

# **BANK OF LATVIA**

FINANCIAL STATEMENTS OF THE BANK OF LATVIA  
FOR THE YEAR ENDED 31 DECEMBER 2010  
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 <sup>1</sup>	2010	2009
<b>FOREIGN ASSETS</b>		<b>4 074 611</b>	3 384 585
Gold	7	187 179	134 365
Special Drawing Rights	8	99 356	91 237
Convertible foreign currencies	9	3 782 167	3 150 992
Participating interest in the European Central Bank	10	750	750
Participating interest in the Bank for International Settlements	11	1 763	1 763
Other foreign assets	12	3 396	5 478
<b>DOMESTIC ASSETS</b>		<b>32 722</b>	175 719
Loans to credit institutions	13	–	140 449
Fixed assets	14, 15	31 003	33 232
Other domestic assets	16, 17	1 719	2 038
<b>TOTAL ASSETS</b>		<b>4 107 333</b>	3 560 304

<sup>1</sup> The accompanying Notes set out on pages 9 to 44 are an integral part of these financial statements.

(cont.)

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

LIABILITIES, CAPITAL AND RESERVES	Notes	2010	2009
<b>FOREIGN LIABILITIES</b>		<b>42 556</b>	71 469
Convertible foreign currencies	18	13 682	19 006
International Monetary Fund	8	274	256
Other international institution deposits in lats	19	8 505	32 502
Foreign bank deposits in lats		726	499
Other foreign liabilities	20	19 369	19 206
<b>LATS IN CIRCULATION</b>	21	<b>937 904</b>	788 155
<b>DOMESTIC LIABILITIES</b>		<b>2 830 233</b>	2 412 922
Balances due to credit institutions	22	1 690 230	1 115 677
Balances due to the government	23	1 081 010	1 291 942
Balances due to other financial institutions		56 738	1 948
Other domestic liabilities	24, 25	2 255	3 355
<b>CAPITAL AND RESERVES</b>		<b>296 640</b>	287 758
Nominal capital	26	25 000	25 000
Reserve capital	26	140 273	114 236
Valuation account	26	107 613	74 129
Profit of the reporting year	26	23 754	74 393
<b>TOTAL LIABILITIES, CAPITAL AND RESERVES</b>		<b>4 107 333</b>	3 560 304

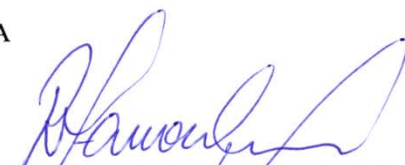
OFF-BALANCE SHEET ACCOUNTS 39

The financial statements, which are set out on pages 3 to 44, were authorised by the Board of the Bank of Latvia on 17 March 2011.

BOARD OF THE BANK OF LATVIA



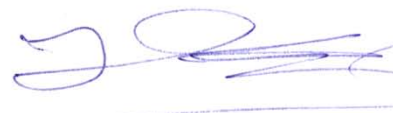
Māris Kālis  
Chairman of the Board



Reinis Jakovļevs  
Deputy Chairman  
of the Board



Andris Nīkitins  
Member of the Board



Harijs Ozols  
Member of the Board



Ilze Posuma  
Member of the Board



Raivo Vanags  
Member of the Board

## PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes	2010	2009
<b>INTEREST INCOME</b>			
Foreign operations	27	<b>57 055</b>	59 245
Interest on securities		52 405	51 702
Interest on deposits with foreign credit institutions and other foreign financial institutions		2 792	3 305
Interest on derivative financial instruments		1 858	4 238
Domestic operations	27	<b>3 618</b>	26 925
Interest on loans to credit institutions		3 618	24 696
Interest on derivative financial instruments		–	2 229
<b>INTEREST EXPENSE</b>			
Foreign operations	27	<b>967</b>	1 662
Interest on deposits		1	93
Interest on derivative financial instruments		966	1 569
Domestic operations	27	<b>13 362</b>	18 515
Interest on deposits of credit institutions		9 140	11 895
Interest on government deposits		4 127	6 592
Interest on deposits of other financial institutions		95	28
<b>NET INTEREST INCOME</b>	27	<b>46 344</b>	65 993

*(cont.)*

(in thousands of lats)

	Notes	2010	2009
<b>REALISED GAINS/LOSSES (-) FROM FINANCIAL OPERATIONS</b>	28	<b>9 147</b>	36 959
Foreign operations		<b>-6 315</b>	22 521
Securities		17 599	28 069
Derivative financial instruments		-23 914	-5 548
Foreign currency exchange transactions		<b>15 462</b>	14 438
<b>WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS</b>	26, 29	<b>12 995</b>	5 474
Foreign operations		<b>11 639</b>	5 462
Securities		11 639	5 462
Foreign currency position		<b>1 356</b>	12
<b>INCOME FROM PARTICIPATING INTEREST</b>	30	<b>611</b>	221
<b>OTHER OPERATING INCOME</b>	31	<b>1 278</b>	4 683
<b>BANKNOTE PRODUCTION AND COINAGE COSTS</b>	32	<b>541</b>	4 695
<b>OTHER OPERATING EXPENSES</b>		<b>20 090</b>	23 294
Remuneration	33	10 278	12 643
Social security costs	33	2 449	2 886
Depreciation and amortisation charges	14, 17	3 044	3 373
Maintenance and operation of information systems		1 554	1 510
Other operating expenses	34	2 765	2 882
<b>PROFIT OF THE REPORTING YEAR</b>		<b>23 754</b>	74 393

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

(in thousands of lats)

	Notes	2010	2009
<b>REVALUATION</b>	26	<b>35 482</b>	27 907
Foreign currency and gold		36 680	18 812
Securities		-1 198	9 095
<b>REALISATION OF ACCUMULATED REVALUATION RESULT</b>	26	<b>-14 993</b>	-27 256
Foreign currency and gold		-3 889	-1 238
Interest rate swap contracts		-	-3 263
Securities		-11 104	-22 755
<b>WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS</b>	26, 29	<b>12 995</b>	5 474
<b>PROFIT OF THE REPORTING YEAR</b>		<b>23 754</b>	74 393
<b>TOTAL</b>		<b>57 238</b>	80 518

## CASH FLOW STATEMENT

(in thousands of lats)

	Notes	2010	2009
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
Profit of the reporting year		<b>23 754</b>	74 393
Non-cash transaction adjustments	35 (1)	<b>16 294</b>	8 850
Net movements in balance sheet positions	35 (1)	<b>-378 945</b>	209 535
Net cash and cash equivalents inflow/outflow (-) from operating activities		<b>-338 897</b>	292 778
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>			
Increase of participating interest in the European Central Bank	10	-	-7
Dividends on shares of the Bank for International Settlements	30	<b>611</b>	221
Acquisition of fixed assets	14	<b>-788</b>	-1 692
Acquisition of intangible assets	17	<b>-146</b>	-50
Net cash and cash equivalents outflow from investing activities		<b>-323</b>	-1 528
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>			
Profit appropriated to the state budget	26	<b>-48 355</b>	-34 734
Net cash and cash equivalents outflow from financing activities		<b>-48 355</b>	-34 734
<b>NET CASH AND CASH EQUIVALENTS INFLOW/OUTFLOW (-)</b>			
Cash and cash equivalents at the beginning of the year	35 (2)	<b>944 225</b>	687 709
Cash and cash equivalents at the end of the year	35 (2)	<b>556 650</b>	944 225



## 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" and other legislative provisions.

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 systems 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 cash as a commercial activity, and controls compliance with the procedure it has established for effecting foreign currency cash 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 and Liepāja. In 2010, the Bank of Latvia closed its Rēzekne Branch, redirecting customers' cash delivery and withdrawal to the other Bank of Latvia branches.

### 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, Audit Committee, and Budget Commission 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 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. The basic principles of investment policy set out in the Guidelines are provided in Note 5. Foreign reserves are managed by classifying them into different investment portfolios. Parameters for a benchmark reflecting the acceptable level of financial risks and return target are set out for each portfolio type in the Guidelines. On a business day basis, the Risk Management Division of the Market Operations Department monitors the compliance of foreign reserves with the requirements set out in the Guidelines.

