

# **LATVIJAS BANKA**

**FINANCIAL STATEMENTS OF LATVIJAS BANKA  
FOR THE YEAR ENDED 31 DECEMBER 2018**

**INDEPENDENT AUDITORS' REPORT TO THE COUNCIL  
OF LATVIJAS BANKA**

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## ABBREVIATIONS

APP	expanded asset purchase programme
BIS	Bank for International Settlements
EC	European Commission
ECB	European Central Bank
ESCB	European System of Central Banks
EU	European Union
FCMC	Financial and Capital Market Commission
IMF	International Monetary Fund
NCB	national central bank
OECD	Organisation for Economic Co-operation and Development
OTC	over-the-counter
SDR	Special Drawing Rights
ST	solidarity tax
UK	United Kingdom
US	United States of America
PSPP	public sector asset purchase programme

## BALANCE SHEET

		(at the end of the year; in thousands of euro)	
	Note <sup>1</sup>	2018	2017
<b>ASSETS</b>			
Gold and gold receivables	6	<b>239 195</b>	230 856
Claims on non-euro area residents denominated in foreign currency	7	<b>3 566 027</b>	3 608 692
Receivables from the International Monetary Fund		146 833	143 477
Balances with banks and security investments, external loans and other external assets		3 419 194	3 465 215
Claims on euro area residents denominated in foreign currency	8	<b>326 308</b>	355 065
Claims on non-euro area residents denominated in euro	9	<b>101 837</b>	101 333
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10	<b>38 750</b>	244 660
Longer-term refinancing operations		38 750	244 660
Other claims on euro area credit institutions denominated in euro	11	<b>488</b>	438
Securities of euro area residents denominated in euro	12	<b>8 813 038</b>	8 131 197
Securities held for monetary policy purposes		7 423 080	6 719 984
Other securities		1 389 958	1 411 213
Intra-Eurosystem claims	13	<b>4 952 780</b>	4 604 114
Participating interest in the European Central Bank		115 082	115 082
Claims equivalent to the transfer of foreign reserves		163 480	163 480
Other claims within the Eurosystem		4 674 218	4 325 552
Other assets	14	<b>208 724</b>	222 287
<b>TOTAL ASSETS</b>		<b>18 247 147</b>	17 498 642

<sup>1</sup> The accompanying Notes set out on pages 7 to 45 are an integral part of these financial statements.

<i>(continued)</i>	<i>(at the end of the year; in thousands of euro)</i>		
	Note	2018	2017
<b>LIABILITIES</b>			
Banknotes in circulation	15	<b>4 536 729</b>	4 314 088
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	16	<b>5 050 101</b>	5 712 980
Current accounts (covering the minimum reserve system)		5 050 101	5 712 980
Other liabilities to euro area credit institutions denominated in euro	17	<b>13 847</b>	22 610
Liabilities to other euro area residents denominated in euro	18	<b>1 449 237</b>	215 712
General government		129 113	29 516
Other liabilities		1 320 124	186 196
Liabilities to non-euro area residents denominated in euro	19	<b>16 524</b>	2 535
Liabilities to euro area residents denominated in foreign currency	20	<b>150 535</b>	144 324
Liabilities to non-euro area residents denominated in foreign currency	21	<b>115 284</b>	634
Intra-Eurosystem liabilities	13	<b>6 212 645</b>	6 339 683
Liabilities related to TARGET2 and correspondent accounts (net)		6 212 645	6 339 683
Other liabilities	22	<b>251 877</b>	305 552
Capital and reserves	23	<b>450 368</b>	440 524
<b>TOTAL LIABILITIES</b>		<b>18 247 147</b>	17 498 642

## PROFIT AND LOSS STATEMENT

(in thousands of euro)


	Note	2018	2017
Net interest income	33	<b>79 494</b>	71 498
Interest income		180 907	138 189
Interest expense		−101 413	−66 691
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions		<b>−42 387</b>	−28 175
Realised gains or losses arising from financial operations	34	−49 690	33 292
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	−47 903	−18 791
Provisions for market risk and credit risk	36	55 206	−42 676
Net expense from fees and commissions		<b>−2 783</b>	−3 087
Fees and commissions income		644	397
Fees and commissions expense		−3 427	−3 484
Income from equity securities and participating interest	37	<b>6 922</b>	5 258
Net result of pooling of monetary income	38	<b>122</b>	3 651
Other operating income	39	<b>9 270</b>	12 382
<b>NET INCOME</b>		<b>50 638</b>	61 527
Remuneration	40	<b>−17 515</b>	−17 616
Social security costs and solidarity tax	40	<b>−4 031</b>	−3 962
Banknote and coin acquisition costs	41	<b>−2 104</b>	−4 542
Depreciation of fixed assets and amortisation of intangible assets	14	<b>−4 189</b>	−3 750
Other operating expenses	42	<b>−8 233</b>	−7 773
<b>PROFIT OF THE REPORTING YEAR</b>		<b>14 566</b>	23 884

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES


(in thousands of euro)			
	Note	2018	2017
Profit of the reporting year		<b>14 566</b>	23 884
Revaluation	23	<b>-26 962</b>	-18 274
Realisation of the accumulated revaluation result	23	<b>-10 139</b>	-29 576
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	<b>47 903</b>	18 791
Total changes in the valuation account	23	<b>10 802</b>	-29 059
<b>TOTAL</b>		<b>25 368</b>	-5 175

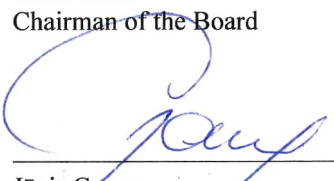
The financial statements, which are set out on pages 3 to 45, were authorised by the Board of Latvijas Banka on 7 March 2019.

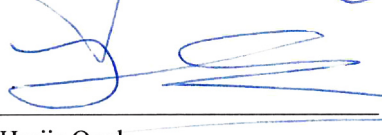
### BOARD OF LATVIJAS BANKA

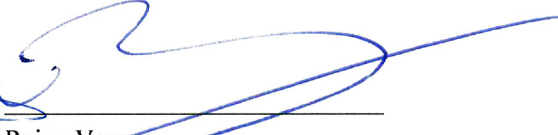
  
Māris Kālis  
Chairman of the Board

  
Ilze Postuma  
Deputy Chairperson of the Board

  
Jānis Blūms  
Member of the Board

  
Jānis Caune  
Member of the Board

  
Harijs Ozols  
Member of the Board

  
Raivo Vanags  
Member of the Board

## NOTES TO THE FINANCIAL STATEMENTS

### 1. PRINCIPAL ACTIVITIES

Latvijas Banka is the central bank of the Republic of Latvia and a member of the ESCB and the Eurosystem. It was established on 19 September 1922 (re-established in 1990). In its activities, Latvijas Banka complies with the Republic of Latvia and EU legislation, inter alia ECB legal acts, in compliance with the Treaty on the Functioning of the European Union and the Statute of the ESCB and of the ECB.

Pursuant to the Law on Latvijas Banka, the primary goal of Latvijas Banka is to maintain price stability. Latvijas Banka has the following primary tasks:

- participate in the formulation and implementation of the Eurosystem's monetary policy;
- manage the foreign reserves and other financial investments;
- ensure cash currency circulation in Latvia and participate in ensuring the cash currency circulation in the euro area;
- participate in promoting smooth functioning of payment systems;
- compile and publish statistical information in order to ensure the performance of the tasks of Latvijas Banka;
- cooperate with the ECB, the central banks of other EU Member States and other countries, as well as other financial institutions;
- operate as the financial agent of Latvia's government and provide financial services to other market participants;
- act as an advisor to the Saeima (Parliament) and Cabinet of Ministers of the Republic of Latvia on monetary policy issues and other issues related to the implementation of the tasks of Latvijas Banka;
- maintain the Credit Register;
- issue licences to legal persons listed in the Register of Enterprises of the Republic of Latvia, except credit institutions, for the purchase and sale of foreign currency as a commercial activity;
- perform the function of the National Analysis Centre and the Coin National Analysis Centre ensuring efficient analysis of currency counterfeits.

Latvijas Banka neither seeks nor takes instructions from the government of Latvia and other EU Member States, EU institutions and other national, foreign or international institutions and their entities. Latvijas Banka is independent in setting and implementing policy under its legal mandate. Latvijas Banka is supervised by the Saeima of the Republic of Latvia.

Latvijas Banka's execution of operating activities is mainly financed from income received from its investment management and monetary policy operations.

The Head Office of Latvijas Banka is situated at K. Valdemāra iela 2A, Riga. Latvijas Banka manages the storage, processing and circulation of cash through its branches in Riga and Liepāja. As a result of improvements in the professional development and training process, Latvijas Banka was able to discontinue the use of its Training Centre and close it in 2018.

### 2. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by Latvijas Banka and applied in the preparation of these financial statements is set out below.

#### 2.1 Basis of preparation

These financial statements have been prepared in accordance with the Guideline of the ECB of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34), Financial Accounting Policy of Latvijas Banka approved by Latvijas Banka's Council, and the requirements of the Law on Latvijas Banka governing financial reporting.

#### 2.2 Basis of measurement

These financial statements have been prepared in accordance with the historical cost basis of accounting. Gold, securities (except held-to-maturity debt securities and securities held for monetary policy purposes that are measured at amortised cost), participating interest (except the participating interest in the ECB), currency future contracts and interest rate derivatives are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 2.15. The comparison of the book value and fair value of these instruments is provided in Note 5.

#### 2.3 Fair value of financial assets and financial liabilities

Fair value is the price at which a financial asset could be sold or financial liability could be transferred in an orderly transaction between market participants at the measurement date.

Fair value of financial instruments is determined by Latvijas Banka 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 measured at fair value as well as of financial instruments that have not been measured at their fair value but whose estimated fair value is different from their book value, taking into account the hierarchy of fair value determination, is provided in Note 5.

## 2.4 Foreign currency and gold translation

For foreign currency translation Latvijas Banka applies foreign exchange rates published by the ECB. The price of gold is set on the basis of the quoted gold market price in US dollars and the exchange rate of the US dollar against the euro published by the ECB. The exchange rate of the SDR is set on the basis of the weights of the SDR basket of currencies published by the IMF and the exchange rates of the respective currencies published by the ECB.

Transactions denominated in foreign currencies are recorded in euro at the respective exchange rates on the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into euro at the exchange rates at the end of the reporting period. Non-monetary assets and liabilities, measured at cost or amortised cost, are translated into euro at the exchange rate for the respective foreign currency on the day of the transaction.

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 foreign currency positions are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve ("Valuation account") in accordance with the principles referred to in Note 2.23. The principles referred to herein and in Note 2.23 for valuation and recording of transactions denominated in foreign currencies are also applied to gold.

The exchange rates of major foreign currencies (currency units per euro) and gold price (euro per troy ounce) in euro used in the preparation of the balance sheet for the year ended 31 December 2018 and the year ended 31 December 2017 are as follows:

		(at the end of the year)	
	2018	2017	Changes (%)
US dollar (USD)	1.1450	1.1993	-4.5
Japanese yen (JPY)	125.85	135.01	-6.8
Canadian dollar (CAD)	1.5605	1.5039	3.8
British pound sterling (GBP)	0.89453	0.88723	0.8
Gold (XAU)	1120.961	1081.881	3.6

## 2.5 Recognition and derecognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised in the balance sheet when Latvijas Banka becomes a contractual party in the respective financial transaction.

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

A regular way purchase or sale of financial assets is recognised and derecognised on the settlement day.

## 2.6 Offsetting financial assets and financial liabilities

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

## 2.7 Use of estimates and assumptions

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 for the reporting year and each year in the future to which it refers.

The major estimates and assumptions in the preparation of the financial statements have been made with respect to the following: impairment of assets (see Note 2.19), the method for establishing the fair value of the BIS shares (see Note 14.2), the exchange probability of those Latvian banknotes and coins that have not been yet exchanged for the euro banknotes and coins (see Note 2.20), the useful life of fixed assets and intangible assets (see Notes 2.17



and 2.18), the repurchasing probability of collector coins (see Note 2.21), provisions for market risk and credit risk (see Notes 2.22 and 36), the breakdown of fair value determination (see Note 5), and the method of recognising a part of the initial valuation account balance in profit and loss statement (see Note 23).

### **2.8 Gold and gold receivables**

Gold is stated at market value in the balance sheet in accordance with the principles described in Note 2.4.

Gold swap arrangements are treated as repurchase agreements (see also Notes 2.11 and 2.15).

Any gain or loss arising from revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve in accordance with the principles described in Note 2.23.

### **2.9 Debt securities**

Debt securities are stated at fair value in the balance sheet, except those held to maturity and securities held for monetary policy purposes, measured at amortised cost. Securities held to maturity are securities with fixed or determinable payments and fixed maturity which Latvijas Banka intends to hold to maturity.

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income (see also Note 2.24).

Gain or loss arising from transactions in debt securities and revaluation of the debt securities stated at fair value are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the securities revaluation reserve in accordance with the principles referred to in Note 2.23.

