertible foreign currencies	–	–	–	19 006	–	–	–	19 006
International Monetary Fund	256 ²	–	–	–	–	–	–	256
Other international institution deposits in lats	32 502	–	–	–	–	–	–	32 502
Foreign bank deposits in lats	499	–	–	–	–	–	–	499
Other foreign liabilities	18 342	–	637	100	–	–	127	19 206
Lats in circulation	788 155	–	–	–	–	–	–	788 155
Domestic liabilities								
Balances due to credit institutions	1 095 781	–	–	19 896	–	–	–	1 115 677
Balances due to the government	30 223	91 237	91 955	1 078 270	71	–	186	1 291 942
Balances due to other financial institutions	1 948	–	–	–	–	–	–	1 948
Other domestic liabilities	2 202	–	264	889	–	–	–	3 355
TOTAL LIABILITIES	1 969 908	91 237	92 856	1 118 161	71	–	313	3 272 546

¹ 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.

² 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.

(cont.)

(in thousands of lats)

	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
Net position on balance sheet	-1 789 521	1 763	838 747	939 014	160 792	134 365	2 598	287 758
Net position on financial instruments' off-balance sheet accounts	-6 178	-	-839 079	1 126 027	-160 143	-134 524	-170	-14 067
Net position on balance sheet and off-balance sheet accounts	-1 795 699	1 763	-332	2 065 041	649	-159	2 428	273 691
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	-256 ¹	-332	2 064 291	649	-159	2 428	2 066 621
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	-0.01	-0.02	99.89	0.03	-0.01	0.12	100.00
Benchmark currency structure (%)	x	0	0	100.00	0	0	0	100.00
As at 31 December 2008								
TOTAL ASSETS	604 983	1 950	786 183	1 746 699	160 525	109 026	4 229	3 413 595
TOTAL LIABILITIES	2 545 261	187	10 962	615 125	9	41	36	3 171 621
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	-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

¹ 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 the BIS (1 763 thousand lats).

40. REPRICING MATURITY AND TRACKING ERROR

The table below reflects the sensitivity of the Bank of Latvia's assets, liabilities and off-balance sheet accounts to a change in interest rates. Items reported in this table are stated at carrying amounts, except for interest rate and currency future contracts and forward transactions in securities 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)							
As at 31 December 2009							
Foreign assets							
Gold	-	-	-	-	-	134 365	134 365
Special Drawing Rights	91 237	-	-	-	-	-	91 237
Convertible foreign currencies	1 820 244	55 039	98 054	677 366	477 515	22 774	3 150 992
Participating interest in the European Central Bank	-	-	-	-	-	750	750
Participating interest in the Bank for International Settlements	-	-	-	-	-	1 763	1 763
Other foreign assets	17	-	-	-	-	5 461	5 478
Domestic assets							
Loans to credit institutions	140 449	-	-	-	-	-	140 449
Fixed assets	-	-	-	-	-	33 232	33 232
Other domestic assets	763	-	-	-	-	1 275	2 038
TOTAL ASSETS	2 052 710	55 039	98 054	677 366	477 515	199 620	3 560 304
Foreign liabilities							
Convertible foreign currencies	-	-	-	-	-	19 006	19 006
International Monetary Fund	-	-	-	-	-	256	256
Other international institution deposits in lats	-	-	-	-	-	32 502	32 502
Foreign bank deposits in lats	-	-	-	-	-	499	499
Other foreign liabilities	-	-	-	-	-	19 206	19 206
Lats in circulation	-	-	-	-	-	788 155	788 155
Domestic liabilities							
Balances due to credit institutions	1 092 267	-	-	-	-	23 410	1 115 677
Balances due to the government	1 291 661	-	-	-	-	281	1 291 942
Balances due to other financial institutions	1 225	-	-	-	-	723	1 948
Other domestic liabilities	252	-	-	-	-	3 103	3 355
TOTAL LIABILITIES	2 385 405	-	-	-	-	887 141	3 272 546

(cont.)

(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	–332 695	55 039	98 054	677 366	477 515	x	x
Assets on financial instruments' off-balance sheet accounts	1 991 053	54 933	72 372	840 742	116 861	x	x
Liabilities on financial instruments' off-balance sheet accounts	2 503 204	175 715	58 845	178 583	173 144	x	x
Net position on balance sheet and off-balance sheet accounts	–844 846	–65 743	111 581	1 339 525	421 232	x	x
As at 31 December 2008							
TOTAL ASSETS	1 546 308	81 187	122 809	864 863	508 813	289 615	3 413 595
TOTAL LIABILITIES	1 837 809	–	–	–	–	1 333 812	3 171 621
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

The exposure of foreign reserves portfolios to credit risk and aggregated market risk (except for the gold reserves portfolio, portfolios of borrowed funds, and asset-backed security portfolios) is 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 reserves portfolio, portfolios of borrowed funds, and asset-backed security portfolios) 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 2009 and 2008, the actual (*ex-post*) tracking error of the foreign currency reserves portfolio managed by the Bank of Latvia was 55 basis points and 102 basis points respectively, whereas the tracking error of the foreign currency reserves portfolio managed by external asset managers was 62 basis points and 177 basis points respectively. The expected (*ex-ante*) tracking error lay within the following basis point intervals during the year:

Tracking error (in basis points)	Number of business days	
	2009	2008
10–39	–	67
40–69	181	149
70–99	66	31
100–129	1	–
Total	248	247