For the purpose of foreign reserves management, including management of related financial risks, the Investment Committee of the Bank of Latvia that develops the investment management strategy, approves tactical decisions and sets detailed limits for financial risks within the framework of the Guidelines as well as oversees the operation of external foreign reserve managers. 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, reviews the reports by financial risk 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 gold price and 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 manages the gold price and currency risk by determining open currency position limits or using tracking error. Tracking error is calculated as the expected annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark. The aggregate market and credit risk of portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark (see also Note 5) is managed by determining the portfolio tracking error limit. Tracking error in 2010 and 2009 is provided in Note 42.

For investment portfolios, except for portfolios of borrowed funds, the benchmark 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. In order to achieve the compliance of open foreign currency positions with the limits, the Bank of Latvia hedges the currency (including gold price) risk by using 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.

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 pursued by the Bank.

Exposure of the Bank of Latvia to market risk (as at the end of 2010 and 2009) is provided in Notes 41 and 42.

### *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 credit rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's. The Bank of Latvia is allowed to invest in financial instruments 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 these 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 2010 and 2009) is provided in Notes 44 to 46.

### *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 reserves in liquid debt securities issued by international institutions, foreign governments and the corporate sector, short-term deposits with foreign financial institutions and other financial instruments. 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 35. The liquidity profile of the Bank of Latvia's assets and liabilities as at the end of 2010 and 2009 is provided in Note 43.

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, which has established the Committee for Managing the Bank of Latvia's Operational Risks to coordinate, on a daily basis, the activities under the operational risk management process and to provide 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, and the Head of Security Department.

In 2010, operational risks to the Bank of Latvia processes and projects were identified, analysed and assessed, with a set of relevant risk limiting measures being developed and assessed. The information thus obtained is compiled in the Risk Register of the Bank of Latvia, a new information system, which is available to the Bank of Latvia employees who are responsible for the Bank of Latvia processes as well as the department heads, project managers and other authorised staff of the Bank of Latvia involved in these processes.

In order to ensure confidentiality, authorised access to and integrity of information, the Bank of Latvia information systems are classified. The Bank of Latvia has appointed owners of information systems who are responsible for determination of security requirements and regulations for use and approve the risk analysis results of the respective information system. Information systems security manager of the Bank of Latvia coordinates the implementation of information systems risk analysis and oversees the introduction of measures aimed at minimising the identified risks. The Head of Information Systems Department ensures logical and physical security of the Bank of Latvia information systems, including accessibility to information systems and compliance with other security requirements coordinated with the information system owners. The Bank of Latvia conducts, on a regular basis, the analysis of information systems security risks and improves security measures and tools.

The management of Bank of Latvia business continuity is organised and conducted in accordance with the "Bank of Latvia Business Continuity Policy", approved by the Council, abiding by the principles of best practice and taking into account the ECB recommendations regarding business continuity management.

In 2010, the Bank of Latvia was not exposed to the risks that could substantially affect or hamper its operation.

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 "Derivative financial instruments". The reconciliation of the book value and fair value of these instruments is provided in Note 39.

### 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 markets, 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. The breakdown of assets and liabilities measured at fair value, taking into account the hierarchy of fair value determination, is provided in Note 6.

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.

#### 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 electronic 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 gains or losses on financial instruments".

The exchange rates of principal foreign currencies and the price of gold set by the Bank of Latvia and used in the preparation of the balance sheet for the year ended 31 December 2010 and the year ended 31 December 2009 are as follows:

	(at the end of the year)		
	<b>2010</b>	2009	Changes (%)
Euro (EUR)	<b>0.702804</b>	0.702804	0
US dollar (USD)	<b>0.535</b>	0.489	9.4
Japanese yen (JPY)	<b>0.00651</b>	0.00533	22.1
Gold (XAU)	<b>752.612</b>	540.256	39.31
Special Drawing Rights (XDR)	<b>0.82</b>	0.766	7.0

#### 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.

#### 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.

#### 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.

#### GOLD

Gold reserves are stated at market value in the balance sheet in accordance with the principles described in Note 3 under "Foreign currency translation".

Any gain or loss arising from transactions in gold and 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 described in Note 3 under "Recognition of gains or losses 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 gains or losses 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.

#### SECURITIES LENDING

Securities lent under automatic securities lending programme agreements are retained in the Bank of Latvia's balance sheet caption "Convertible foreign currencies" along with other securities that are not involved in these transactions. Only cash collateral placed on the account of the Bank of Latvia, is recognised in the balance sheet.

Income from securities lending transactions is recognised as interest income in the profit and loss statement.

#### 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 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, is 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 gains or losses 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:

	(%)	
	2010	2009
Buildings		
– structures	1	1
– outer finishing	5	5
– interior decorations	5–20	5–20
– engineering communications	5	5
– other components	10–14	10–14
Buildings and structures not accounted by components	3	3
External systems and networks	7	7
Improvement of territory	10	10
Transport vehicles	10	10
Office equipment and inventories, of which	4–20	10–20
– office furniture	7	10
– office electrical equipment	20	20
Cash processing and verifying equipment	7–20	10–20
Computer and telecommunications equipment	14–50	14–33
Equipment and inventory of building systems and technical security systems	10–20	10–20
Other fixed assets	7–20	20–50

The Board of the Bank of Latvia assessed the useful life of fixed assets and applied the extension to the following major groups of fixed assets: furniture, safes and strong-boxes, tools, security equipment, and cash processing equipment.

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 stated 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 recognised 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 securities, deposits, loans granted, forward exchange rate contracts, and currency and interest rate swap arrangements. Interest on 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 market participants, 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 financial operations 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 financial operations 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 banknote and coin 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 2010, the Bank of Latvia assets grew by 547.0 million lats mainly on account of an increase in foreign assets.

Convertible foreign currencies posted an increase of 631.2 million lats mainly on account of the loans to the Latvian government granted by the EC, the IMF and other international lenders, which was deposited on the Treasury accounts with the Bank of Latvia. Meanwhile, currency interventions, with the Bank of Latvia selling a part of its foreign currency reserves to credit institutions, had a decreasing effect. Although the reverse currency interventions, with the Bank of Latvia buying the euro from the Treasury, amounted to 1 268.4 million lats<sup>1</sup> in 2010, these interventions did not affect the balance sheet caption "Convertible foreign currencies", because, in order to conduct these interventions, the Treasury used its euro deposits with the Bank of Latvia. As a result of currency interventions in 2010, the Bank of Latvia bought euro in exchange for lats in the net amount of 851.0 million lats<sup>1</sup>.

Given the excess liquidity in the banking sector, the Bank of Latvia had not granted loans to credit institutions at the end of 2010, and deposits of credit institutions increased by 574.6 million lats.

With the demand for cash growing, the amount of cash in circulation grew in 2010, hence the Bank of Latvia balance sheet caption "Lats in circulation" increased by 149.7 million lats.

Capital and reserves of the Bank of Latvia grew by 8.9 million lats on account of earned profit (23.8 million lats) and net changes in valuation of financial instruments (33.5 million lats) in 2010, while profits remitted to the state budget revenue in the amount of 48.4 million lats had a decreasing effect.

#### FINANCIAL PERFORMANCE

In 2010, the Bank of Latvia's profit amounted to 23.8 million lats.

In 2010, net interest income was by 19.6 million lats lower than in 2009, primarily determined by the contraction in the average lending to credit institutions. As a result, interest income from loans to credit institutions decreased by 21.1 million lats. Net interest income was also adversely affected by low interest rates in the US and euro area, such impact, however, being partly offset by an increase in the Bank of Latvia's foreign

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<sup>1</sup> On a settlement date basis.



reserves and investment decisions, which ensured a higher return on foreign reserves in comparison with that on the benchmark.

Net interest on derivative financial instruments declined by 4.0 million lats, because domestic credit institutions did not use currency swap arrangements and the narrowing spread between the euro and US dollar short-term interest rates resulted in lower net interest income from financial derivatives used by the Bank of Latvia for hedging currency risk exposure.

Notwithstanding the increase in deposits of credit institutions with the Bank of Latvia in 2010 as a result of excess bank liquidity, upon decreasing the interest rates on these deposits the interest expense on credit institution deposits, including remuneration for holding the minimum reserves, fell by 2.8 million lats. Lower lats interest rates accounted also for a 2.5 million lats drop in interest expense on government deposits.

Realised gains arising from investment in financial operations contracted by 27.8 million lats primarily due to the increase of 18.4 million lats in the negative result of currency future contracts concluded for the purpose of hedging currency risks, while the positive revaluation result of the hedged balance sheet items is reported in the balance sheet caption "Valuation account" in equal value. Realised gains from the disposal of debt securities declined by 10.5 million lats, as the drop in interest rates in the US and euro area stabilised, thus reducing the positive effect on the market value of the Bank of Latvia's debt securities.