### **2.10 Reverse repurchase agreements**

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not reported on Latvijas Banka's balance sheet. The related funding provided to the counterparty is reported on Latvijas Banka's balance sheet at nominal value as claims on the seller of the securities.

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

### **2.11 Repurchase agreements**

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

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.

### **2.12 Securities lending**

Securities lent under automated security lending programme agreements are reported on Latvijas Banka's balance sheet along with other securities that are not involved in these transactions. Only cash collateral placed on the account of Latvijas Banka is recognised in the balance sheet.

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

### **2.13 Loans to credit institutions, deposits and similar financial claims and financial liabilities**

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

### **2.14 Equity securities and participating interest**

Equity securities consist of investments in marketable capital instruments made in the course of investment management by Latvijas Banka.

Participating interest includes permanent investments of Latvijas Banka in equity. Latvijas Banka 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 securities and participating interest are reported at fair value in the balance sheet, except participating interest in the ECB, which is reported at cost in the balance sheet in accordance with the ECB's legal framework for accounting and financial reporting.

The change in fair value of participating interest is reported under the balance sheet item "Capital and reserves" as the revaluation reserve.

### **2.15 Derivative financial instruments**

Latvijas Banka enters into commitments involving forward exchange rate contracts, currency, gold 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, except gold swap arrangements that are treated as repurchase agreements and related claims and liabilities are reported on the balance sheet of Latvijas Banka. Forward exchange rate contracts and currency swap arrangements are included in the net position of the respective currency on the transaction day at the spot rate of the transaction and are recorded in the balance sheet in euro at the exchange rate of the respective currency 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 over the term of the agreement. Any gain or loss arising from a change in fair value of interest rate and currency future contracts, as well as OTC interest rate swap arrangements is included in the profit and loss statement taking into account 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 item "Capital and reserves" as the revaluation reserve in accordance with the principles referred to in Note 2.23.

## **2.16 Accrued interest income and expense**

Accrued interest income and expense are reported under balance sheet items of other assets or other liabilities.

## **2.17 Fixed assets**

Fixed assets are tangible long-term investments with the useful life of over one year. Capitalisation limit of fixed assets is 150 euro, except the costs related to real estate improvements and replacement of fixed asset parts for which the Board of Latvijas Banka has set a higher capitalisation limit depending on their significance. Fixed assets are used in the provision of services as well as in the maintenance of other fixed assets and to ensure operation of Latvijas Banka.

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. Buildings and structures are accounted for by separate components, with individual useful life set for each such component.

In 2018, the useful lives set for fixed assets were not changed. In 2018 and 2017, the useful lives set for fixed assets were as follows:

	(years)	
	2018	2017
Buildings and their components, improvements to the territory, incl.	5–100	5–100
structures	100	100
finishing, equipment and engineering communications	5–20	5–20
Transport vehicles	10–15	10–15
Office equipment and tools	5–25	5–25
Cash processing, verifying and storage equipment	5–15	5–15
Computer and telecommunication equipment	2–5	2–5
Other fixed assets	5–15	5–15

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.

## **2.18 Intangible assets**

Intangible assets are long-term investments without physical substance with a useful life of over one year. Capitalisation limit of intangible assets is 150 euro. 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 respective assets using the straight-line method; however, this period may not exceed 10 years.

Costs related to software development by Latvijas Banka are recognised in the profit and loss statement when incurred.

## **2.19 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 impairment allowances for the respective asset are made. Such impairment allowances are recognised in the profit and loss statement with a respective reduction in the asset's carrying amount.

The ECB carries out impairment assessment of securities held for monetary policy purposes, identifying any potential changes in future cash flows and any other factors encumbering the fulfilment of the liabilities by the securities issuer. Assets are impaired when the carrying amount of securities held for monetary policy purposes exceed their recoverable amount. The latter in its turn is defined as the present value of a future cash flow estimate. The ECB Governing Council approves the results of the asset impairment assessment carried out by the ECB.

## **2.20 Currency in circulation**

In view of the fact that euro banknotes are issued by all euro area NCBs and the ECB, they report a certain share of the total amount of euro banknotes issued by the Eurosystem on their balance sheets. The ECB's share is 8% of the total amount of euro banknotes issued by the Eurosystem; the remaining 92% are allocated to the Eurosystem NCBs in proportion to their respective shares in the ECB's capital and reported under the balance sheet item "Banknotes in circulation". Of the total amount of euro banknotes issued by the Eurosystem, the share allocated to Latvijas Banka is larger than the actual net amount of euro banknotes it has issued (see Note 15); consequently, claims on the ECB for the allocation of banknotes are reported under the balance sheet item "Intra-Eurosystem claims".

Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited.

The lats banknotes and coins issued by Latvijas Banka which have not been yet exchanged for the euro banknotes and coins are recognised in the balance sheet as liabilities considering the exchange probability of such lats banknotes and coins within 20 years from the euro changeover. The exchange probability of the lats banknotes and coins is assessed annually on the basis of the actual exchange data of the above banknotes and coins.

Euro coins and the lats banknotes and coins in circulation issued by Latvijas Banka that have been recognised as liabilities by Latvijas Banka, except collector coins (see also Note 2.21), are reported under the balance sheet item "Other liabilities" at nominal value.

## **2.21 Collector coins**

Collector coins sold are not included in the balance sheet as liabilities, as the probability, that the coins will be sold back to Latvijas Banka at their nominal value is low or the value of precious metals of which the coins are made exceeds the nominal value. Proceeds from sales of collector coins are recognised in the profit and loss statement when incurred. The accounting principles established with respect to collector coins are applied to the lats gold circulation coins and collector coins.

## **2.22 Provisions**

Provisions are recognised in the financial statements when Latvijas Banka 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 Latvijas Banka.

In addition, on the basis of reasonable risk estimates and in accordance with the legal framework for accounting and financial reporting in the ESCB, Latvijas Banka's Council decides on making provisions for market risk (price, interest rate and currency risks) and credit risk associated with Latvijas Banka's investment management and other financial transactions (see also Note 36), as well as the use of the provisions should the above risks materialise.

## **2.23 Recognition of gains or losses on financial instruments, foreign currency and gold position**

Gains or losses on financial instruments, foreign currency and gold position are recognised in accordance with the following principles provided by the ECB's legal framework for accounting and financial reporting:

- (a) realised gains and losses shall be recognised in the profit and loss statement;
- (b) unrealised gains shall be recognised in the balance sheet item "Capital and reserves" as the revaluation reserve;
- (c) unrealised losses recognised in the balance sheet item "Capital and reserves" as the revaluation reserve at the end of the reporting year shall be transferred to the profit and loss statement if they exceed the previous revaluation gain on the respective financial instrument, foreign currency or gold position;
- (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 position in the subsequent years;
- (e) there shall be no netting of unrealised losses in a financial instrument, foreign currency or gold position against unrealised gains in other financial instrument, foreign currency or gold position.

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

#### **2.24 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, securities lending, deposits placed, loans granted, forward exchange rate contracts, currency and interest rate swap arrangements, and intra-Eurosystem claims, as well as negative interest on deposits received. 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, credit institutions and other financial institutions, as well as interest on forward exchange rate contracts and currency and interest rate swap arrangements, and intra-Eurosystem liabilities, as well as negative interest on deposits placed.

In the profit and loss statement received negative interest is reported as interest income; paid negative interest is reported as interest expense. Accrued negative interest on balance sheet liabilities is reported under the balance sheet item "Other assets"; accrued negative interest on balance sheet assets is reported under the balance sheet item "Other liabilities".

#### **2.25 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 time of settlement.

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

#### **2.26 Income from equity securities and participating interest**

The change in fair value of equity securities and participating interest is reported under the balance sheet item "Capital and reserves" as the revaluation reserve.

Dividends on equity securities and participating interest are recognised in the profit and loss statement when the right to receive payment is established.

In recognising income from equity securities, the income recognition principles established by the ECB legal framework for accounting and financial reporting are applied to the investment portfolio rather than individual securities where externally managed investments in equity securities replicate the structure of an index-linked equity fund.

Pursuant to the decision of the Governing Council of the ECB, the income gained by the ECB on the claims for the allocation of banknotes within the Eurosystem, and from the Securities Markets Programme, the asset-backed securities purchase programme, the third covered bond purchase programme, as well as from the PSPP shall be distributed as interim profit for the reporting year in which it accrues. The Governing Council of the ECB decides on the interim profit distribution in January of the following year; however, it may resolve not to do so in cases when the ECB's net profit for the reporting year is less than its income included in the ECB's interim profit distribution, as well as in the event the Governing Council decides to establish provisions for market risk and credit risk. In addition, the Governing Council of the ECB may resolve to make deductions from the interim profit distribution result in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes; the deductions may not exceed income on the claims for the allocation of banknotes within the Eurosystem.

Moreover, after the approval of the ECB's Annual Accounts, the Governing Council distributes the remainder of the ECB's annual profit of the reporting year to euro area NCBs in proportion to their shares in the ECB's capital (see Note 13.1).

Income from equity securities and participating interest is reported under the profit and loss statement item "Income from equity securities and participating interest".

#### **2.27 Net result of pooling of monetary income**

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs gain income from the implementation of the single monetary policy of the Eurosystem. Total monetary income of the Eurosystem equals the income on assets arising from the issue of euro banknotes and receiving deposits from credit institutions. The income is allocated to euro area NCBs in proportion to their shares in the capital of the ECB. For the first six years following the joining of the Eurosystem an euro area NCB's monetary income is adjusted in compliance with a definite coefficient to avoid significant euro area NCB income fluctuations (see also Note 33).

The net monetary income pooled by Latvijas Banka includes the income derived from earmarkable assets of Latvijas Banka, reduced by expenses for the monetary liabilities of Latvijas Banka. The earmarkable assets of Latvijas Banka for the allocation of monetary income include gold, assets acquired as a result of monetary policy operations, intra-Eurosystem claims as well as other assets in the amount necessary to fully cover the monetary

liabilities. Monetary liabilities of Latvijas Banka include banknotes in circulation, deposits of credit institutions resulting from monetary policy operations and intra-Eurosystem liabilities.

Latvijas Banka's monetary income received comprises Latvijas Banka's share in the Eurosystem's total monetary income set on the basis of Latvijas Banka's share in the ECB's capital.

### **2.28 Banknote and coin acquisition costs**

Banknote and coin acquisition costs are charged to the profit and loss statement at the time of banknote and coin acquisition.

### **2.29 Other expense and income**

Bank's other operating expense and income are 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.

## **3. SUMMARY OF THE FINANCIAL POSITION AND FINANCIAL PERFORMANCE OF LATVIJAS BANKA**

### **3.1 Financial position**

In 2018, Latvijas Banka's assets grew by 748.5 million euro, mostly due to securities purchases for monetary policy purposes.

In 2018, following the decisions of the Governing Council of the ECB on the PSPP, Latvijas Banka made purchases of securities issued by the Latvian government and international institutions; mostly as a result of the above purchases, the balance of the balance sheet item "Securities held for monetary policy purposes" increased by 703.1 million euro. Euro area NCBs purchased PSPP securities in proportion to their shares in the ECB's capital. In 2018, the amounts of securities purchases were smaller vis-à-vis 2017 as the ECB's Governing Council made a decision to gradually reduce the monthly average pace of security purchases set by the Eurosystem to 30 billion euro from January to September 2018 and to 15 billion euro from October to December. The ECB's Governing Council decided to discontinue net purchases of those securities under the PSPP starting from 2019 and in the future merely reinvest the principal payments from maturing securities.

A decrease in the assets under the balance sheet item "Balances with credit institutions and security investments, external loans and other external assets" and "Claims on euro area residents denominated in foreign currency" basically resulted from revaluation of the above investments due to a rise in interest rates (see also Note 4).

In 2018, the amount of loans granted to credit institutions by Latvijas Banka as a result of monetary policy operations (longer-term refinancing operations) decreased by 205.9 million euro (see also Note 13.4).

Other claims related to other operational requirements within the Eurosystem grew by 348.7 million euro, mostly due to a rise in claims on banknote allocation in the Eurosystem (see also Note 13.4).

In 2018, banknotes in circulation increased by 222.6 million euro, in line with the pickup in the overall amount of banknotes in circulation of the euro area NCBs.

At the end of 2018, credit institution deposits, reported under the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro", decreased by 662.9 million euro. The decrease is mostly related to the reclassification of funds from the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro" to the balance sheet item "Liabilities to other euro area residents denominated in euro".

As a result of cross-border payments, liabilities to the ECB for the settlement result in TARGET2, reported under the balance sheet item "Intra-Eurosystem liabilities", decreased by 127.1 million euro to 6 212.6 million euro (6 339.7 million euro at the end of 2017).

Capital and reserves of Latvijas Banka increased by 9.8 million euro due to net changes in the "Valuation account" balance (10.8 million euro) and the profits earned in 2018 (14.6 million euro), while the share of profits earned in 2017 and remitted to the state budget revenue (15.5 million euro) had a decreasing effect.