41. LIQUIDITY PROFILE

At the end of 2009 and 2008, the liquidity profile of the Bank of Latvia's assets and liabilities was as follows:

(in thousands of lats)						
	2009			2008		
	Up to 3 months	No fixed maturity	Total	Up to 3 months	No fixed maturity	Total
Assets						
Foreign assets	3 381 667	2 918	3 384 585	2 731 466	2 929	2 734 395
Domestic assets	141 511	34 208	175 719	643 135	36 065	679 200
TOTAL ASSETS	3 523 178	37 126	3 560 304	3 374 601	38 994	3 413 595
Liabilities						
Foreign liabilities	71 437	32	71 469	402 112	33	402 145
Lats in circulation	–	788 155	788 155	–	1 018 092	1 018 092
Domestic liabilities	2 412 922	–	2 412 922	1 750 741	643	1 751 384
TOTAL LIABILITIES	2 484 359	788 187	3 272 546	2 152 853	1 018 768	3 171 621
Net position on balance sheet	1 038 819	–751 061	x	1 221 748	–979 774	x

42. SECTORAL PROFILE OF ASSETS

The sectoral profile of the Bank of Latvia's assets at the end of 2009 and 2008 was as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2009	2008	2009	2008
Claims				
Foreign central governments and other governmental institutions	1 327 922	1 148 514	37.3	33.6
Foreign local governments	86 146	79 057	2.4	2.3
Foreign central banks and credit institutions	1 480 509	1 149 663	41.6	33.7
Other foreign financial institutions	376 264	365 159	10.6	10.7
Foreign non-financial corporations	12 427	9 967	0.3	0.3
International institutions	141 194	42 674	4.0	1.3
Latvian central government	101 110	589 843	2.8	17.3
Domestic credit institutions	47	836	0	0
Unclassified assets	34 685	27 882	1.0	0.8
Total	3 560 304	3 413 595	100.0	100.0

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.

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

At the end of 2009 and 2008, 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 (%)	
	2009	2008	2009	2008
Euro area	2 003 361	1 415 730	59.2	51.8
Other EU countries	324 963	378 361	9.6	13.8
US	588 869	579 994	17.4	21.2
Japan	160 300	175 362	4.7	6.4
Other countries	165 898	142 274	4.9	5.2
International institutions	141 194	42 674	4.2	1.6
Total	3 384 585	2 734 395	100.0	100.0

44. ASSETS BY CREDIT RATINGS ASSIGNED TO THE COUNTERPARTY

At the end of 2009 and 2008, 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 (%)	
		2009	2008	2009	2008
FOREIGN ASSETS					
Gold	AAA	134 365	108 998	3.8	3.2
Special Drawing Rights	AAA	91 237	187	2.6	0
Foreign debt securities	AAA	1 597 094	1 310 234	44.9	38.4
	AA+	97 909	123 443	2.8	3.6
	AA	37 236	19 019	1.0	0.6
	AA-	183 745	199 854	5.2	5.9
	A+	65 680	64 241	1.8	1.9
	A	3 565	62 777	0.1	1.8
	A-	2 389	1 366	0.1	0
	BBB+	23 966	–	0.7	–
	BBB	445	12 766	0	0.4
	BBB-	231	–	0	–
	BB	–	7 287	–	0.2
	Deposits with foreign financial institutions	AAA	758 524	589 371	21.3
AA+		487	1 353	0	0
AA		93 001	14 122	2.6	0.4
AA-		15 805	46 945	0.4	1.4
A+		177 692	–	5.0	–
A		56 310	29 629	1.6	0.9
A-		17 570	–	0.5	–
Foreign currency in cash	AAA	19 343	6 286	0.5	0.2
Participating interest in the European Central Bank	AAA	750	743	0	0
Participating interest in the Bank for International Settlements	AAA	1 763	1 763	0.1	0.1
Derivative financial instruments	AAA	1 084	11 139	0	0.3
	AA	316	9 395	0	0.3
	AA-	19	57 112	0	1.6
	A+	1 567	31 698	0.1	0.9
	A	1 521	20 732	0	0.6
	A-	549	3 475	0	0.1
Accrued interest income	Different	17	27	0	0
Other foreign assets	Different	405	433	0	0
DOMESTIC ASSETS					
Loans to credit institutions	Different	140 449	639 263	3.9	18.7
Other	Different	35 270	39 937	1.0	1.2
TOTAL		3 560 304	3 413 595	100.0	100.0

At the end of 2009 and 2008, 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 (%)	
		2009	2008	2009	2008
Foreign assets	AAA	2 604 160	2 028 722	76.9	74.2
	AA	428 518	471 242	12.7	17.2
	A	326 843	213 918	9.7	7.8
	BBB	24 642	12 766	0.7	0.5
	BB	–	7 287	–	0.3
	Different	422	460	0	0
Total		3 384 585	2 734 395	100.0	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 2009, 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 43.

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.

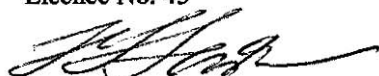
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In 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 of the Bank give a true and fair view of the financial position of the Bank as at 31 December 2009, 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".

Deloitte Audits Latvia SIA
Licence No. 43



Inguna Staša
Board Member
Riga, Latvia
16 March 2010

The State Audit Office
of the Republic of Latvia



Inguna Sudraba
Auditor General
Riga, Latvia
17 March 2010