The write-downs on financial assets and positions increased by 7.5 million lats in comparison with 2009. The increase was mainly driven by increase in interest rates in the US and euro area at the end of 2010, negatively affecting the market value of the Bank of Latvia's debt securities.

Banknote production and coinage costs contracted by 4.2 million lats, as in 2010 the Bank of Latvia replenished its banknote and coin stocks in a small amount.

With the Bank of Latvia cutting its administrative expense, including remuneration of employees, the Bank of Latvia's other operating expense decreased year-on-year by 3.2 million lats in 2010.

The uncertainty of the Bank of Latvia's further financial performance is mostly related to interest rate developments in the euro area and US financial markets since the Bank of Latvia is exposed to the interest rate risk. In view of the very 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 foreign financial markets may negatively affect the income on the fixed income securities.

## **5. INVESTMENT POLICY**

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.

Foreign reserves include the assets reported under "Gold", "Special Drawing Rights" and "Convertible foreign currencies" as well as derivative financial instruments and spot exchange rate contracts whose book value is reported under relevant balance sheet captions of other assets or other liabilities.

Foreign reserves are managed by classifying them into different investment portfolios by investment strategy and source of funding. Portfolios of borrowed funds include foreign reserves which correspond to the Bank of Latvia's liabilities in foreign currencies to other institutions, mainly foreign reserves arising from the Treasury of the Republic of Latvia deposits and foreign exchange swaps conducted in pursuit of monetary policy. Foreign reserves that are not included in the portfolios of borrowed funds (net reserves) are included in the portfolios of gold reserves, portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark. A part of foreign currency reserves included in the portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark are managed by external foreign reserves managers.

The parameters for a benchmark reflecting the acceptable level of financial risks and return target are set out for each portfolio type in the Guidelines.

The breakdown of foreign reserves by type of investment portfolio at the end of 2010 and 2009 was as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2010	2009	2010	2009
Portfolios managed against multi-currency fixed income securities benchmark	<b>2 602 693</b>	1 762 219	<b>64.9</b>	53.1
Portfolios of borrowed funds	<b>1 061 213</b>	1 270 522	<b>26.4</b>	38.2
Gold reserves portfolio	<b>184 090</b>	134 128	<b>4.6</b>	4.0
Portfolios managed against asset-backed securities benchmark	<b>165 090</b>	154 934	<b>4.1</b>	4.7
<b>Total</b>	<b>4 013 086</b>	3 231 803	<b>100.0</b>	100.0

The benchmark of portfolios managed against multi-currency fixed income securities benchmark 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.

The benchmark for borrowed funds is formed in compliance with the parameters of respective liabilities.

The benchmark of gold reserves portfolio is pledged to the euro money market short-term index.

The benchmark of portfolios managed against asset-backed securities benchmark is pledged to the US mortgage-backed securities index and denominated in euro, eliminating the currency risk.

According to the exchange rate policy of the Bank of Latvia, the Guidelines provide that, except for portfolios of borrowed funds, the currency of the foreign reserves benchmark is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the parameters of respective liabilities.

The description of the main methods used in financial risk management is provided in Note 2.

## **6. ASSETS AND LIABILITIES AT FAIR VALUE**

Fair value of Bank of Latvia's assets and liabilities is determined using the following hierarchy:

- quoted price. Fair value is determined using quoted prices for identical financial instruments in active markets;
- observable data. Fair value is determined using quoted prices for similar financial instruments in active markets, quoted prices for similar or identical financial instruments in inactive markets or using models where all significant inputs are observable;
- non-observable data. Fair value is determined using models where significant inputs are not observable.

At the end of 2010 and 2009, Bank of Latvia's investments in debt securities were generally valued on the basis of quoted price. At the end of 2010 and 2009, the Bank of Latvia did not have such assets and liabilities whose fair value is determined by using non-observable data. At the end of 2010 and 2009, the breakdown of assets and liabilities carried at fair value according to the fair value hierarchy was as follows:

	(in thousands of lats)		
	Quoted price	Observable data	Total
<b>As at 31 December 2010</b>			
<b>FOREIGN ASSETS</b>			
Gold	187 179	–	187 179
Convertible foreign currencies			
Debt securities	2 223 881	465 531	2 689 412
Other foreign assets			
Forward transactions in debt securities	63	–	63
<b>Total foreign assets at fair value</b>	<b>2 411 123</b>	<b>465 531</b>	<b>2 876 654</b>
<b>FOREIGN LIABILITIES</b>			
Other foreign liabilities			
Forward transactions in debt securities	319	1	320
<b>Total foreign liabilities at fair value</b>	<b>319</b>	<b>1</b>	<b>320</b>
<b>As at 31 December 2009</b>			
<b>FOREIGN ASSETS</b>			
Gold	134 365	–	134 365
Convertible foreign currencies			
Debt securities	1 796 323	215 937	2 012 260
Other foreign assets			
Forward transactions in debt securities	275	–	275
<b>Total foreign assets at fair value</b>	<b>1 930 963</b>	<b>215 937</b>	<b>2 146 900</b>
<b>FOREIGN LIABILITIES</b>			
Other foreign liabilities			
Forward transactions in debt securities	417	–	417
<b>Total foreign liabilities at fair value</b>	<b>417</b>	<b>–</b>	<b>417</b>

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.

## 7. GOLD

Movements in gold reserves in 2010 and 2009 were as follows:

	Troy ounces	In thousands of lats
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
<b>During 2010</b>		
Increase in gold market value	x	52 815
Net change resulting from gold depositing and deposit withdrawal	-1	-1
<b>As at 31 December 2010</b>	<b>248 706</b>	<b>187 179</b>

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 41). 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".

## 8. 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 SDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in lats and IMF allocations. In 2010, liabilities to the IMF increased by 268 448 thousand SDR as a result of the loan granted to the Latvian government.

At the end of 2010, the claims on the IMF in SDR as recorded on the Bank of Latvia's balance sheet were equivalent to 99 356 thousand lats (at the end of 2009 – 91 237 thousand lats), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 274 thousand lats (at the end of 2009 – 256 thousand lats) held on its Accounts No. 1 and No. 2.

At the end of 2010 and 2009, Latvia's net claims and liabilities to the IMF were as follows:

	(in thousands of lats)		(in thousands of SDR)	
	2010	2009	2010	2009
Latvia's quota in the IMF	<b>103 976</b>	97 129	<b>126 800</b>	126 800
IMF holdings in lats	<b>-909 382</b>	-643 865	<b>-1 109 002</b>	-840 554
Promissory notes of the Latvian government	-909 108	-643 609	-1 108 668	-840 220
Account No. 1	-260	-243	-317	-317
Account No. 2	-14	-13	-17	-17
Stand-by Arrangement for Latvia	<b>805 437</b>	546 765	<b>982 240</b>	713 792
Reserve position in IMF	<b>45</b>	42	<b>55</b>	55
SDR	<b>99 356</b>	91 237	<b>121 166</b>	119 108
General allocation	<b>-77 077</b>	-72 002	<b>-93 998</b>	-93 998
Special allocation	<b>-21 996</b>	-20 547	<b>-26 824</b>	-26 824
Latvia's net claims/liabilities (-) to the IMF	<b>328</b>	-1 270	<b>399</b>	-1 659

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 translated into lats at the SDR exchange rate set by the Bank of Latvia at the end of the year.

## 9. CONVERTIBLE FOREIGN CURRENCIES

Bank of Latvia's foreign assets in convertible foreign currencies 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 (24 234 thousand lats at the end of 2010 and 16 947 thousand lats at the end of 2009).

At the end of 2010 and 2009, the balance sheet asset caption "Convertible foreign currencies" was comprised of the following assets:

	(in thousands of lats)	
	2010	2009
Debt securities of foreign governments, financial institutions and non-financial corporations	<b>2 689 412</b>	2 012 260
Demand deposits with foreign central banks, credit institutions and international institutions	<b>531 735</b>	805 403
Time deposits with foreign credit institutions and other foreign financial institutions	<b>545 307</b>	313 986
Foreign currency in cash	<b>15 713</b>	19 343
Total	<b>3 782 167</b>	3 150 992

## 10. 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 of 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.

The Bank of Latvia's percentage share in the ECB's capital is 0.2837%. Pursuant to the decision of the Governing Council of the ECB, on 29 December 2010 the ECB's subscribed capital was increased by 5 billion euro; as a result, the share of the Bank of Latvia in the ECB's capital increased from 16 343 thousand euro (11 486 thousand lats) to 30 528 thousand euro (21 455 thousand lats). The ECB's General Council decided that the minimum contribution of the non-euro area central banks should be 3.75% of their total subscribed capital in the ECB (7% at the end of 2009). As a result of the above decisions, the Bank of Latvia's contribution to the

ECB subscribed capital amounted to 1 145 thousand euro (750 thousand lats) at the end of 2010 (1 144 thousand euro or 750 thousand lats at the end of 2009; see also Note 40).