### **3.2 Financial performance**

In 2018, Latvijas Banka's profit amounted to 14.6 million euro (23.9 million euro in 2017). Net interest income in 2018 grew by 8.0 million euro as compared to 2017.

42.7 million euro growth in interest income resulted from a 25.5 million euro rise in interest income on investment due to increasing interest rates. Interest income on monetary policy operations grew by 14.1 million euro, basically as a result of PSPP securities purchases in 2018 and an increase in negative interest received on credit institution demand deposits.

An 34.7 million euro increase in interest expense was mostly a result of a rise in interest expense on investment in relation to the transactions carried out by Latvijas Banka for the purpose of hedging currency risk.

The realised result from financial operations was negative (49.7 million euro) in contrast to the positive result of 33.3 million euro a year ago, while the recognition of the negative revaluation result on financial assets and positions in profit and loss statement amounted to 47.9 million euro (18.8 million euro in 2017) due to a rise in interest rates in Latvijas Banka's major investment markets.

In view of the negative realised result from financial operations and the negative revaluation result on financial assets and positions determined by a rise in interest rates in Latvijas Banka's major investment markets, Latvijas Banka used the established provisions for market risk and credit risk in the amount of 55.6 million euro (in 2017 the respective provisions were increased by 42.4 million euro).

Pursuant to the Statute of the ESCB and of the ECB, the income generated by euro area NCBs through the implementation of the single monetary policy of the Eurosystem is allocated to euro area NCBs in proportion to their shares in the ECB's capital. In 2018, Latvijas Banka's net result of pooling of monetary income was 122 thousand euro (3.7 million euro in 2017).

Other operating income (9.3 million euro; 12.4 million euro in 2017) decreased primarily due to a smaller result of remeasurement of liabilities for the issued lats banknotes and coins.

Total recognised financial result, including changes in the "Valuation account" balance, increased by 30.5 million euro on account of a 39.9 million euro increase in the "Valuation account" primarily due to the recognition of the negative result on revaluation of financial instruments in the profit and loss statement, while the profits of the reporting year dropped 9.3 million euro as compared to 2017.

In the future, Latvijas Banka's financial performance will be mostly affected by the monetary policy pursued by the Eurosystem and by interest rate developments in the financial markets of the euro area and US since Latvijas Banka is exposed to interest rate risk.

#### 4. FINANCIAL INVESTMENT POLICY

Investments are managed in compliance with the basic principles set by the Council of Latvijas Banka, inter alia preserving the value of investments, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting the monetary policy implemented by the Eurosystem.

Investments include assets reported under the balance sheet items "Gold and gold receivables", "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Claims on non-euro area residents denominated in euro", "Other claims on euro area credit institutions denominated in euro" and "Other securities", as well as derivative financial instruments and spot exchange rate contracts whose book value is reported under relevant balance sheet items of other assets or other liabilities.

Investments are managed by classifying them into different investment portfolios by investment strategy and source of funding. Portfolios of borrowed funds include investments which correspond to Latvijas Banka's liabilities in foreign currencies to government or government deposits. Investments that are not included in the portfolios of borrowed funds (net investments) are included in the portfolios of 1–10 year fixed income securities, mortgage-backed securities, long-term fixed income securities, equity securities, Latvian government securities, and gold. The equity securities portfolio, part of investments included in the 1–10 year fixed income securities portfolios and mortgage-backed securities portfolios are managed by external investment managers.

The parameters for a benchmark reflecting the acceptable level of financial risks and return are set out for the 1–10 year fixed income securities portfolios, mortgage-backed securities portfolios, portfolios of borrowed funds, and the equity securities portfolio.

The breakdown of investments by type of investment portfolio at the end of 2018 and 2017 was as follows:

	Book value (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
1–10 year fixed income securities portfolios	<b>3 564 297</b>	3 708 630	<b>62.2</b>	63.9
Mortgage-backed securities portfolios	<b>1 131 910</b>	1 158 211	<b>19.8</b>	20.0
Long-term fixed income securities portfolio	<b>502 397</b>	502 820	<b>8.8</b>	8.7
Gold portfolio	<b>239 195</b>	230 856	<b>4.2</b>	4.0
Portfolios of borrowed funds	<b>150 535</b>	144 324	<b>2.6</b>	2.5
Equity securities portfolio	<b>90 618</b>	–	<b>1.6</b>	–
Latvian government securities portfolio	<b>47 847</b>	49 481	<b>0.8</b>	0.9
Total	<b>5 726 799</b>	5 794 322	<b>100.0</b>	100.0

The 1–10 year fixed income securities portfolio benchmark at the end of 2017 was the weighted 1–10 year government securities index of the UK, the US, euro area countries and Canada. In 2018, Latvijas Banka changed the 1–10 year fixed income securities portfolio benchmark. At the end of 2018, the 1–10 year fixed income securities portfolio benchmark comprised the weighted 1–10 year government securities index of the UK and euro area countries, and the 1–3 year government securities index of the US and Canada.

The mortgage-backed securities portfolio benchmark is the US mortgage-backed securities index.

The long-term fixed income securities portfolio comprises euro area government securities denominated in euro, with the original maturity of 10 years.

The gold portfolio comprises the gold of Latvijas Banka.

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

In 2018, Latvijas Banka established an equity securities portfolio. The equity securities portfolio benchmark is the equity securities index covering the developed markets across the world.

Latvian government securities portfolio comprises euro denominated Latvian government bonds with term to maturity of 5–10 years at the time of acquisition.

The benchmark currency of Latvijas Banka's investment portfolios is the euro, except for portfolios of borrowed funds, the equity securities portfolio and the gold portfolio, thus limiting the currency risk. For portfolios of borrowed funds, the benchmark currency structure is formed considering the currency of the respective liabilities.

The description of the main methods used in financial risk management is provided in Note 25.1.

## **BALANCE SHEET NOTES**

### **5. FAIR VALUE MEASUREMENT**

Fair value of Latvijas Banka's assets is determined using the following hierarchy (see also Note 2.3):

- quoted market 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 a model where significant inputs are non-observable.

At the end of 2018 and 2017, Latvijas Banka's assets carried at fair value were generally valued on the basis of a quoted market price.

At the end of 2018 and 2017, participating interest in the BIS was assessed using non-observable data. The assessment was conducted using the 70% net asset value method (see also Note 14.2).

At the end of 2018 and 2017, the breakdown of financial instruments and gold carried at fair value and of the financial instruments whose fair value is different from their book value, according to the fair value hierarchy was as follows:

(in thousands of euro)						
	Book value	Fair value			Total fair value	Difference between fair value and book value
		Quoted market price	Observable data	Non-observable data		
As at 31 December 2017						
Gold	230 856	230 856	–	–	230 856	–
Securities in investment portfolios	5 280 437	4 766 081	517 419	–	5 283 500	3 063
Forward exchange rate contracts	30 907	–	27 971	–	27 971	–2 936
Securities held for monetary policy purposes	6 781 748	6 811 835	–	–	6 811 835	30 087
Participating interest in the Bank for International Settlements	30 414	–	–	30 414	30 414	–
Total	12 354 362	11 808 772	545 390	30 414	12 384 576	30 214
As at 31 December 2018						
Gold	239 195	239 195	–	–	239 195	–
Securities in investment portfolios	5 159 064	4 614 683	544 966	–	5 159 649	585
Forward exchange rate contracts	20 942	–	19 428	–	19 428	–1 514
Interest rate swap arrangements	–378	–378	–	–	–378	–
Securities held for monetary policy purposes	7 486 168	7 481 885	–	–	7 481 885	–4 283
Participating interest in the Bank for International Settlements	31 321	–	–	31 321	31 321	–
Total	12 936 312	12 335 385	564 394	31 321	12 931 100	–5 212

The securities, including accrued income on the above securities are reported under the balance sheet items "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Claims on non-euro area residents denominated in euro", "Securities of euro area residents denominated in euro", "Other assets" and "Other liabilities".

The book value of forward exchange rate contracts is reported under the balance sheet items "Other assets" or "Other liabilities", while the present Note discloses the total net book value.

The average market prices on the last trading day of the reporting year are obtained from the electronic information systems Bloomberg and Interactive Data (quoted market price if the market of the respective financial instrument is active; observable data if the market is inactive). Where the above quoted price for a financial instrument is absent in the electronic information systems and the market for the financial instrument is inactive, the price provided by a market participant or the discounted cash flow is used for evaluating the financial instrument (observable data).



## 6. GOLD AND GOLD RECEIVABLES

	Troy ounces	In thousands of euro
As at 31 December 2016	213 384	234 305
During 2017		
Decrease in gold market value	x	–3 449
As at 31 December 2017	213 384	230 856
<b>During 2018</b>		
Increase in gold market value	x	8 339
<b>As at 31 December 2018</b>	<b>213 384</b>	<b>239 195</b>

The revaluation result of gold is recognised under the balance sheet item "Capital and reserves" as the revaluation reserve.

At the end of 2018, gold in the amount of 117 701 thousand euro (0 at the end of 2017) had been involved in gold swaps arrangements (see also Notes 21 and 44).

At the end of 2018 and 2017, Latvijas Banka had no gold receivables.

## 7. CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

### 7.1 Receivables from the International Monetary Fund

Pursuant to the Law on the Republic of Latvia Joining the International Monetary Fund, Latvijas Banka serves as a depository for the IMF and services the IMF accounts in the member state currency without compensation. The IMF holdings in euro 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 denominated in SDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in euro and IMF allocations. At the end of 2018, the receivables from the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 146 833 thousand euro (143 477 thousand euro at the end of 2017), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 1 025 thousand euro (1 007 thousand euro at the end of 2017) held on its Accounts No. 1 and No. 2 (see also Note 19).

At the end of 2018 and 2017, Latvia's net receivables from the IMF were as follows:

	(in thousands of euro)		(in thousands of SDR)	
	2018	2017	2018	2017
Latvia's quota in the International Monetary Fund	<b>403 877</b>	394 640	<b>332 300</b>	332 300
International Monetary Fund holdings in euro	<b>–403 825</b>	–394 595	<b>–332 257</b>	–332 262
Promissory note of the Latvian government	–402 800	–393 587	–331 414	–331 414
Account No. 1	–1 010	–987	–831	–831
Account No. 2	–15	–21	–12	–17
Reserve position in the International Monetary Fund	<b>67</b>	66	<b>55</b>	55
SDR	<b>146 833</b>	143 477	<b>120 811</b>	120 813
General allocation	<b>–114 245</b>	–111 632	<b>–93 998</b>	–93 998
Special allocation	<b>–32 602</b>	–31 856	<b>–26 824</b>	–26 824
Latvia's net receivables from the International Monetary Fund	<b>53</b>	55	<b>44</b>	46

The reserve position in the IMF is the difference between Latvia's quota in the IMF and the IMF holdings in euro, excluding the balance on Account No. 2.

## **7.2 Balances with credit institutions and security investments, external loans and other external assets**

	(in thousands of euro)	
	2018	2017
Securities	3 320 051	3 395 413
Demand deposits	99 119	51 436
Reverse repurchase agreements	–	18 344
Foreign currency in cash	24	22
Total	3 419 194	3 465 215

## **8. CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**

	(in thousands of euro)	
	2018	2017
Securities	326 081	354 947
Demand deposits	227	118
Total	326 308	355 065

## **9. CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN EURO**

	(in thousands of euro)	
	2018	2017
Securities	98 940	96 414
Demand deposits	2 897	4 919
Total	101 837	101 333

## **10. LENDING TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO**

At the end of 2018, the total amount of Eurosystem loans in monetary policy operations reached 734 382 million euro (764 310 million euro at the end of 2017), including 38.8 million euro (244.7 million euro at the end of 2017) of loans granted by Latvijas Banka. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are allocated among euro area NCBs in proportion to their share in the ECB's capital (see Note 2.27). Losses from Eurosystem lending related to monetary policy operations might only be incurred where the counterparty defaults on its obligations and the funds recovered as a result of the disposal of the collateral provided by the counterparty are not sufficient (see also Note 25.1.2).

### **10.1 Main refinancing operations**

Main refinancing operations are open market operations executed through liquidity providing reverse transactions, conducted through weekly standard tenders with a maturity of one week. These operations play a key role in steering interest rates, managing market liquidity and signalling the monetary policy stance. At the end of 2018 and 2017, Latvijas Banka had granted no loans in main refinancing operations.

### **10.2 Longer-term refinancing operations**

Longer-term refinancing operations are open market operations with a maturity of over 1 week, executed through reverse transactions with the aim to provide credit institutions with additional longer-term refinancing. Following the decision of the Governing Council of the ECB, targeted longer-term refinancing operations were launched in 2014. These liquidity providing reverse operations are conducted by way of a fixed-rate tender procedure aiming to promote lending to households and non-financial corporations by credit institutions in euro area countries. At the end of 2018, the balance of the targeted longer-term refinancing operations conducted by Latvijas Banka stood at 38 750 thousand euro (year of maturity of these operations: 2020; at the end of 2017 the

balance was 244 660 thousand euro), with several credit institutions making an early repayment of the loans granted in the above operations.