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.

#### **11. PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS**

At the end of 2010 and 2009, the Bank of Latvia owned 1 070 shares in the BIS, which correspond to 0.20% of the total subscribed and paid-up BIS capital.

The nominal value of the Bank of Latvia's shareholding in the BIS is 5 350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1 338 thousand SDR or 25%. The deemed cost of this holding at the end of 2010 and 2009 is reported in the Bank of Latvia's balance sheet in the amount of 1 763 thousand lats (see also Note 40).

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 assets<sup>1</sup>, differs from their book value and was 17 741 thousand lats at the end of 2010 (14 409 thousand lats at the end of 2009).

#### **12. OTHER FOREIGN ASSETS**

At the end of 2010 and 2009, other foreign assets consisted of the following items:

	(in thousands of lats)	
	<b>2010</b>	2009
Non-traded financial derivative and spot exchange rate contracts with foreign financial institutions	<b>2 825</b>	5 056
Prepaid expense	<b>459</b>	326
Interest accrued on deposits	<b>79</b>	17
Other	<b>33</b>	79
<b>Total</b>	<b>3 396</b>	5 478

#### **13. LOANS TO CREDIT INSTITUTIONS**

In 2010, ample liquidity was maintained in the banking sector, hence the Bank of Latvia had not granted loans to credit institutions at the end of 2010. At the end of 2009, loans to domestic credit institutions included short-term loans to JSC *Parex banka* in the amount of 140 449 thousand lats, fully repaid in May 2010. These loans were secured by collateral of government securities and private sector debt securities with the fair value of 211 501 thousand lats at the end of 2009 (see also the section "Credit risk" in Note 2).

<sup>1</sup> 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.

#### 14. FIXED ASSETS

The following changes in fixed assets took place in 2010 and 2009:

	(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 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
<b>During 2010</b>						
Additions	206	430	-	-	152	788
Change in classification	-66	-29	-	-	95	-
Disposals and write-offs	-297	-378	-49	-50	-297	-1 071
Net change in cost	-157	23	-49	-50	-50	-283
Depreciation charge	-1 800	-365	-243	-104	-250	-2 762
Change in classification	23	12	-	-	-35	-
Accumulated depreciation on disposals and write-offs	55	375	49	49	288	816
Net change in accumulated depreciation	-1 722	22	-194	-55	3	-1 946
<b>As at 31 December 2010</b>						
Cost	37 000	6 368	4 580	1 235	5 133	54 316
Accumulated depreciation	-11 041	-4 878	-2 488	-743	-4 163	-23 313
<b>Net book value</b>	<b>25 959</b>	<b>1 490</b>	<b>2 092</b>	<b>492</b>	<b>970</b>	<b>31 003</b>

At the end of 2010, the total cadastral value of land under the ownership and possession of the Bank of Latvia was 1 999 thousand lats (3 168 thousand lats at the end of 2009; the change is mostly related to a change

in the cadastral value of land). Land is reported in the balance sheet of the Bank of Latvia at cost (1 669 thousand lats at the end of 2009 and 2010).

### 15. 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 2010 and 2009 was as follows:

	(in thousands of lats)
<b>As at 31 December 2009</b>	
Cost	1 086
Accumulated depreciation	-381
<b>Net book value</b>	<b>705</b>
<b>As at 31 December 2010</b>	
Cost	1 059
Accumulated depreciation	-422
<b>Net book value</b>	<b>637</b>

### 16. OTHER DOMESTIC ASSETS

At the end of 2010 and 2009, other domestic assets consisted of the following items:

	(in thousands of lats)	
	<b>2010</b>	2009
Intangible assets	<b>625</b>	761
Non-traded spot exchange rate contracts with domestic institutions	<b>532</b>	147
Prepaid expense	<b>124</b>	160
Accrued interest on loans to credit institutions	-	763
Other	<b>438</b>	207
<b>Total</b>	<b>1 719</b>	2 038



## 17. INTANGIBLE ASSETS

The following changes in intangible assets took place in 2010 and 2009:

	(in thousands of lats)	
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 disposals		1
Net change in accumulated amortisation		-289
As at 31 December 2009		
Cost		3 769
Accumulated amortisation		-3 008
Net book value		761
<b>During 2010</b>		
Additions		146
Derecognised assets		-37
Net change in cost		109
Amortisation charge		-282
Accumulated amortisation on derecognised assets		37
Net change in accumulated amortisation		-245
<b>As at 31 December 2010</b>		
Cost		3 878
Accumulated amortisation		-3 253
<b>Net book value</b>		<b>625</b>

## 18. CONVERTIBLE FOREIGN CURRENCIES

At the end of 2010 convertible foreign currency liabilities mostly consisted of funds on the EC account for settlements in euro, as well as the cash collateral in the amount of 503 thousand lats received by the Bank of Latvia for securing transactions in derivative financial instruments. The EC account is used by the EC for the distribution of EU budgetary funds (see also Note 19).

At the end of 2010 and 2009, convertible foreign currency liabilities consisted of the following items:

	(in thousands of lats)	
	2010	2009
EC demand deposits	13 121	19 006
Other liabilities	561	-
Total	13 682	19 006

### 19. OTHER INTERNATIONAL INSTITUTION DEPOSITS IN LATS

Other international institution deposits in lats mostly 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 18).

At the end of 2010 and 2009, the breakdown of deposits of other international institutions in lats was as follows:

	(in thousands of lats)	
	2010	2009
EC demand deposits	8 258	32 252
Other deposits	247	250
Total	8 505	32 502

### 20. OTHER FOREIGN LIABILITIES

At the end of 2010 and 2009, other foreign liabilities consisted of the following items:

	(in thousands of lats)	
	2010	2009
Non-traded financial derivative contracts and spot exchange rate contracts with foreign financial institutions	19 074	18 826
Accrued expense	245	332
Other	50	48
Total	19 369	19 206

## 21. LATS IN CIRCULATION

At the end of 2010 and 2009, the following units of lats (LVL) and santims (s) were in circulation:

Nominal	Amount		Number		Percentage	
	(in thousands of lats)		(in thousands of units)		(%)	
	2010	2009	2010	2009	2010	2009
<b>Banknotes</b>						
LVL 500	<b>72 549</b>	62 842	<b>145</b>	126	<b>7.7</b>	8.0
LVL 100	<b>118 390</b>	94 337	<b>1 184</b>	943	<b>12.6</b>	12.0
LVL 50	<b>79 637</b>	61 163	<b>1 593</b>	1 223	<b>8.5</b>	7.8
LVL 20	<b>471 147</b>	388 305	<b>23 557</b>	19 415	<b>50.2</b>	49.3
LVL 10	<b>68 574</b>	63 321	<b>6 857</b>	6 332	<b>7.3</b>	8.0
LVL 5	<b>66 273</b>	61 313	<b>13 255</b>	12 263	<b>7.3</b>	7.7
Total banknotes	<b>876 570</b>	731 281	<b>x</b>	x	<b>93.6</b>	92.8
<b>Coins</b>						
LVL 100	<b>405</b>	405	<b>4</b>	4	<b>0</b>	0.1
LVL 10	<b>145</b>	145	<b>15</b>	15	<b>0</b>	0
LVL 2	<b>8 317</b>	7 985	<b>4 159</b>	3 993	<b>0.9</b>	1.0
LVL 1	<b>31 358</b>	27 936	<b>31 359</b>	27 937	<b>3.3</b>	3.5
50 s	<b>7 820</b>	7 677	<b>15 639</b>	15 353	<b>0.8</b>	1.0
20 s	<b>4 481</b>	4 287	<b>22 405</b>	21 435	<b>0.5</b>	0.5
10 s	<b>2 736</b>	2 638	<b>27 362</b>	26 375	<b>0.3</b>	0.3
5 s	<b>2 093</b>	2 018	<b>41 852</b>	40 352	<b>0.2</b>	0.3
2 s	<b>2 268</b>	2 163	<b>113 417</b>	108 159	<b>0.2</b>	0.3
1 s	<b>1 711</b>	1 620	<b>171 138</b>	161 959	<b>0.2</b>	0.2
Total coins	<b>61 334</b>	56 874	<b>x</b>	x	<b>6.4</b>	7.2
Total lats in circulation	<b>937 904</b>	788 155	<b>x</b>	x	<b>100.0</b>	100.0

At the end of 2010 and 2009, 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 (see also principles described in Note 3 under "Gold circulation coins").

As at the end of 2010, collector coins with the total nominal value of 1 528 thousand lats had been issued (1 480 thousand lats at the end of 2009). These coins are not included in the balance sheet caption "Lats in circulation".

## 22. 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 and 7-day deposits (deposit facility) received from them. 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 2010, the overnight deposit facility rate and 7-day deposit facility rate as set by the Bank of Latvia was 0.25% and 0.375% respectively (in 2009, the overnight deposit facility rate was 1.0% whereas no 7-day deposit facility existed at that time).

At the end of 2010 and 2009, balances due to domestic credit institutions consisted of the following items:

	(in thousands of lats)	
	2010	2009
Overnight deposit facility	800	260 020
7-day deposit facility	873 000	–
Current account balances in lats	796 405	835 761
Current account balances in euro	20 025	19 896
<b>Total</b>	<b>1 690 230</b>	<b>1 115 677</b>

### 23. BALANCES DUE TO THE GOVERNMENT

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

At the end of 2010 and 2009, the breakdown of Latvian government deposits was as follows:

	(in thousands of lats)	
	2010	2009
Time deposits in foreign currencies	789 809	1 063 849
Demand deposits in foreign currencies	236 674	197 870
Demand deposits in lats	54 527	30 223
<b>Total</b>	<b>1 081 010</b>	<b>1 291 942</b>

### 24. OTHER DOMESTIC LIABILITIES

At the end of 2010 and 2009, other domestic liabilities consisted of the following items:

	(in thousands of lats)	
	2010	2009
Accrued expense and similar liabilities	1 598	1 689
Accrued interest expense	169	252
Tax liabilities	80	18
Other	408	1 396
<b>Total</b>	<b>2 255</b>	<b>3 355</b>

## 25. TAX

In 2010 and 2009, 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
Claims as at 31 December 2008	0	0	0	0	-209	0	-209
<b>During 2009</b>							
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
<b>During 2010</b>							
Calculated	2 294	2 449	924	91	359	1	6 118
Increase in deferred liabilities	0	24	0	0	0	0	24
Paid	-2 294	-2 473	-924	-91	-297	-1	-6 080
<b>Liabilities as at 31 December 2010</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>80</b>	<b>0</b>	<b>80</b>

In addition to the tax payments indicated herein, the Bank of Latvia transfers 65% of the profit for the reporting year, including the payment for the usage of state capital (48 355 thousand lats in 2010; 34 734 thousand lats in 2009; see also Notes 26 and 36) to the state budget. The Bank of Latvia is not subject to corporate income tax.

## 26. CAPITAL AND RESERVES

In 2010 and 2009, 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 2008	25 000	95 533	68 004	53 437	241 974
<b>During 2009</b>					
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	0
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
<b>During 2010</b>					
Revaluation, realisation, and write-downs	x	x	33 484	x	33 484
Profit appropriated to the state budget	x	x	x	-48 355	-48 355
Profit transferred to the reserve capital	x	26 037	x	-26 037	0
Profit of the reporting year	x	x	x	23 754	23 754
<b>As at 31 December 2010</b>	<b>25 000</b>	<b>140 273</b>	<b>107 613</b>	<b>23 754</b>	<b>296 640</b>

The capital of the Bank of Latvia is comprised of the nominal capital, reserve capital and the balance sheet item "Valuation account", as well as the undistributed profit. The Bank of Latvia does not take decisions affecting the formation of the nominal capital, reserve capital, and the profit distribution as they are provided for by the Law "On the Bank of Latvia". The balance sheet item "Valuation account" comprises the positive result on revaluation of the financial instruments. The accounting policies, harmonised 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) and 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 monetary policy 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 shall be transferred to the state budget. At the end of 2010 and 2009, 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 2010 by the Council of the Bank of Latvia. In 2011, the Bank of Latvia will transfer 15 440 thousand lats from its profit earned in 2010 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 2010 and 2009, changes in the balance sheet caption "Valuation account" were as follows:

	(in thousands of lats)								
	2010	Write-downs	Revaluation	Realisation	2009	Write-downs	Revaluation	Realisation	2008
Initial valuation account	<b>24 093</b>	x	x	-190	24 283	x	x	216	24 067
Deferred result on revaluation of foreign currencies and gold	24 018	x	x	-	24 018	x	x	-	24 018
Deferred result on revaluation of securities	75	x	x	-190	265	x	x	216	49
Result on revaluation of foreign currencies and gold	<b>55 624</b>	1 356	36 680	-3 889	21 477	12	18 812	-1 238	3 891
Result on revaluation of non-traded interest rate swap arrangements	-	-	-	-	-	-	-	-3 263	3 263
Result on revaluation of securities	<b>27 896</b>	11 639	-1 198	-10 914	28 369	5 462	9 095	-22 971	36 783
<b>Total</b>	<b>107 613</b>	12 995	35 482	-14 993	74 129	5 474	27 907	-27 256	68 004

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 2010 is related to the recognition of the net profit from the financial instruments held by the Bank of Latvia at the end of 2006 and disposed of in the reporting year in the amount of 190 thousand lats (net loss in the amount of 216 thousand lats in 2009).

## 27. NET INTEREST INCOME

In 2010, the Bank of Latvia's net interest income amounted to 46 344 thousand lats (65 993 thousand lats in 2009). The income was mainly derived from investing foreign currency reserves. The fall in net interest income was mostly on account of a decrease in loans granted to domestic credit institutions, with the low levels of interest rates in the US and euro area also contributing to it.

In 2010, interest income from foreign operations shrank by 2 190 thousand lats in comparison with 2009, and interest expense contracted by 695 thousand lats year-on-year.

Interest income from domestic operations fell by 23 307 thousand lats in comparison with 2009 as lending to domestic credit institutions contracted.

Interest expense on domestic operations (13 362 thousand lats; 18 515 thousand lats in 2009) was largely comprised of interest on deposits of domestic credit institutions and the Latvian government.

Interest expense on credit institution deposits decreased by 2 755 thousand lats. Although the excess bank liquidity resulted in an increase in the amount of bank deposits, interest expense decreased on account of lower interest rates paid on these deposits.

In 2010 the Bank of Latvia received a larger average amount of Latvian government funds as deposits than in 2009; however, interest paid on these deposits fell, therefore interest expense on government deposits decreased by 2 465 thousand lats.

## 28. REALISED GAINS/LOSSES FROM FINANCIAL OPERATIONS

Realised gains or losses from financial operations comprise the gains and losses from the disposal of securities, gains and losses on derivative financial instruments, as well as realised gains and losses on foreign exchange transactions.

Realised results from financial operations were positively affected by the interest rate fall in the US and euro area in the first half of 2010, increasing profits gained from securities disposal. The Bank of Latvia also realised the positive securities revaluation result of 10 914 thousand lats, accumulated on the valuation account in previous reporting years. Gains from the disposal of foreign securities decreased by 10 470 thousand lats in comparison with 2009 on account of a moderating positive impact of the decline in US and euro area interest rates on the market value of debt securities held by the Bank of Latvia.

The realised gains or losses from financial operations were negatively affected by the negative result on derivative financial instruments, exceeding the result of 2009 by 18 366 thousand lats, mostly on account of currency future contracts concluded for the purpose of hedging currency risk exposure, while the positive

revaluation result of the hedged balance sheet items is reported in the balance sheet caption "Valuation account" in equal value.

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

The revaluation result of several securities and foreign currency positions at the end of 2010 and 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 26).

### 30. INCOME FROM PARTICIPATING INTEREST

Income from participating interest in the amount of 611 thousand lats (221 thousand lats in 2009) comprises the dividends received from the participating interest in the BIS (see also Note 11). The increase in dividends paid in 2010 is related to the BIS decision, in view of the BIS financial performance results, to pay normal dividends as well as supplementary dividends.