In 2018, the interest rate on the previously conducted targeted longer-term refinancing operations was fixed. Pursuant to the decision of the Governing Council of the ECB, the applicable interest rate is set within the range of -0.4% to 0% depending on the compliance of credit institutions with the criteria for the loans they issue. Following the interest rate fixation, the result of interest recalculation for the previous years was reported in the profit and loss statement for 2018.

#### 11. OTHER CLAIMS ON EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

Other claims on euro area credit institutions denominated in euro mostly include Latvijas Banka's demand deposits in euro with euro area credit institutions (488 thousand euro at the end of 2018; 168 thousand euro at the end of 2017). At the end of 2017, Latvijas Banka's pledged assets for providing collateral for transactions in financial derivatives were also reported under this item and their book value and market value amounted to 270 thousand euro.

#### 12. SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

In 2018, Latvijas Banka purchased securities issued by the Latvian government and international institutions under the PSPP; and the balance sheet item "Securities held for monetary policy purposes" grew by 703 096 thousand euro.

At the end of 2018, the amount of securities held by the Eurosystem for monetary policy purposes totalled 2 651 billion euro (2 386 billion euro at the end of 2017). Of them, Latvijas Banka held 7 423 080 thousand euro (6 719 984 thousand euro at the end of 2017). Pursuant to the Statute of the ESCB and of the ECB, any income and losses, if any materialise, are allocated among euro area NCBs in proportion to their share in the ECB's capital, except any risks associated with the purchases of government securities carried out by Latvijas Banka and other euro area NCBs under the PSPP. Of the total amount of securities held by the Eurosystem for monetary policy purposes, at the end of 2018 the amount of government securities purchased by the euro area NCBs under the PSPP totalled 1 681 113 million euro (1 508 842 million euro at the end of 2017); of them, Latvijas Banka held securities in the amount of 1 186 436 thousand euro (982 537 thousand euro at the end of 2017).

The ECB's Governing Council made a decision to increase the monthly amount of security purchases under the APP from 60 billion euro to 80 billion euro from April 2016, and after March 2017 to continue monthly purchases of securities in the amount of 60 billion euro up to December 2017. From January 2018 to December 2018, the monthly average net securities purchases were gradually reduced from 30 billion euro at the beginning of 2018 to 15 billion euro, continuing the respective purchases by the end of 2018.

Securities held for monetary policy purposes and securities held to maturity are measured at amortised cost. The comparison of the book value and fair value of the above securities is represented in Note 5. Other securities are accounted for at fair value.

	(in thousands of euro)	
	Book value	
	2018	2017
Securities held for monetary policy purposes	<b>7 423 080</b>	6 719 984
Latvian government securities	1 186 436	982 537
Debt securities issued by international institutions	6 236 644	5 737 447
Other securities	<b>1 389 958</b>	1 411 213
Securities not held to maturity	887 561	908 393
Securities held to maturity	502 397	502 820
Total	<b>8 813 038</b>	8 131 197

### 13. INTRA-EUROSISTEM CLAIMS/LIABILITIES (–)

		(in thousands of euro)	
	Note	2018	2017
Participating interest in the European Central Bank	13.1	<b>115 082</b>	115 082
Claims in respect of foreign reserves transferred to the European Central Bank	13.2	<b>163 480</b>	163 480
Claims for the allocation of banknotes in the Eurosystem	13.4	<b>4 669 321</b>	4 317 942
Claims related to other operational requirements within the Eurosystem	13.5	<b>4 897</b>	7 610
Total intra-Eurosystem claims		<b>4 952 780</b>	4 604 114
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	13.3	<b>–6 212 645</b>	–6 339 683
Total intra-Eurosystem liabilities		<b>–6 212 645</b>	–6 339 683
Intra-Eurosystem liabilities (net)		<b>–1 259 865</b>	–1 735 569

#### 13.1 Participating interest in the European Central Bank

With Latvia's accession to the EU, Latvijas Banka became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and of the ECB, the weighting assigned to Latvijas Banka in the ECB capital subscription key is calculated on the basis of Latvia's population and gross domestic product data. The weightings assigned to the NCBs in the ECB's capital subscription key are adjusted every five years or at shorter intervals depending on changes in the number of the EU Member State NCBs that contribute to the ECB's capital. Since 1 January 2014 Latvijas Banka's weighting in the ECB's capital key was 0.2821%, equivalent to 30 537 thousand euro; however, on 1 January 2019, the weightings of NCBs in the ECB's capital subscription key were adjusted, therefore Latvijas Banka's weighting in the ECB capital subscription key decreased to 0.2731%, equivalent to 29 563 thousand euro.

The Statute of the ESCB and of the ECB stipulates that a euro area NCB shall pay up its subscribed share in the ECB's capital in full, as well as in the ECB's reserve capital, provisions equivalent to reserves and the valuation account for financial instruments, in proportion to its share in the ECB's capital. As of 1 January 2014, participating interest in the ECB consists of the paid up shares in the amount of 30 537 thousand euro in the ECB's capital, transfers to the financial instrument revaluation account amounting to 42 752 thousand euro and the difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro (see also Note 13.2).

ECB's capital shares are not traded in the public securities market, and Latvijas Banka's participating interest in the ECB can be increased or decreased only in the cases referred to in this Note.

	2018	2017
Total amount of the European Central Bank's subscribed capital (in thousands of euro)	<b>10 825 007</b>	10 825 007
The subscribed and paid-up share of Latvijas Banka in the European Central Bank's capital (in thousands of euro)	<b>30 537</b>	30 537
The percentage share of Latvijas Banka in the European Central Bank's capital (%)	<b>0.2821</b>	0.2821

At the end of 2018 and 2017, the percentage shares of NCBs in the ECB's capital (capital key) were as follows:

	(%)	
	2018	2017
Nationale Bank van België/Banque Nationale de Belgique	2.4778	2.4778
Deutsche Bundesbank	17.9973	17.9973
Eesti Pank	0.1928	0.1928
Banc Ceannais na hÉireann/Central Bank of Ireland	1.1607	1.1607
Bank of Greece	2.0332	2.0332
Banco de España	8.8409	8.8409
Banque de France	14.1792	14.1792
Banca d'Italia	12.3108	12.3108
Central Bank of Cyprus	0.1513	0.1513
Latvijas Banka	0.2821	0.2821
Lietuvos bankas	0.4132	0.4132
Banque centrale du Luxembourg	0.2030	0.2030
Bank Ċentrali ta' Malta/Central Bank of Malta	0.0648	0.0648
De Nederlandsche Bank	4.0035	4.0035
Oesterreichische Nationalbank	1.9631	1.9631
Banco de Portugal	1.7434	1.7434
Banka Slovenije	0.3455	0.3455
Národná banka Slovenska	0.7725	0.7725
Suomen Pankki – Finlands Bank	1.2564	1.2564
Subtotal for euro area NCBs	70.3915	70.3915
Българска народна банка (Bulgarian National Bank)	0.8590	0.8590
Česká národní banka	1.6075	1.6075
Danmarks Nationalbank	1.4873	1.4873
Hrvatska narodna banka	0.6023	0.6023
Magyar Nemzeti Bank	1.3798	1.3798
Narodowy Bank Polski	5.1230	5.1230
Banca Națională a României	2.6024	2.6024
Sveriges Riksbank	2.2729	2.2729
Bank of England	13.6743	13.6743
Subtotal for non-euro area NCBs	29.6085	29.6085
Total	100.0000	100.0000

In 2018, the subscribed and paid-up capital of the ECB remained unchanged.

The subscribed and paid-up NCB shares in the ECB's capital at the end of 2018 and 2017 were as follows:

(in thousands of euro)

	Subscribed capital		Paid-up capital	
	2018	2017	2018	2017
Nationale Bank van België/ Banque Nationale de Belgique	<b>268 222</b>	268 222	<b>268 222</b>	268 222
Deutsche Bundesbank	<b>1 948 209</b>	1 948 209	<b>1 948 209</b>	1 948 209
Eesti Pank	<b>20 871</b>	20 871	<b>20 871</b>	20 871
Banc Ceannais na hÉireann/Central Bank of Ireland	<b>125 646</b>	125 646	<b>125 646</b>	125 646
Bank of Greece	<b>220 094</b>	220 094	<b>220 094</b>	220 094
Banco de España	<b>957 028</b>	957 028	<b>957 028</b>	957 028
Banque de France	<b>1 534 899</b>	1 534 899	<b>1 534 899</b>	1 534 899
Banca d'Italia	<b>1 332 645</b>	1 332 645	<b>1 332 645</b>	1 332 645
Central Bank of Cyprus	<b>16 378</b>	16 378	<b>16 378</b>	16 378
Latvijas Banka	<b>30 537</b>	30 537	<b>30 537</b>	30 537
Lietuvos bankas	<b>44 729</b>	44 729	<b>44 729</b>	44 729
Banque centrale du Luxembourg	<b>21 975</b>	21 975	<b>21 975</b>	21 975
Bank Ċentrali ta' Malta/Central Bank of Malta	<b>7 015</b>	7 015	<b>7 015</b>	7 015
De Nederlandsche Bank	<b>433 379</b>	433 379	<b>433 379</b>	433 379
Oesterreichische Nationalbank	<b>212 506</b>	212 506	<b>212 506</b>	212 506
Banco de Portugal	<b>188 723</b>	188 723	<b>188 723</b>	188 723
Banka Slovenije	<b>37 400</b>	37 400	<b>37 400</b>	37 400
Národná banka Slovenska	<b>83 623</b>	83 623	<b>83 623</b>	83 623
Suomen Pankki – Finlands Bank	<b>136 005</b>	136 005	<b>136 005</b>	136 005
Subtotal for euro area NCBs	<b>7 619 885</b>	7 619 885	<b>7 619 885</b>	7 619 885
Българска народна банка (Bulgarian National Bank)	<b>92 987</b>	92 987	<b>3 487</b>	3 487
Česká národní banka	<b>174 012</b>	174 012	<b>6 525</b>	6 525
Danmarks Nationalbank	<b>161 000</b>	161 000	<b>6 038</b>	6 038
Hrvatska narodna banka	<b>65 199</b>	65 199	<b>2 445</b>	2 445
Magyar Nemzeti Bank	<b>149 363</b>	149 363	<b>5 601</b>	5 601
Narodowy Bank Polski	<b>554 565</b>	554 565	<b>20 796</b>	20 796
Banca Națională a României	<b>281 710</b>	281 710	<b>10 564</b>	10 564
Sveriges Riksbank	<b>246 042</b>	246 042	<b>9 227</b>	9 227
Bank of England	<b>1 480 244</b>	1 480 244	<b>55 509</b>	55 509
Subtotal for non-euro area NCBs	<b>3 205 122</b>	3 205 122	<b>120 192</b>	120 192
Total <sup>2</sup>	<b>10 825 007</b>	10 825 007	<b>7 740 077</b>	7 740 077

### 13.2 Claims equivalent to the transfer of foreign reserves to the European Central Bank

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs shall transfer a definite amount of their foreign reserves to the ECB. The amount of foreign reserves to be transferred shall be fixed in proportion to the

<sup>2</sup> The total amount and the sum of the components may differ due to rounding.

percentage share of each euro area NCB in the ECB's capital. For the foreign reserves transferred to the ECB Latvijas Banka received a euro-denominated claim on the ECB in the amount of 163 480 thousand euro, i.e. in proportion to the value of the respective claims of other euro area NCBs. The difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro is reported as participating interest in the ECB (see also Note 13.1). The interest rate on the main refinancing operations set by the ECB is applied to the claims equivalent to the transfer of foreign reserves to the ECB (see also Note 33).

### **13.3 Claims/liabilities related to TARGET2 and national central bank correspondent accounts (net)**

TARGET2 system is a real-time gross settlement system for large value payments in euro. Claims and liabilities related to TARGET2 settlements originate as a result of cross-border payments settled in the central bank money. The above settlements result in bilateral claims and liabilities in the TARGET2 accounts held by NCBs. The net positions for the bilateral balances are attributed to the ECB and calculated on a daily basis, leaving each NCB with a single net position vis-à-vis the ECB. This is reported on the NCB's balance sheet as net claims or liabilities related to TARGET2 settlements.

In 2018, liabilities related to TARGET2 and national central bank correspondent accounts (net) decreased as a result of the cross-border payments effected by credit institutions and Latvijas Banka.

The interest rate on the main refinancing operations set by the ECB is applied to the above claims and liabilities.

### **13.4 Claims for the allocation of banknotes in the Eurosystem**

In view of the fact that euro banknotes are issued by all euro area NCBs and the ECB, they report a definite share of the total amount of euro banknotes issued by the Eurosystem on their balance sheets. Of the total amount of euro banknotes issued, the share allocated to Latvijas Banka is larger than the net amount of euro banknotes it has actually issued (see Note 15); in view of the above, the adjustment related to banknotes in circulation results in corresponding claims on the ECB for the allocation of banknotes, reported under the balance sheet item "Claims related to other operational requirements within the Eurosystem".