### 31. OTHER OPERATING INCOME

Other operating income in 2010 and 2009 was as follows:

	(in thousands of lats)	
	2010	2009
Income from sale of collector coins	702	525
Income from payment and securities settlement services	310	301
Other	266	3 857
<b>Total</b>	<b>1 278</b>	<b>4 683</b>

### 32. BANKNOTE PRODUCTION AND COINAGE COSTS

The breakdown of banknote production and coinage costs in 2010 and 2009 was as follows:

	(in thousands of lats)	
	2010	2009
Banknote production	–	3 322
Coinage of circulation coins	83	842
Coinage of collector coins	458	531
<b>Total</b>	<b>541</b>	<b>4 695</b>

### 33. REMUNERATION AND SOCIAL SECURITY COSTS

Remuneration and social security costs in 2010 and 2009 were as follows:

	(in thousands of lats)	
	2010	2009
Remuneration		
Remuneration of Members of the Council and the Board	873	1 106
Remuneration of other personnel	9 405	11 537
<b>Total remuneration</b>	<b>10 278</b>	<b>12 643</b>
Social security costs	2 449	2 886
<b>Total remuneration and social security costs</b>	<b>12 727</b>	<b>15 529</b>

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 2010 and 2009 was as follows:

	<b>2010</b>	2009
Number of employees at the end of the year		
Members of the Council and the Board	<b>13</b>	14
Other personnel	<b>557</b>	604
Total at the end of the year	<b>570</b>	618
Average number of employees per period	<b>605</b>	634

From July 2010 to February 2011 the position of a Member of the Council of the Bank of Latvia was vacant. A decrease in the number of employees in 2010 is mostly related to the closing down of the Rēzekne Branch as well as other changes in the operational organisation of the Bank of Latvia.

#### **34. OTHER OPERATING EXPENSES**

Other operating expenses in 2010 and 2009 were as follows:

	(in thousands of lats)	
	<b>2010</b>	2009
Municipal services	<b>577</b>	565
Maintenance of buildings, territory and equipment	<b>328</b>	415
Risk insurance	<b>294</b>	291
Disposal of material values	<b>255</b>	3
Business travel	<b>192</b>	235
Telecommunications services and system maintenance	<b>189</b>	228
Information and public relations	<b>180</b>	222
Personnel training	<b>156</b>	240
Transport provision	<b>126</b>	147
Acquisition of low value office supplies	<b>113</b>	197
Tax on real estate	<b>89</b>	91
Audit, advisory and legal services	<b>34</b>	26
Other	<b>232</b>	222
Total	<b>2 765</b>	2 882

An increase in the expenses of disposal of material values in 2010 is mostly related to the closing down of the Rēzekne Branch.

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 2010 financial statements (22 thousand lats in 2009).

### 35. CASH FLOW STATEMENT

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

	(in thousands of lats)	
	<b>2010</b>	2009
Profit before appropriation	<b>23 754</b>	74 393
Non-cash transaction adjustments		
Depreciation of fixed assets and amortisation of intangible assets	3 044	3 373
Losses on disposal of fixed assets	255	3
Write-downs on financial assets and positions	12 995	5 474
Net non-cash transaction adjustments	<b>16 294</b>	8 850
Change in balance sheet items		
Net decrease of gold	1	–
Net increase in Special Drawing Rights	–1 687	–91 050
Net increase in foreign debt securities and other foreign investments	–1 056 008	–300 030
Net decrease in loans to domestic credit institutions	140 449	498 814
Net decrease in other assets	419	3 007
Net decrease in foreign convertible currency liabilities	–5 324	–112 246
Net decrease in foreign bank and other international institution deposits in lats	–23 770	–220 503
Net increase/decrease (–) in lats in circulation	149 749	–229 937
Net increase in deposits of domestic credit institutions	574 553	21 382
Net increase/decrease (–) in Latvian government deposits	–210 932	653 886
Net increase in deposits of other financial institutions	54 790	243
Net decrease in other liabilities	–1 185	–14 031
Net change in balance sheet items	<b>–378 945</b>	209 535
Net cash and cash equivalents inflow/outflow (–) arising from operating activities	<b>–338 897</b>	292 778

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

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

	<b>2010</b>	Change	2009	Change	2008
Convertible foreign currencies in cash	<b>15 713</b>	–3 630	19 343	13 057	6 286
Demand deposits with foreign credit institutions and other foreign financial institutions	<b>531 735</b>	–273 668	805 403	143 662	661 741
Time deposits with foreign credit institutions and other foreign financial institutions with original maturity up to 5 business days	<b>9 202</b>	–110 277	119 479	99 797	19 682
Total cash and cash equivalents	<b>556 650</b>	–387 575	944 225	256 516	687 709

### 36. 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 2010 and 2009 the Bank of Latvia did not perform such transactions). 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 2010 and 2009, 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 (%)	
	2010	2009	2010	2009
Liabilities/claims (–)				
Time deposits in foreign currencies	<b>789 809</b>	1 063 849	<b>0.22–0.57</b>	0.17–0.38
Demand deposits in foreign currencies	<b>236 674</b>	197 870	<b>0.01–0.34</b>	0.00–0.05
Demand deposits in lats	<b>54 527</b>	30 223	<b>0.41</b>	1.18
Accrued interest expense	<b>95</b>	4	<b>x</b>	x
Tax liabilities	<b>80</b>	18	<b>x</b>	x
Spot exchange rate contracts	–	–105	<b>x</b>	x
Total net liabilities	<b>1 081 185</b>	1 291 859	<b>x</b>	x

In 2010 and 2009, 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 of the previous reporting year appropriated to the state budget was as follows (see also Notes 25–27):

	(in thousands of lats)	
	2010	2009
Expense and the Bank of Latvia's profit appropriated to the state budget		
Interest on government deposits	<b>4 127</b>	6 592
Taxes	<b>6 118</b>	6 846
Profit appropriated to the state budget	<b>48 355</b>	34 734
Total expense and the Bank of Latvia's profit appropriated to the state budget	<b>58 600</b>	48 172

### 37. PLEDGED ASSETS

Securities and other financial instruments with the market value of 18 968 thousand lats, as at the end of 2010 (14 905 thousand lats at the end of 2009), have been pledged to provide collateral for interest rate and currency future contracts. These financial instruments are included in the balance sheet asset caption "Convertible foreign currencies".

### 38. SECURITIES LENDING

On behalf of the Bank of Latvia its agents conclude securities lending transactions, as part of an automatic securities lending programme, where Bank of Latvia's securities are lent against cash or other securities collateral. Securities lending transactions provide additional income without any material impact on foreign currency reserve liquidity as the securities lent are readily available to the Bank of Latvia. The Bank of Latvia's agent administers the securities lending programme and monitors the securities lending and related collateral.

At the end of 2010, the fair value of Bank of Latvia's securities lent was 474 421 thousand lats (99 625 thousand lats as at the end of 2009).

At the end of 2010 and 2009, the fair value of collateral provided in securities lending transactions was as follows:

	(in thousands of lats)	
	2010	2009
Foreign currency cash	<b>323 344</b>	95 155
Debt securities of foreign governments, financial institutions and non-financial corporations	<b>158 698</b>	6 521
<b>Total</b>	<b>482 042</b>	101 676

Foreign currency cash or securities provided as collateral in securities lending transactions is not recognised in the Bank of Latvia's balance sheet (see also principles described in Note 3 under "Securities lending").

### 39. OFF-BALANCE SHEET ACCOUNTS

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

At the end of 2010 and 2009, 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	
	2010	2009	2010	2009	2010	2009
<b>Non-traded financial derivative and spot exchange rate contracts with foreign financial institutions</b>						
Forward exchange rate contracts and currency swap arrangements	<b>1 803 979</b>	1 365 021	<b>1 292</b>	4 676	<b>18 542</b>	18 216
Spot exchange rate contracts	<b>54 523</b>	68 664	<b>1 152</b>	–	<b>6</b>	137
<b>Total</b>	<b>x</b>	x	<b>2 444</b>	4 676	<b>18 548</b>	18 353
<b>Traded financial derivative contracts with foreign financial institutions</b>						
Interest rate future contracts	<b>2 336 784</b>	1 307 220	<b>–3 820</b>	–668	<b>1 156</b>	1 971
Currency future contracts	<b>319 217</b>	210 230	<b>1 774</b>	–1 241	<b>–3 220</b>	6 745
<b>Total</b>	<b>x</b>	x	<b>–2 046</b>	–1 909	<b>–2 064</b>	8 716
<b>Non-traded spot exchange rate contracts with domestic institutions</b>						
Spot exchange rate contracts	<b>53 448</b>	14 654	<b>532</b>	147	–	–
<b>Total</b>	<b>x</b>	x	<b>532</b>	147	–	–
<b>Other transactions</b>						
Agreements concluded on a regular way placement and receipt of time deposits	<b>233 331</b>	520 045	<b>x</b>	x	<b>x</b>	x
Forward transactions in securities	<b>202 350</b>	123 547	<b>381</b>	380	<b>526</b>	467
Contracted commitments related to acquisition of fixed assets	<b>4 456</b>	79	<b>x</b>	x	<b>x</b>	x

As at the end of 2010 and 2009, 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 2010 and 2009, 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	
	2010	2009	2010	2009	2010	2009
Non-traded financial derivative contracts with foreign financial institutions and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	-17 388	-13 552	-17 250	-13 540	-138	-12
Spot exchange rate contracts	1 146	-137	1 146	-137	0	0
<b>Total</b>	<b>-16 242</b>	<b>-13 689</b>	<b>-16 104</b>	<b>-13 677</b>	<b>-138</b>	<b>-12</b>
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	-2 664	1 303	-2 664	1 303	0	0
Currency futures contracts	-1 446	5 504	-1 446	5 504	0	0
<b>Total</b>	<b>-4 110</b>	<b>6 807</b>	<b>-4 110</b>	<b>6 807</b>	<b>0</b>	<b>0</b>
Spot exchange rate contracts with domestic credit institutions						
Spot exchange rate contracts	532	147	532	147	0	0
<b>Total</b>	<b>532</b>	<b>147</b>	<b>532</b>	<b>147</b>	<b>0</b>	<b>0</b>

#### 40. 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. On 12 October 2010, the court of first instance ruled as follows: to satisfy the claim against the Bank of Latvia in part, collecting 60 million lats from the Bank of Latvia for the benefit of the JSC *Banka Baltija* undergoing liquidation for the purpose of reimbursing losses, and 32 thousand lats as stamp duty for the benefit of the State. The Bank of Latvia is confident that the claim is without merits; therefore no provision is recognised in the financial statements. The Bank of Latvia has appealed the judgement of the court of first instance, thus it has not taken effect. The final ruling on the case is expected no earlier than in 2012.

The Bank of Latvia has not paid up 96.25% 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 2010, the Bank of Latvia's unpaid share in the ECB subscribed capital was 29 383 thousand euro (20 651 thousand lats; at the end of 2009 – 15 199 thousand euro or 10 682 thousand lats, see also Note 10).

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 2010, the uncalled portion of the BIS share holding was 4 013 thousand SDR (3 291 thousand lats; 4 013 thousand SDR or 3 074 thousand lats at the end of 2009; see also Note 11).

At the end of 2010, the Bank of Latvia had issued collector coins in the nominal value of 1 528 thousand lats (1 480 thousand lats at the end of 2009) and gold circulation coins with a nominal value of 1 988 thousand lats (1 988 thousand lats at the end of 2009). 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.

#### 41. CURRENCY PROFILE

At the end of 2010 and 2009, the currency profile of the Bank of Latvia's assets, liabilities and off-balance sheet accounts was as follows:

	(in thousands of lats)							
	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
<b>As at 31 December 2010</b>								
Assets								
Foreign assets	2 715	101 119	1 311 889	2 200 244	262 317	187 179	9 148	4 074 611
Domestic assets	32 691	–	–	31	–	–	–	32 722
<b>TOTAL ASSETS</b>	<b>35 406</b>	<b>101 119</b>	<b>1 311 889</b>	<b>2 200 275</b>	<b>262 317</b>	<b>187 179</b>	<b>9 148</b>	<b>4 107 333</b>
Liabilities								
Foreign liabilities	28 030	–	1 269	13 215	2	–	40	42 556
Lats in circulation	937 904	–	–	–	–	–	–	937 904
Domestic liabilities	1 783 437	99 356	129 463	798 750	10 792	–	8 435	2 830 233
<b>TOTAL LIABILITIES</b>	<b>2 749 371</b>	<b>99 356</b>	<b>130 732</b>	<b>811 965</b>	<b>10 794</b>	<b>–</b>	<b>8 475</b>	<b>3 810 693</b>
Net position on balance sheet	–2 713 965	1 763	1 181 157	1 388 310	251 523	187 179	673	296 640
Net position on financial instruments' off-balance sheet accounts	53 980	–	–1 185 852	1 552 017	–252 006	–187 400	1 167	–18 094
Net position on balance sheet and off-balance sheet accounts	–2 659 985	1 763	–4 695 294	2 940 327	–483	–221	1 840	278 546
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	–274 <sup>1</sup>	–4 695 293	2 939 577	–483	–221	1 840	2 935 744
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	–0.01	–0.15	100.13	–0.02	–0.01	0.06	100.00
Benchmark currency structure (%)	x	0	0	100.00	0	0	0	100.00
<b>As at 31 December 2009</b>								
<b>TOTAL ASSETS</b>	<b>180 387</b>	<b>93 000</b>	<b>931 603</b>	<b>2 057 175</b>	<b>160 863</b>	<b>134 365</b>	<b>2 911</b>	<b>3 560 304</b>
<b>TOTAL LIABILITIES</b>	<b>1 969 908</b>	<b>91 237</b>	<b>92 856</b>	<b>1 118 161</b>	<b>71</b>	<b>–</b>	<b>313</b>	<b>3 272 546</b>
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	–332 206	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	–332 206	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

<sup>1</sup> Net SDR position on balance sheet and off-balance sheet accounts exposed to currency risk comprises liabilities to the IMF (274 thousand lats) and does not include participating interest in the BIS (1 763 thousand lats).

## 42. 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)							
<b>As at 31 December 2010</b>							
Foreign assets							
Gold	–	–	–	–	–	187 179	187 179
Special Drawing Rights	99 356	–	–	–	–	–	99 356
Convertible foreign currencies	1 753 723	102 874	144 036	904 889	857 959	18 686	3 782 167
Participating interest in the European Central Bank	–	–	–	–	–	750	750
Participating interest in the Bank for International Settlements	–	–	–	–	–	1 763	1 763
Other foreign assets	79	–	–	–	–	3 317	3 396
Domestic assets							
Fixed assets	–	–	–	–	–	31 003	31 003
Other domestic assets	–	–	–	–	–	1 719	1 719
<b>TOTAL ASSETS</b>	<b>1 853 158</b>	<b>102 874</b>	<b>144 036</b>	<b>904 889</b>	<b>857 959</b>	<b>244 417</b>	<b>4 107 333</b>
Foreign liabilities							
Convertible foreign currencies	561	–	–	–	–	13 121	13 682
International Monetary Fund	–	–	–	–	–	274	274
Other international institution deposits in lats	–	–	–	–	–	8 505	8 505
Foreign bank deposits in lats	–	–	–	–	–	726	726
Other foreign liabilities	–	–	–	–	–	19 369	19 369
Lats in circulation	–	–	–	–	–	937 904	937 904
Domestic liabilities							
Balances due to credit institutions	1 670 205	–	–	–	–	20 025	1 690 230
Balances due to the government	979 733	–	–	–	–	101 277	1 081 010
Balances due to other financial institutions	55 960	–	–	–	–	778	56 738
Other domestic liabilities	129	–	–	–	–	2 126	2 255
<b>TOTAL LIABILITIES</b>	<b>2 706 588</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>1 104 105</b>	<b>3 810 693</b>

(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	–853 430	102 874	144 036	904 889	857 959	x	x
Assets on financial instruments' off-balance sheet accounts	3 548 301	–	–	913 397	293 321	x	x
Liabilities on financial instruments' off-balance sheet accounts	3 414 636	–	–	1 072 461	283 494	x	x
Net position on balance sheet and off-balance sheet accounts	–719 765	102 874	144 036	745 825	867 786	x	x
As at 31 December 2009							
TOTAL ASSETS	2 052 710	55 039	98 054	677 366	477 515	199 620	3 560 304
TOTAL LIABILITIES	2 385 405	–	–	–	–	887 141	3 272 546
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

The exposure to aggregate market risk and credit risk of foreign reserves, included in portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark is characterised by the tracking error, which is measured as the expected annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark (see also risk management principles described in Note 2 under "Financial risks"). In 2010 and 2009, the actual (*ex-post*) tracking error of the portfolios managed against multi-currency fixed income securities benchmark was 65 basis points and 55 basis points respectively, whereas the tracking error of the portfolios managed against asset-backed securities benchmark was 81 basis points and 116 basis points respectively.