### **13.5 Claims related to other operational requirements within the Eurosystem**

Claims related to other operational requirements within the Eurosystem comprise claims on the ECB associated with the net result of pooling of monetary income and the ECB's interim profit distribution.

Monetary income to be received by Latvijas Banka in 2018 was higher than its monetary income to be pooled. This resulted in a claim on the ECB associated with the net result of pooling of monetary income, standing at 122 thousand euro at the end of 2018 (3 651 thousand euro at the end of 2017; see also Notes 2.27 and 38).

Claims for the ECB's interim profit distribution in the amount of 4 775 thousand euro are set as per Latvijas Banka's percentage share in the ECB's capital (3 959 thousand euro at the end of 2017; see also Notes 2.26 and 37).

## **14. OTHER ASSETS**

		(in thousands of euro)	
	Note	2018	2017
Accrued income on securities		<b>85 690</b>	83 973
OTC financial derivative contracts and spot exchange rate contracts	24	<b>38 999</b>	42 551
Fixed assets	14.1	<b>37 790</b>	39 665
Participating interest in the Bank for International Settlements	14.2	<b>31 321</b>	30 414
Claims on collateral for the use of the instant payment service	17	<b>10 017</b>	20 960
Intangible assets	14.3	<b>2 406</b>	2 363
Other accrued income		<b>1 159</b>	791
Prepaid expenses		<b>704</b>	867
Other		<b>638</b>	703
<b>Total</b>		<b>208 724</b>	222 287

## 14.1 Fixed assets

(in thousands of euro)

	Buildings, improve- ment of territory, and land	Furniture and office equipment	Computer and telecom- munication equipment	Cash processing and storage equipment	Transport vehicles	Other fixed assets	Total
<b>As at 31 December 2016</b>							
Cost	59 306	4 761	5 427	7 033	1 727	7 923	86 177
Accumulated depreciation	-27 682	-3 792	-3 979	-5 125	-1 231	-6 757	-48 566
Net book value	31 624	969	1 448	1 908	496	1 166	37 611
<b>During 2017</b>							
Additions	2 154	1 597	679	175	110	787	5 502
Change in classification	-5	66	-	12	-	-73	-
Disposals and write-offs	-	-66	-171	-134	-85	-234	-690
Net change in cost	2 149	1 597	508	53	25	480	4 812
Depreciation charge	-1 884	-148	-617	-388	-88	-301	-3 426
Change in classification	-	-61	-	-12	-	73	-
Accumulated depreciation on disposals and write-offs	-	51	170	132	82	233	668
Net change in accumulated depreciation	-1 884	-158	-447	-268	-6	5	-2 758
<b>As at 31 December 2017</b>							
Cost	61 455	6 358	5 935	7 086	1 752	8 403	90 989
Accumulated depreciation	-29 566	-3 950	-4 426	-5 393	-1 237	-6 752	-51 324
Net book value	31 889	2 408	1 509	1 693	515	1 651	39 665
<b>During 2018</b>							
Additions	995	95	235	48	771	219	2 363
Disposals and write-offs	-1 101	-138	-1 575	-88	-649	-586	-4 137
Net change in cost	-106	-43	-1 340	-40	122	-367	-1 774
Depreciation charge	-1 961	-269	-619	-375	-118	-347	-3 689
Accumulated depreciation on disposals and write-offs	656	121	1 573	84	594	560	3 588
Net change in accumulated depreciation	-1 305	-148	954	-291	476	213	-101
<b>As at 31 December 2018</b>							
Cost	61 349	6 315	4 595	7 046	1 874	8 036	89 215
Accumulated depreciation	-30 871	-4 098	-3 472	-5 684	-761	-6 539	-51 425
<b>Net book value</b>	<b>30 478</b>	<b>2 217</b>	<b>1 123</b>	<b>1 362</b>	<b>1 113</b>	<b>1 497</b>	<b>37 790</b>

At the end of 2018, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 209 thousand euro (306 thousand euro at the end of 2017).

## 14.2 Participating interest in the Bank for International Settlements

At the end of 2018 and 2017, Latvijas Banka owned 1 070 shares in the BIS, which corresponded to 0.19% of the total subscribed and paid-up BIS capital.



The total nominal value of Latvijas Banka'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% (see also Note 46). At the end of 2018 and 2017, the BIS shareholding is reported in Latvijas Banka's balance sheet at fair value. The shares in the BIS are not traded in the public securities market. In the opinion of Latvijas Banka's management, the most appropriate method for establishing the fair value of the BIS shares is the use of 70% of the BIS net asset value based on the latest published financial statements of the BIS. The BIS applied this valuation method for calculating the issue price of its shares; the International Court at The Hague has also recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. At the end of 2018, the estimated fair value of BIS shares was 31 321 thousand euro (30 414 thousand euro at the end of 2017).

### 14.3 Intangible assets

(in thousands of euro)

<b>As at 31 December 2016</b>	
Cost	6 617
Accumulated amortisation	–4 644
Net book value	1 973
<b>During 2017</b>	
Additions	718
Derecognised intangible assets	–77
Net change in cost	641
Amortisation charge	–324
Accumulated amortisation on derecognised intangible assets	73
Net change in accumulated amortisation	–251
<b>As at 31 December 2017</b>	
Cost	7 258
Accumulated amortisation	–4 895
Net book value	2 363
<b>During 2018</b>	
Additions	543
Derecognised intangible assets	–1
Net change in cost	542
Amortisation charge	–500
Accumulated amortisation on derecognised intangible assets	1
Net change in accumulated amortisation	–499
<b>As at 31 December 2018</b>	
Cost	7 800
Accumulated amortisation	–5 394
<b>Net book value</b>	<b>2 406</b>

## 15. BANKNOTES IN CIRCULATION

	(in thousands of euro)	
	2018	2017
Euro banknotes	4 536 729	4 314 088
Net issuance of euro banknotes by Latvijas Banka	-132 592	-3 854
Adjustment for banknote allocation in the Eurosystem	4 669 321	4 317 942
Total	4 536 729	4 314 088

The euro coins issued by Latvijas Banka are reported under the balance sheet item "Other liabilities" (see also Note 22).

As a result of cross-border flows of euro banknotes, in 2018 the amount of banknotes deposited with Latvijas Banka continued to exceed that of banknotes withdrawn from Latvijas Banka; consequently, the negative net issuance of euro banknotes by Latvijas Banka increased to 132 592 thousand euro. At the end of 2018, the total amount of euro banknotes in circulation in the Eurosystem grew to 1 231 billion euro (1 171 billion euro at the end of 2017); as a result, an increase in the adjustment for banknote allocation in the Eurosystem was reported on the balance sheet of Latvijas Banka.

## 16. LIABILITIES TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

### 16.1 Current accounts (covering the minimum reserve system)

Current accounts contain the credit balances on the transaction accounts of credit institutions that are required to hold minimum reserves. The latest available interest rate used by the Eurosystem in its tenders for main refinancing operations is applied to the balances held on those accounts within the framework of the reserve requirements. Since June 2014, the lower rate of either zero per cent or the ECB's deposit facility rate has been applied to the reserves held in excess of the required minimum reserves. At the end of 2017, balance on the current accounts with Latvijas Banka was 5 050 101 thousand euro (5 712 980 thousand euro at the end of 2017), including the minimum reserves in the amount of 156 079 thousand euro (211 742 thousand euro at the end of 2017).

### 16.2 Deposit facility

Deposit facility is a standing facility of the Eurosystem used by credit institutions to place their overnight deposits at a pre-specified rate. No such deposits were placed with Latvijas Banka at the end of 2018 and 2017.

## 17. OTHER LIABILITIES TO EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

Other liabilities to euro area credit institutions denominated in euro resulted from funds received as collateral for the use of the instant payment service and forward exchange rate contracts accounting for 13 847 thousand euro at the end of 2018 (22 610 thousand euro at the end of 2017). Collateral received from credit institutions for the use of the instant payment service has been transferred to the respective service provider (see also Note 14).

## 18. LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

Liabilities to other euro area residents denominated in euro comprise demand deposits by the Latvian government and other financial institutions. Government deposits comprise the Treasury demand deposits received by Latvijas Banka acting as the financial agent of the Latvian government (see also Note 43).

Deposits of other financial institutions include the funds of the FCMC and the Deposit Guarantee Fund and Fund for the Protection of the Insured, both managed by the FCMC. At the end of 2018, an increase in the deposits of other financial institutions was mostly related to the reclassification of funds from the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro" to the balance sheet item "Liabilities to other euro area residents denominated in euro".

**19. LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO**

	(in thousands of euro)	
	<b>2018</b>	2017
European Commission	<b>11 076</b>	186
Other financial institutions	<b>4 423</b>	1 342
International Monetary Fund	<b>1 025</b>	1 007
Total	<b>16 524</b>	2 535

**20. LIABILITIES TO EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**

Liabilities to euro area residents denominated in foreign currency comprise demand deposits of the Latvian government in foreign currency standing at 150 535 thousand euro at the end of 2018 (144 324 thousand euro at the end of 2017; see also Note 43).

**21. LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**

	(in thousands of euro)	
	<b>2018</b>	2017
Liabilities for gold swap arrangements	<b>114 323</b>	–
Liabilities for collateral for forward exchange rate contracts	<b>961</b>	634
Total	<b>115 284</b>	634

To reduce the costs for hedging currency risks and increase return on financial investments, Latvijas Banka started to engage in gold swap arrangements in 2018 (see also Notes 6 and 24).

**22. OTHER LIABILITIES**

		(in thousands of euro)	
	Note	<b>2018</b>	2017
Provisions for market risk and credit risk	36	<b>123 970</b>	179 176
Euro coins in circulation	22.1	<b>73 513</b>	67 099
Lats banknotes in circulation	22.1	<b>25 798</b>	34 091
OTC financial derivative contracts	24	<b>17 003</b>	11 404
Accrued expense and similar liabilities		<b>6 533</b>	7 408
Lats coins in circulation	22.1	<b>3 116</b>	4 440
Tax liabilities	22.2	<b>66</b>	75
Other		<b>1 878</b>	1 859
Total		<b>251 877</b>	305 552

**22.1 Banknotes and coins in circulation**

Apart from the lats and euro circulation coins issued by Latvijas Banka and recognised on the balance sheet, euro collector coins, lats collector coins and precious metal circulation coins were also in circulation with the total nominal value of 6 878 thousand euro at the end of 2018 (6 703 thousand euro at the end of 2017). The above coins in circulation have not been reported under the balance sheet item "Other liabilities" (see also Note 2.21 and 46).

Issued lats banknotes and coins with low probability of exchange, in the amount of 95 600 thousand euro (lats banknotes in the amount of 35 791 thousand euro and lats coins in the amount of 59 809 thousand euro; 88 400 thousand euro, including lats banknotes in the amount of 29 731 thousand euro and lats coins in the amount of 58 669 thousand euro at the end of 2017) have not been reported as a liability on the balance sheet (see also Note 46).

## 22.2 Tax liabilities

At the end of 2018 and 2017, tax liabilities of Latvijas Banka were as follows:

	(in thousands of euro)						
	Personal income tax	State compul- sory social security contribu- tions and ST (by employer)	State compul- sory social security contribu- tions and ST (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2016	–	–	–	–	159	–	159
During 2017							
Calculated	3 254	3 962	1 764	228	1 379	2	10 589
Decrease in deferred liabilities	–	2	–	–	–	–	2
Paid	–3 254	–3 964	–1 760	–228	–1 467	–2	–10 675
Liabilities as at 31 December 2017	–	–	4	–	71	–	75
<b>During 2018</b>							
Calculated	3 081	4 031	1 844	228	1 326	3	10 513
Decrease in deferred liabilities	–	12	–	–	–	–	12
Paid	–3 081	–4 043	–1 848	–228	–1 332	–2	–10 534
<b>Liabilities as at 31 December 2018</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>65</b>	<b>1</b>	<b>66</b>

In addition to the tax payments indicated herein, in 2018 and 2017 Latvijas Banka transferred to the state budget 65% of the profit for the previous year (15 524 thousand euro in 2018; 7 653 thousand euro in 2017; see also Notes 23 and 43). The transfer includes the payment for the usage of state capital. Latvijas Banka is not subject to corporate income tax.

## 23. CAPITAL AND RESERVES

	(in thousands of euro)				
	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2016	100 000	223 883	117 696	11 773	453 352
During 2017					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	–29 059	x	–29 059
Profit appropriated to the state budget	x	x	x	–7 653	–7 653
Profit transferred to the reserve capital	x	4 120	x	–4 120	–
Profit of the reporting year	x	x	x	23 884	23 884
As at 31 December 2017	100 000	228 003	88 637	23 884	440 524
<b>During 2018</b>					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	10 802	x	10 802
Profit appropriated to the state budget	x	x	x	–15 524	–15 524
Profit transferred to the reserve capital	x	8 360	x	–8 360	–
Profit of the reporting year	x	x	x	14 566	14 566
<b>As at 31 December 2018</b>	<b>100 000</b>	<b>236 363</b>	<b>99 439</b>	<b>14 566</b>	<b>450 368</b>

The capital and reserves of Latvijas Banka comprises the nominal capital, reserve capital and the valuation account, as well as the undistributed profit of the reporting year.

The legal framework does not provide for any capital adequacy requirements for Latvijas Banka; nevertheless, the amount of its capital should be adequate to promote credibility of the monetary policy implemented by Latvijas Banka, and to ensure implementation of its operations and financial independence when performing the tasks set forth by the Statute of the ESCB and of the ECB and the Law on Latvijas Banka. The implementation of the monetary policy as well as exposure to financial and operational risks may adversely affect Latvijas Banka's income or result in losses to be covered from the capital and reserves of Latvijas Banka.

The nominal capital of Latvijas Banka is comprised of the state-allotted resources, transfers from the reserve capital and Latvijas Banka's profit allocations.

The Law on Latvijas Banka establishes that a part of Latvijas Banka'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, as well as that the Council of Latvijas Banka, upon approving the annual report, may make a decision on reducing the percentage share of the payment for the usage of state capital where it is necessary for increasing the reserve capital of Latvijas Banka in relation to the financial risks Latvijas Banka is exposed to when executing its tasks. At the end of 2018 the corporate income tax rate applicable to residents of Latvia was 20% (15% at the end of 2017). Therefore, unless the Council of Latvijas Banka decides otherwise, 70% of Latvijas Banka's profit of the reporting year or 10 196 thousand euro shall be transferred to the state budget within 15 days following the approval of the Annual Report of 2018 by the Council of Latvijas Banka.

Latvijas Banka's profit remaining after making the above deductions shall be transferred to the reserve capital as prescribed by the Law on Latvijas Banka. The reserve capital shall be formed to cover potential losses.

The valuation account comprises the positive result on revaluation of the financial instruments and gold. The accounting policy, harmonised with the principal accounting policies established by the ECB's legal framework for accounting and financial reporting and described in Note 2 stipulates 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 "Capital and reserves" as the revaluation reserve, thus facilitating the preservation of the capital under the impact of financial instrument price, interest rate and exchange rate fluctuations.

In 2018 and 2017, changes in the valuation account were as follows:

	(in thousands of euro)				
	2018	Recognition in Revaluation profit and loss statement	Realisation	2017	
Initial valuation account	2 859	x	x	–5 662	8 521
Revaluation reserve for participating interest	28 812	–	907	–	27 905
Result on revaluation of foreign currencies and gold	45 280	407	12 596	–169	32 446
Result on revaluation of interest rate swap arrangements	–	346	–346	–	–
Result on revaluation of securities	22 488	47 150	–40 119	–4 308	19 765
Total	99 439	47 903	–26 962	–10 139	88 637
	2017	Recognition in Revaluation profit and loss statement	Realisation	2016	
Initial valuation account	8 521	x	x	–8 395	16 916
Revaluation reserve for participating interest	27 905	–	–1 821	–	29 726
Result on revaluation of foreign currencies and gold	32 446	2 862	–5 626	–239	35 449
Result on revaluation of securities	19 765	15 929	–10 827	–20 942	35 605
Total	88 637	18 791	–18 274	–29 576	117 696

In accordance with the ECB's legal framework for accounting and financial reporting, on 1 January 2014 Latvijas Banka reclassified the accumulated result on revaluation of foreign currencies to the initial valuation account. The initial valuation account also comprises the accumulated result on revaluation of financial instruments and gold prior to the change in the accounting policy on 1 January 2007.

The balance on the initial valuation account is recognised in the profit and loss statement to compensate lower remuneration for claims related to the banknote allocation within the Eurosystem as per the coefficients applied in accordance with the decisions of the Governing Council of the ECB for the calculation of the remuneration adjustment for claims related to the banknote allocation within the Eurosystem in the first six years after an NCB joins the Eurosystem (see Note 33). The amount to be recognised in the profit and loss statement for the respective year is calculated by multiplying the balance on the initial valuation account as at 1 January 2014 with the share of the coefficient for calculating the compensation amount for the respective year in the total coefficients (indicated in Note 33) during the transition period when the adjustment amounts for the claims on banknote allocation in the Eurosystem are calculated.

The revaluation reserve for participating interest has been established to account for the result on revaluation of the BIS shares. The result on revaluation of the BIS shares is not recognised in the profit and loss statement.

## 24. DERIVATIVE FINANCIAL INSTRUMENTS AND SPOT EXCHANGE RATE CONTRACTS

Latvijas Banka enters into forward and spot exchange rate contracts, currency and interest rate swap arrangements, forward transactions in securities, and interest rate and currency future contracts in order to manage interest rate and currency risks associated with Latvijas Banka's investments. At the end of 2018 and 2017, the contract or notional amounts and book value of the above transactions were as follows:

	(in thousands of euro)					
	Contract or notional amount		Book value			
			Assets		Liabilities	
	2018	2017	2018	2017	2018	2017
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	4 183 931	4 230 740	35 347	41 165	13 880	10 709
Spot exchange rate contracts	378 896	391 716	–	451	525	–
Forward transactions in securities	881 305	1 223 116	3 500	935	2 068	695
Interest rate swap arrangements	52 838	11 257	152	–	530	–
Total	x	x	38 999	42 551	17 003	11 404
Derivative OTC gold swap arrangements	114 323	–	117 701	–	114 480	–
Traded financial derivative contracts						
Interest rate future contracts	1 938 588	1 030 055	x	x	x	x
Currency future contracts	100 000	100 000	x	x	x	x

The book value of the OTC financial derivative contracts and spot exchange rate contracts is reported under the balance sheet items "Other assets" or "Other liabilities" (see also Notes 14 and 22). Since settlement has been made for the change in the fair value of future contracts, the change is reported as demand deposits under the respective balance sheet asset item.

To reduce the costs for hedging currency risks and increase return on financial investments, Latvijas Banka started to engage in gold swap arrangements in 2018 (see also Notes 6 and 21).

## MAJOR RISKS AND PRINCIPLES FOR THEIR MANAGEMENT

### 25. RISK MANAGEMENT

Financial and operational risks are the main risks associated with the activities of Latvijas Banka. Management of Latvijas Banka's risks is organised and implemented according to the Risk Management Policy of Latvijas Banka approved by the Council of Latvijas Banka.

Risk management at Latvijas Banka is carried out as part of a systemic process identifying, analysing and assessing risks, developing and implementing relevant risk mitigating measures, overseeing and reviewing risks on a regular basis in order to timely identify, assess and efficiently manage risks that are likely to have a negative

effect on the financial position and financial performance of Latvijas Banka as well as Latvijas Banka's capability to perform the tasks provided for in the legislative acts in a quality and efficient manner, inter alia to participate in the implementation of the ESCB functions.

The risk management process is organised in compliance with the international principles of best practice in risk management, in view of the aims and tasks of Latvijas Banka and the external environment developments, as well as complying with the requirements of the ECB.

## **25.1 Financial risks**

Market risk (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks Latvijas Banka is exposed to in its daily activities. Financial risks are managed to mitigate a potential negative impact on Latvijas Banka's financial position and financial performance that might arise from adverse changes in financial market factors or a counterparty default. When managing financial risks, acceptable types of risks and their parameters are taken into consideration to preserve the value of investments ensuring the required liquidity and income earning in the long term.

Latvijas Banka manages financial risks related to its investments in line with the Procedure, adopted by the Council of Latvijas Banka; the basic principles of its investment policy are described in Note 4. Investments are managed by classifying them into different investment portfolios. Parameters for a benchmark reflecting the acceptable level of financial risks and return are set out for each financial instrument portfolio. The Risk Management Division of the Market Operations Department monitors the investment compliance with the established requirements.

For the purpose of investment management, including management of the related financial risks, the Investment Committee of Latvijas Banka develops an investment management strategy, approves tactical decisions and sets detailed limits for financial risks, as well as oversees the operation of the external managers. The Investment Committee of Latvijas Banka reviews the investment strategy once a quarter, and on a weekly basis receives and reviews reports on and forecasts for developments in financial markets, prepared by financial investment portfolio managers, reports by financial risk managers, and approves the investment management tactical decisions for the forthcoming week. The Market Operations Department informs the Council and the Board of Latvijas Banka about the results of investment management on a regular basis.

Latvijas Banka purchases assets under the PSPP in accordance with the decisions of the ECB's Governing Council. Latvijas Banka makes the purchases and manages financial risks in line with the guidelines of the ECB's Governing Council and the procedure adopted by the Board of Latvijas Banka. Financial risks arising as a result of implementing monetary policy are shared among the euro area NCBs in proportion to their shares in the ECB's capital, except risks associated with the purchases of Latvian government securities carried out by Latvijas Banka under the PSPP.

### **25.1.1 Market risk**

Market risk is exposure to losses due to adverse changes in financial markets.

Latvijas Banka is exposed to interest rate risk due to investing in foreign debt securities and interest rate derivatives that are subject to interest rate fluctuations and have been purchased within the course of investment management. Latvijas Banka manages interest rate risk by using a modified duration and deviation limits set individually for each investment portfolio.

Latvijas Banka's exposure to currency risk is determined by its investment structure. Latvijas Banka manages currency risk by establishing that the benchmark currency is the euro, thus hedging the currency risk (except for the gold portfolio as Latvijas Banka discontinued the hedging of the gold price risk in 2017, and the equity securities portfolio where investments are made in the stock denomination currencies of the respective equity securities index), and using tracking error limits in relation to the respective benchmark. Tracking error is calculated as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark. The aggregate market and credit risk of 1–10 year fixed income securities portfolios, and mortgage-backed securities portfolios (see Note 4) is managed by determining the tracking error limit. Tracking error in 2018 and 2017 is disclosed in Note 28.

For investment portfolios, except for portfolios of borrowed funds, the equity securities portfolio, and the gold portfolio, the benchmark currency is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the respective currency. 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, Latvijas Banka hedges the currency risk by using forward exchange rate contracts, currency swap arrangements, and currency future contracts.

The Risk Management Division of the Market Operations Department monitors the compliance of the modified duration, tracking error, and open currency positions with the Procedure adopted by the Council of Latvijas Banka and the related resolutions passed by the Investment Committee of Latvijas Banka.

Latvijas Banka's exposure to market risk (as at the end of 2018 and 2017) is disclosed in Notes 26–28.

### **25.1.2 Credit risk**

Credit risk is exposure to losses resulting from counterparty default. Latvijas Banka's exposure to credit risk results mainly from investments in foreign financial instruments, and as a result of monetary policy operations. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are shared among euro area NCBs in proportion to their share in the ECB's capital, except risks associated with the purchases of Latvian government securities carried out by Latvijas Banka under the PSPP.

Latvijas Banka manages exposure to credit risk related to investments made in foreign financial instruments by establishing limits on investments of different credit quality. Credit quality is evaluated on the basis of ratings assigned by the international credit rating agencies Fitch Ratings, Moody's Investors Service, Standard & Poor's, and DBRS. Latvijas Banka is allowed to invest in financial instruments of certain credit quality of the OECD countries. Limits are also set on the maximum investment in financial instruments of the same class and counterparty, as well as in financial instruments of one issuer. Forward transactions in mortgage-backed securities are partly secured with short-term financial instruments. To hedge the credit risk associated with OTC derivative counterparties, Latvijas Banka and the respective counterparties enter into Master Agreements of International Swaps and Derivatives Association, Inc. (ISDA Master Agreement) with Credit Support Annex, and the external managers of mortgage-backed securities portfolios enter with their counterparties into Treasury Market Practices Group (TMPG) Master Securities Forward Transaction Agreements. In order to monitor Latvijas Banka's credit risk exposure associated with its investments, the Risk Management Division of the Market Operations Department monitors compliance with the Procedure, adopted by the Council of Latvijas Banka.

In 2018 and 2017, loans granted to credit institutions in monetary policy operations were secured by securities collateral in compliance with the ECB requirements. The Market Operations Department monitors the adequacy of collateral of the respective loans and its eligibility and compliance with the ECB's requirements on a regular basis, as well as maintains a list of securities issued and held in the Republic of Latvia and eligible for monetary policy operations.

Latvijas Banka's exposure to market risk (as at the end of 2018 and 2017) is disclosed in Notes 30–32.

### **25.1.3 Liquidity risk**

Liquidity risk is associated with a failure to dispose investment in a short time and at a competitive market price. Along with Latvia's participation in the euro area, the need for liquidity as well as the risk associated with a failure to meet liabilities in a timely manner has moderated. Following its investment strategy, Latvijas Banka manages liquidity risk by investing a certain amount of its investments 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. The liquidity structure of Latvijas Banka's assets and liabilities as at the end of 2018 and 2017 is disclosed in Note 29.