The expected (*ex-ante*) tracking error lay within the following basis point intervals during the year:

	Book value (at the end of the year; in thousands of lats)	Expected tracking error (number of business days)			
		10–39	40–69	70–99	100–130
<b>During 2010</b>					
Portfolios managed against multi-currency fixed income securities benchmark	2 602 693	–	219	30	–
Portfolios managed against asset-backed securities benchmark	165 090	–	231	18	–
<b>During 2009</b>					
Portfolios managed against multi-currency fixed income securities benchmark	1 762 219	–	181	66	1
Portfolios managed against asset-backed securities benchmark	154 934	5	212	31	–



### 43. LIQUIDITY PROFILE

At the end of 2010 and 2009, the liquidity profile of the Bank of Latvia's assets and liabilities was as follows:

(in thousands of lats)

	2010			2009		
	Up to 3 months	No fixed maturity	Total	Up to 3 months	No fixed maturity	Total
<b>Assets</b>						
Foreign assets	4 071 606	3 005	<b>4 074 611</b>	3 381 667	2 918	3 384 585
Domestic assets	690	32 032	<b>32 722</b>	141 511	34 208	175 719
<b>TOTAL ASSETS</b>	<b>4 072 296</b>	<b>35 037</b>	<b>4 107 333</b>	<b>3 523 178</b>	<b>37 126</b>	<b>3 560 304</b>
<b>Liabilities</b>						
Foreign liabilities	42 522	34	<b>42 556</b>	71 437	32	71 469
Lats in circulation	–	937 904	<b>937 904</b>	–	788 155	788 155
Domestic liabilities	2 830 233	–	<b>2 830 233</b>	2 412 922	–	2 412 922
<b>TOTAL LIABILITIES</b>	<b>2 872 755</b>	<b>937 938</b>	<b>3 810 693</b>	<b>2 484 359</b>	<b>788 187</b>	<b>3 272 546</b>
Net position on balance sheet	1 199 541	–902 901	<b>x</b>	1 038 819	–751 061	<b>x</b>

In the Note, asset items are reported on the basis of the Bank of Latvia's capability to convert them into cash. Liabilities items are reported by their expected settlement date.

### 44. SECTORAL PROFILE OF ASSETS

The sectoral profile of the Bank of Latvia's assets at the end of 2010 and 2009 was as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2010	2009	2010	2009
Foreign central governments and other governmental institutions	<b>1 234 527</b>	1 327 922	<b>30.1</b>	37.3
Foreign local governments	<b>64 268</b>	86 146	<b>1.6</b>	2.4
Foreign central banks and credit institutions	<b>1 809 206</b>	1 480 509	<b>44.0</b>	41.6
Other foreign financial institutions	<b>704 888</b>	376 264	<b>17.2</b>	10.6
Foreign non-financial corporations	<b>65 687</b>	12 427	<b>1.6</b>	0.3
International institutions	<b>196 395</b>	141 194	<b>4.8</b>	4.0
Latvian central government	–	101 110	–	2.8
Domestic credit institutions	<b>584</b>	47	<b>0</b>	0
Unclassified assets	<b>31 778</b>	34 685	<b>0.7</b>	1.0
<b>Total</b>	<b>4 107 333</b>	<b>3 560 304</b>	<b>100.0</b>	<b>100.0</b>

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

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

At the end of 2010 and 2009, 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 (%)	
	2010	2009	2010	2009
Euro area	<b>1 910 391</b>	2 003 361	<b>46.9</b>	59.2
Other EU countries	<b>697 914</b>	324 963	<b>17.1</b>	9.6
US	<b>594 517</b>	588 869	<b>14.6</b>	17.4
Japan	<b>256 361</b>	160 300	<b>6.3</b>	4.7
Other countries and international institutions	<b>615 428</b>	307 092	<b>15.1</b>	9.1
Total	<b>4 074 611</b>	3 384 585	<b>100.0</b>	100.0

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

At the end of 2010 and 2009, 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 (%)	
		2010	2009	2010	2009
<b>FOREIGN ASSETS</b>					
Gold	AAA	<b>187 179</b>	134 365	<b>4.6</b>	3.8
Special Drawing Rights	AAA	<b>99 356</b>	91 237	<b>2.4</b>	2.6
Foreign debt securities	AAA	<b>1 814 171</b>	1 597 094	<b>44.1</b>	44.9
	AA+	<b>78 814</b>	97 909	<b>1.9</b>	2.8
	AA	<b>154 700</b>	37 236	<b>3.8</b>	1.0
	AA-	<b>483 514</b>	183 745	<b>11.8</b>	5.2
	A+	<b>129 596</b>	65 680	<b>3.2</b>	1.8
	A	<b>24 238</b>	3 565	<b>0.6</b>	0.1
	A-	<b>3 646</b>	2 389	<b>0.1</b>	0.1
	BBB+	<b>733</b>	23 966	<b>0</b>	0.7
	BBB	–	445	–	0
	BBB-	–	231	–	0
Deposits with foreign financial institutions	AAA	<b>518 452</b>	758 524	<b>12.7</b>	21.3
	AA+	<b>2 454</b>	487	<b>0.1</b>	0
	AA	<b>59 918</b>	93 001	<b>1.5</b>	2.6
	AA-	<b>133 053</b>	15 805	<b>3.2</b>	0.4
	A+	<b>190 607</b>	177 692	<b>4.6</b>	5.0
	A	<b>144 444</b>	56 310	<b>3.5</b>	1.6
	A-	<b>28 114</b>	17 570	<b>0.7</b>	0.5
Foreign currency in cash	AAA	<b>15 713</b>	19 343	<b>0.4</b>	0.5
Participating interest in the European Central Bank	AAA	<b>750</b>	750	<b>0</b>	0
Participating interest in the Bank for International Settlements	AAA	<b>1 763</b>	1 763	<b>0</b>	0.1
Derivative financial instruments	AAA	<b>385</b>	1 084	<b>0</b>	0
	AA	<b>115</b>	316	<b>0</b>	0
	AA-	<b>470</b>	19	<b>0</b>	0
	A+	<b>1 503</b>	1 567	<b>0</b>	0.1
	A	<b>315</b>	1 521	<b>0</b>	0
	A-	<b>37</b>	549	<b>0</b>	0
Accrued interest income	Different	<b>79</b>	17	<b>0</b>	0
Other foreign assets	Different	<b>492</b>	405	<b>0</b>	0
<b>DOMESTIC ASSETS</b>					
Loans to credit institutions	Different	–	140 449	–	3.9
Other	Different	<b>32 722</b>	35 270	<b>0.8</b>	1.0
<b>TOTAL</b>		<b>4 107 333</b>	3 560 304	<b>100.0</b>	100.0

At the end of 2010 and 2009, 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 (%)	
		2010	2009	2010	2009
Foreign assets	AAA	<b>2 637 769</b>	2 604 160	<b>64.8</b>	76.9
	AA	<b>913 038</b>	428 518	<b>22.4</b>	12.7
	A	<b>522 500</b>	326 843	<b>12.8</b>	9.7
	BBB	<b>733</b>	24 642	<b>0</b>	0.7
	Different	<b>571</b>	422	<b>0</b>	0
<b>Total</b>		<b>4 074 611</b>	3 384 585	<b>100.0</b>	100.0

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

# INDEPENDENT AUDITORS' REPORT

## TO THE COUNCIL OF THE BANK OF LATVIA

We have audited the accompanying financial statements of the Bank of Latvia ("the Bank"), which comprise the balance sheet as at 31 December 2010, and the related statements of profit and loss, total recognised gains and losses and cash flows 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 44.

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

The Board of the Bank 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 Council of the Bank, and the law "On the Bank of Latvia", and for such internal control as the Board of the Bank determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### *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 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 the Board of the Bank, 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 2010, 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 Council of the Bank, and the law "On the Bank of Latvia".

Deloitte Audits Latvia SIA  
Licence No. 43



Inguna Stasa  
Board Member

Riga, Latvia  
14 March 2011

The State Audit Office  
of the Republic of Latvia



Inguna Sudraba  
Auditor General

Riga, Latvia  
14 March 2011