Liquidity risk can be limited by investment diversification. Latvijas Banka 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.

### **25.2 Operational risks**

Operational risks are managed to mitigate a potential negative impact on Latvijas Banka's operation, reputation or financial position or financial performance resulting from inadequate or erroneous execution of Latvijas Banka's processes, acts or omissions on the part of an employee, inadequate operation or unavailability of either the infrastructure of information systems, the information systems, or other infrastructure of Latvijas Banka, or external events..

Latvijas Banka's operational risks are managed subject to a uniform operational risk management framework, with the major operational risks being compliance risks (inter alia in preventing conflict of interests, anti-corruption control, personal data protection, prevention of money laundering and terrorism financing, and ensuring workplace environment protection), risks related to business continuity, physical security, information security and information systems (including cyber security).

Latvijas Banka's operational risks are managed through processes and projects by identifying and assessing risks and, depending on the risk assessment, defining and implementing the most appropriate actions. The management of operational risks in 2018 was organised by the Operational Risk Manager of Latvijas Banka and conducted, on a daily basis, by the structural units of Latvijas Banka, project managers and other employees of Latvijas Banka responsible for the execution of Latvijas Banka's processes. In 2018, the operational risk management was overseen by the Operational Risk Management Committee of Latvijas Banka, appointed by the Board of Latvijas Banka, which ensured coordination of the measures to be carried out under the operational risk management process and provided support to the Board of Latvijas Banka in the area of risk management. As part of further improvement of the risk management process, inter alia for the purpose of concentrating resources allocated for operational risk management, thus developing a more efficient model for managing this process, Operational Risk Management Department is in place as of 1 February 2019.

Compliance risks are managed to ensure compliance of Latvijas Banka's operation with the legislative acts.



Risks related to the business continuity of Latvijas Banka are managed to mitigate a potential negative impact on the execution of critical processes where their discontinuity may cause negative consequences for Latvia's financial system or adversely affect the implementation of Latvijas Banka's tasks, inter alia by ensuring continuity of the critical processes or their recovery as soon as possible and to a full extent in the event of their disruption or failure, as well as efficient incident management.

Risks related to physical security, inter alia risks associated with fire safety and civil protection are managed to mitigate a potential negative impact on the physical security of persons present on the premises of Latvijas Banka, the premises of Latvijas Banka, transportation of its valuables and the events organised by Latvijas Banka.

Risks related to information security are managed to prevent unauthorised disclosure or use of confidential information, classifying it by its degree of confidentiality and ensuring appropriate protection, at the same time taking care that the protective measures do not prevent Latvijas Banka from providing non-classified information to its cooperation partners and general public.

Risks related to information systems, including cyber security risks are managed to prevent a potential negative impact on availability, security and integrity of the information systems and infrastructure of Latvijas Banka. Information systems at Latvijas Banka are classified on the basis of their importance for implementing Latvijas Banka's tasks and the confidentiality, integrity and availability requirements regarding the data to be processed, establishing appropriate physical and logical protection for each level of classification.

In view of the persistently growing cyber security risks, additional security tests were carried out and measures were taken to improve the information system infrastructure and their protection in 2018.

Latvijas Banka ensures risk management training for its employees, inter alia to maintain appropriate level of their know-how and skills, and conducts, on a regular basis, training sessions and tests in risk management for employees.

As part of the framework of operational risk mitigation measures, Latvijas Banka is insured against a possible impact of certain types of operational risks.

In 2018, operational risks, inter alia risks related to ensuring Latvijas Banka's business continuity, information and information systems security, as well as physical security were appropriately managed. The above risks as well as events disclosed in Note 47 did not substantially hamper Latvijas Banka's operation.

## 26. CURRENCY STRUCTURE

(in thousands of euro)

	EUR	USD	CAD	GBP	Gold	Other	Total
<b>As at 31 December 2018</b>							
Total assets	14 145 578	3 063 666	353 345	331 782	239 195	113 581	18 247 147
Total liabilities	18 015 451	192 871	576	12 127	–	26 122	18 247 147
Net position on balance sheet	–3 869 873	2 870 795	352 769	319 655	239 195	87 459	0
Net position on financial instruments' off-balance sheet accounts	3 565 725	–2 807 729	–348 794	–314 702	–	–72 504	21 996
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>–304 148</b>	<b>63 066</b>	<b>3 975</b>	<b>4 953</b>	<b>239 195</b>	<b>14 955</b>	<b>21 996</b>
<b>Net position on balance sheet and off-balance sheet accounts to total assets (%)</b>	<b>–1.6</b>	<b>0.3</b>	<b>0.0</b>	<b>0.0</b>	<b>1.3</b>	<b>0.1</b>	<b>0.1</b>
<b>As at 31 December 2017</b>							
Total assets	13 337 282	3 207 840	365 280	320 727	230 856	36 657	17 498 642
Total liabilities	17 393 027	66 822	246	11 879	–	26 668	17 498 642
Net position on balance sheet	–4 055 745	3 141 018	365 034	308 848	230 856	9 989	0
Net position on financial instruments' off-balance sheet accounts	3 851 322	–3 131 099	–364 533	–306 232	–	–18 311	31 147
Net position on balance sheet and off-balance sheet accounts	–204 423	9 919	501	2 616	230 856	–8 322	31 147
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–1.2	0.1	0.0	0.0	1.3	0.0	0.2

## 27. REPRICING MATURITY

The table below reflects the sensitivity of Latvijas Banka'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 the items sensitive to a change in interest rates reported in this table.

(in thousands of euro)

	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
<b>As at 31 December 2018</b>							
Gold and gold receivables	–	–	–	–	–	239 195	239 195
Claims on non-euro area residents denominated in foreign currency	44 487	103 076	448 148	–	2 645 773	324 543	3 566 027
Claims on euro area residents denominated in foreign currency	5 220	–	90 800	1	228 668	1 619	326 308
Claims on non-euro area residents denominated in euro	–	–	–	–	98 911	2 926	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	–	38 750	–	–	–	38 750
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	488	488
Securities of euro area residents denominated in euro	17 179	114 914	888 757	–	7 792 188	–	8 813 038
Intra-Eurosystem claims	–	–	–	–	–	4 952 780	4 952 780
Other assets	16	1 290	11 976	2	72 432	123 008	208 724
<b>Total assets</b>	<b>66 902</b>	<b>219 280</b>	<b>1 478 431</b>	<b>3</b>	<b>10 837 972</b>	<b>5 644 559</b>	<b>18 247 147</b>
Banknotes in circulation	–	–	–	–	–	4 536 729	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 050 101	–	–	–	–	–	5 050 101
Other liabilities to euro area credit institutions denominated in euro	13 847	–	–	–	–	–	13 847
Liabilities to other euro area residents denominated in euro	1 449 237	–	–	–	–	–	1 449 237
Liabilities to non-euro area residents denominated in euro	15 499	–	–	–	–	1 025	16 524
Liabilities to euro area residents denominated in foreign currency	150 535	–	–	–	–	–	150 535
Liabilities to non-euro area residents denominated in foreign currency	115 284	–	–	–	–	–	115 284
Intra-Eurosystem liabilities	6 212 645	–	–	–	–	–	6 212 645
Other liabilities	157	–	–	–	–	251 720	251 877
Capital and reserves	–	–	–	–	–	450 368	450 368
<b>Total liabilities</b>	<b>13 007 305</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>5 239 842</b>	<b>18 247 147</b>
Net position on balance sheet	–12 940 403	219 280	1 478 431	3	10 837 972	404 717	–
Assets on financial instruments' off- balance sheet accounts	5 449 230	289 956	777 991	10 123	926 481	–	7 453 781
Liabilities on financial instruments' off-balance sheet accounts	6 633 299	–	96 452	297 467	404 567	–	7 431 785
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>–14 124 472</b>	<b>509 236</b>	<b>2 159 970</b>	<b>–287 341</b>	<b>11 359 886</b>	<b>404 717</b>	<b>21 996</b>

*(continued)*

(in thousands of euro)

	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non- interest bearing items	Total
As at 31 December 2017							
Gold and gold receivables	–	–	–	–	–	230 856	230 856
Claims on non-euro area residents denominated in foreign currency	67 100	121 206	68 878	831 120	2 325 453	194 935	3 608 692
Claims on euro area residents denominated in foreign currency	3 326	–	44 883	178 647	128 091	118	355 065
Claims on non-euro area residents denominated in euro	–	–	–	6 011	90 403	4 919	101 333
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	–	–	244 660	–	–	244 660
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	438	438
Securities of euro area residents denominated in euro	–	–	47 224	300 226	7 783 747	–	8 131 197
Intra-Eurosystem claims	–	–	–	–	–	4 604 114	4 604 114
Other assets	3	–	424	5 286	78 056	138 518	222 287
<b>Total assets</b>	<b>70 429</b>	<b>121 206</b>	<b>161 409</b>	<b>1 565 950</b>	<b>10 405 750</b>	<b>5 173 898</b>	<b>17 498 642</b>
Banknotes in circulation	–	–	–	–	–	4 314 088	4 314 088
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 712 980	–	–	–	–	–	5 712 980
Other liabilities to euro area credit institutions denominated in euro	22 610	–	–	–	–	–	22 610
Liabilities to other euro area residents denominated in euro	213 147	–	–	–	–	2 565	215 712
Liabilities to non-euro area residents denominated in euro	1 528	–	–	–	–	1 007	2 535
Liabilities to euro area residents denominated in foreign currency	144 324	–	–	–	–	–	144 324
Liabilities to non-euro area residents denominated in foreign currency	634	–	–	–	–	–	634
Intra-Eurosystem liabilities	6 339 683	–	–	–	–	–	6 339 683
Other liabilities	–	–	–	–	–	305 552	305 552
Capital and reserves	–	–	–	–	–	440 524	440 524
<b>Total liabilities</b>	<b>12 434 906</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>5 063 736</b>	<b>17 498 642</b>
<b>Net position on balance sheet</b>	<b>–12 364 477</b>	<b>121 206</b>	<b>161 409</b>	<b>1 565 950</b>	<b>10 405 750</b>	<b>110 162</b>	<b>–</b>
Assets on financial instruments' off-balance sheet accounts	5 438 300	3 335	168 598	165 842	1 184 268	–	6 960 343
Liabilities on financial instruments' off-balance sheet accounts	6 352 409	2 501	182 468	30 850	360 968	–	6 929 196
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>–13 278 586</b>	<b>122 040</b>	<b>147 539</b>	<b>1 700 942</b>	<b>11 229 050</b>	<b>110 162</b>	<b>31 147</b>

## 28. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in 1–3 year fixed income securities and 1–10 year government fixed income securities portfolios and mortgage-backed securities portfolios 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 the respective benchmark (see also Note 25.1). At the end of 2018 and 2017, the actual (ex-post) tracking error of the 1–10 year fixed income securities portfolios was 30 and 16 basis points respectively. At the end of 2018 and 2017, the actual (ex-post) tracking errors of the mortgage-backed securities portfolios were 61 basis points and 53 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 euro)	Expected tracking error (number of business days)		
		10–39	40–69	70–99
<b>During 2018</b>				
1–10 year fixed income securities portfolios	3 564 297	252	–	–
Mortgage-backed securities portfolios	1 131 910	220	32	–
During 2017				
1–10 year fixed income securities portfolios	3 708 630	253	–	–
Mortgage-backed securities portfolios	1 158 211	13	240	–

## 29. LIQUIDITY STRUCTURE

In the liquidity structure, asset items are reported on the basis of Latvijas Banka's capability to convert them into cash. Liabilities items are reported by their expected settlement date.

	(in thousands of euro)			
	Up to 3 months	Over 3 months	No fixed maturity	Total
<b>As at 31 December 2018</b>				
<b>Assets</b>				
Gold and gold receivables	239 195	–	–	<b>239 195</b>
Claims on non-euro area residents denominated in foreign currency	3 566 027	–	–	<b>3 566 027</b>
Claims on euro area residents denominated in foreign currency	326 308	–	–	<b>326 308</b>
Claims on non-euro area residents denominated in euro	101 837	–	–	<b>101 837</b>
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	38 750	–	<b>38 750</b>
Other claims on euro area credit institutions denominated in euro	488	–	–	<b>488</b>
Securities of euro area residents denominated in euro	8 310 641	502 397	–	<b>8 813 038</b>
Intra-Eurosystem claims	4 897	–	4 947 883	<b>4 952 780</b>
Other assets	135 865	–	72 859	<b>208 724</b>
<b>Total assets</b>	<b>12 685 258</b>	<b>541 147</b>	<b>5 020 742</b>	<b>18 247 147</b>
<b>Liabilities</b>				
Banknotes in circulation	–	–	4 536 729	<b>4 536 729</b>
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 050 101	–	–	<b>5 050 101</b>
Other liabilities to euro area credit institutions denominated in euro	13 847	–	–	<b>13 847</b>
Liabilities to other euro area residents denominated in euro	1 449 237	–	–	<b>1 449 237</b>
Liabilities to non-euro area residents denominated in euro	16 524	–	–	<b>16 524</b>
Liabilities to euro area residents denominated in foreign currency	150 535	–	–	<b>150 535</b>
Liabilities to non-euro area residents denominated in foreign currency	115 284	–	–	<b>115 284</b>
Intra-Eurosystem liabilities	6 212 645	–	–	<b>6 212 645</b>
Other liabilities	149 424	–	102 453	<b>251 877</b>
<b>Total liabilities</b>	<b>13 157 597</b>	<b>–</b>	<b>4 639 182</b>	<b>17 796 779</b>
<b>Net position on balance sheet</b>	<b>–472 339</b>	<b>541 147</b>	<b>381 560</b>	<b>x</b>

*(continued)*

(in thousands of euro)

	Up to 3 months	Over 3 months	No fixed maturity	Total
As at 31 December 2017				
<b>Assets</b>				
Gold and gold receivables	230 856	–	–	230 856
Claims on non-euro area residents denominated in foreign currency	3 608 692	–	–	3 608 692
Claims on euro area residents denominated in foreign currency	355 065	–	–	355 065
Claims on non-euro area residents denominated in euro	101 333	–	–	101 333
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	244 660	–	244 660
Other claims on euro area credit institutions denominated in euro	438	–	–	438
Securities of euro area residents denominated in euro	7 628 377	502 820	–	8 131 197
Intra-Eurosystem claims	7 610	–	4 596 504	4 604 114
Other assets	148 275	–	74 012	222 287
<b>Total assets</b>	<b>12 080 646</b>	<b>747 480</b>	<b>4 670 516</b>	<b>17 498 642</b>
<b>Liabilities</b>				
Banknotes in circulation	–	–	4 314 088	4 314 088
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 712 980	–	–	5 712 980
Other liabilities to euro area credit institutions denominated in euro	22 610	–	–	22 610
Liabilities to other euro area residents denominated in euro	215 712	–	–	215 712
Liabilities to non-euro area residents denominated in euro	2 535	–	–	2 535
Liabilities to euro area residents denominated in foreign currency	144 324	–	–	144 324
Liabilities to non-euro area residents denominated in foreign currency	634	–	–	634
Intra-Eurosystem liabilities	6 339 683	–	–	6 339 683
Other liabilities	199 894	–	105 658	305 552
<b>Total liabilities</b>	<b>12 638 372</b>	<b>–</b>	<b>4 419 746</b>	<b>17 058 118</b>
<b>Net position on balance sheet</b>	<b>–557 726</b>	<b>747 480</b>	<b>250 770</b>	<b>x</b>

### 30. SECTORAL STRUCTURE OF ASSETS

	Amount (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
International institutions	<b>5 240 794</b>	4 661 390	<b>28.7</b>	26.6
European Central Bank	<b>4 952 780</b>	4 604 114	<b>27.1</b>	26.3
Central governments and other governmental institutions	<b>3 864 866</b>	3 872 539	<b>21.2</b>	22.1
Other financial institutions	<b>3 147 598</b>	3 100 377	<b>17.2</b>	17.7
Central banks and credit institutions	<b>732 836</b>	985 722	<b>4.0</b>	5.6
Local governments	<b>168 883</b>	165 704	<b>0.9</b>	0.9
Non-financial corporations	<b>88 566</b>	42 895	<b>0.5</b>	0.2
Unclassified assets	<b>50 824</b>	65 901	<b>0.4</b>	0.6
Total	<b>18 247 147</b>	17 498 642	<b>100.0</b>	100.0

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

	Amount (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
International institutions	<b>5 240 794</b>	4 661 390	<b>28.7</b>	26.6
European Central Bank	<b>4 952 780</b>	4 604 114	<b>27.1</b>	26.3
Euro area countries	<b>4 397 379</b>	4 506 818	<b>24.1</b>	25.8
US	<b>1 914 927</b>	2 005 183	<b>10.5</b>	11.5
UK	<b>600 132</b>	625 523	<b>3.3</b>	3.6
Canada	<b>569 508</b>	585 857	<b>3.1</b>	3.3
Other European Union countries	<b>174 396</b>	160 235	<b>1.0</b>	0.9
Japan	<b>118 417</b>	73 199	<b>0.6</b>	0.4
Other countries	<b>278 814</b>	276 323	<b>1.6</b>	1.6
Total	<b>18 247 147</b>	17 498 642	<b>100.0</b>	100.0

### 32. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Amount (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
European Central Bank	<b>4 952 780</b>	4 604 114	<b>27.1</b>	26.3
AAA	<b>6 822 777</b>	6 261 804	<b>37.4</b>	35.8
AA	<b>4 044 179</b>	4 171 968	<b>22.2</b>	23.8
A	<b>1 919 038</b>	1 446 160	<b>10.5</b>	8.3
BBB	<b>399 965</b>	704 458	<b>2.2</b>	4.0
Assets not exposed to credit risk and assets without counterparty credit rating	<b>108 408</b>	310 138	<b>0.6</b>	1.8
Total	<b>18 247 147</b>	17 498 642	<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 table show the breakdown of Latvijas Banka'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. "BBB" is a medium grade considered to be the lowest level of investment-grade rating.

Assets not exposed to credit risk and assets without counterparty credit rating mostly comprise securities purchased in longer-term refinancing operations with Latvian credit institutions (38 750 thousand euro; 244 660 thousand euro at the end of 2017) and fixed assets (37 790 thousand euro; 39 665 thousand euro at the end of 2017).

## PROFIT AND LOSS STATEMENT NOTES

### 33. NET INTEREST INCOME

	(in thousands of euro)	
	2018	2017
Interest income	<b>180 907</b>	138 189
Interest on investments	116 817	91 353
Interest on customer deposits	4 077	881
Interest on monetary policy operations	60 013	45 955
Interest expense	<b>–101 413</b>	–66 691
Interest on investments	–98 771	–64 404
Interest on monetary policy operations	–2 642	–2 287
Net interest income	<b>79 494</b>	71 498

Net interest income was mainly derived from debt securities. In 2018, net interest income increased by 7 996 thousand euro in comparison with 2017. Positive contribution mostly resulted from higher interest rates on investment and an increase in the amount of monetary policy operations, while a negative impact resulted from higher interest expense on investment, mainly due to a rise in the costs for hedging currency risks resulting from the widening of the spread between the interest rates of the euro and other investment currencies of Latvijas Banka.

Interest income from and interest expense on the intra-Eurosystem claims and liabilities are remunerated by applying the ECB's interest rate on the main refinancing operations and include income from foreign reserves transferred to the ECB and claims on allocation of banknotes in the Eurosystem, as well as expense on liabilities related to TARGET2 settlements. The interest rate on the main refinancing operations set by the ECB was 0% in 2018 and 2017, therefore Latvijas Banka had neither such interest income nor interest expense.

According to the ECB Governing Council's decision on the allocation of monetary income for first six years following the euro changeover the remunerable part of euro area NCBs of the claims on banknote allocation in the Eurosystem is reduced in compliance with a definite coefficient to avoid significant income fluctuations of these NCBs. The adjustment of the reduction of the remunerable part of Latvijas Banka's claims on banknote allocation in the Eurosystem in the course of the six years is as follows:

Reporting year	Coefficient (%)
2014	100.00000
2015	86.06735
2016	70.13472
2017	53.34835
2018	35.98237
2019	18.17225

In 2018, interest income on monetary policy operations increased due to the implementation of the PSPP and higher interest income received on credit institution's demand deposits.



The application of the interest on deposits is stipulated in the Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU).

### 34. REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	(in thousands of euro)	
	2018	2017
Derivative financial instruments	–36 668	8 753
Debt securities	–25 306	15 073
Foreign exchange transactions	12 284	9 466
Total	–49 690	33 292

The result on derivative financial instruments posted a decrease of 45 421 thousand euro in comparison with 2017, mostly due to the result of interest rate future contracts, negatively affected by interest rate changes, as well as the result of currency future contracts concluded for the purpose of hedging currency risks. The positive result of the currency future contracts concluded for the purpose of hedging currency risk exposure is offset in equal value by the negative revaluation result of the balance sheet items hedged for foreign currency risk.

The result on the disposal of debt securities decreased by 40 379 thousand euro in comparison with 2017, mostly due to a rise in interest rates.

In 2018 and 2017, the realised gains on foreign exchange transactions resulted from the recognition of a part of the initial valuation account balance in profit and loss statement (see also Note 23), as well as the appreciation of the US dollar vis-à-vis the euro in 2018.

### 35. RECOGNITION OF REVALUATION RESULT ON FINANCIAL ASSETS AND POSITIONS IN PROFIT AND LOSS STATEMENT

	(in thousands of euro)	
	2018	2017
Securities	–47 150	–15 929
Foreign currency positions	–407	–2 862
Interest rate swap arrangements	–346	–
Total	–47 903	–18 791

The revaluation result of several debt securities, foreign currency positions, and interest rate swap arrangements at the end of 2018 and 2017 was negative, and it has been recognised in the profit and loss statement. At the end of 2018, the total revaluation result on the equity securities portfolio was negative, and this was recognised in the profit and loss statement, while the positive result on the revaluation of debt securities, foreign currency positions, and interest rate swap arrangements has been reported under the balance sheet item "Capital and reserves" as the revaluation reserve of securities, foreign currency, and interest rate swap arrangements (see also Note 23).

The increase in the negative result on revaluation of debt securities is related to a rise in interest rates in Latvijas Banka's major investment markets in 2018.

### 36. PROVISIONS FOR MARKET RISK AND CREDIT RISK

Financial risks of Latvijas Banka relate primarily to its investments in financial instruments, as well as the implementation of the single monetary policy operations associated with Latvijas Banka's participation in the Eurosystem and sharing of the related risks and financial results. Latvijas Banka's financial assets are mostly exposed to market risk and credit risk.

The financial risks for the gold portfolio, long-term fixed income securities portfolio and equity securities portfolio have been assessed in compliance with the ECB's common methodology for Eurosystem financial risk assessment using the Expected Shortfall (ES) measure with confidence level of 99% for a risk horizon of one year. ES99% describes the losses determined by the average value of 1% of the most unfavourable simulated profitability scenarios. The above methodology takes account of various market risk and credit risk factors as well as uses historical data and assumptions of the Eurosystem/ESCB's Risk Management Committee. ES99% includes assumptions concerning development of adverse financial market factors, e.g. interest rate rise, widening of the interest rate spreads, euro appreciation, and credit rating downgrades. Meanwhile, for the other portfolios financial risks have been assessed according to the change in the investment portfolio value if the interest rates rise by

100 basis points. According to the above methodology, the targeted amount of provisions for market risk and credit risk in 2018 was 190 000 thousand euro (220 000 thousand euro in 2017). In 2018, the decrease in the targeted amount of provisions for market risk and credit risk resulted from changes in the structure of Latvijas Banka's investment portfolios, mostly due to a decrease in the modified duration of the benchmark portfolios. Review of the targeted amount of provisions takes place on an annual basis taking into account the level of financial risks, the available financial reserves and long-term prospects of the financial market development.

Provisions for market risk and credit risk are established during a longer time period in the amount of 25%–75% of the positive total financial performance result included in the profit and loss statement of the reporting year before establishment of provisions for financial risks, not exceeding the targeted amount of provisions for financial risks. Provisions for market risk and credit risk are used, if the financial risks materialise and their negative result is not covered by other income or the balance of the provisions considerably exceed the targeted amount of the provisions.

In 2018, due to the substantial rise in interest rates in Latvijas Banka's major investment markets, the revaluation result on debt securities to be recognised in the profit and loss statement at the end of the year, as well as the realised result of interest rate future contracts were negative; therefore, in 2018 the Council of Latvijas Banka decided to use the provisions for market risk and credit risk related to the financial investments managed by Latvijas Banka, reducing the total amount by 55 576 thousand euro (in 2017 the respective provisions were increased by 42 400 thousand euro). In addition to the above, provisions for credit risk, associated with the Eurosystem monetary policy operations, in the amount of 370 thousand euro were established (276 thousand euro in 2017); as a result, the total outstanding amount of provisions reached 123 970 thousand euro at the end of 2018 (179 176 thousand euro at the end of 2017).

### 37. INCOME FROM EQUITY SECURITIES AND PARTICIPATING INTEREST

Income from participating interest comprises dividends received from the participating interest in the BIS in the amount of 305 thousand euro (390 thousand euro in 2017; see also Note 14.2) and income from the ECB's interim profit distribution for the reporting year and the remainder of the ECB's annual profit of the previous year in the amount of 5 925 thousand euro (4 868 thousand euro in 2017, see also Note 2.26).

Income from equity securities comprises the accrued and received dividends of the equity securities portfolio in the amount of 692 thousand euro (0 in 2017).

### 38. NET RESULT OF POOLING OF MONETARY INCOME

	(in thousands of euro)	
	2018	2017
Monetary income pooled	–50 208	–39 575
Monetary income received	50 330	43 226
Net result of pooling of monetary income	122	3 651

The monetary income pooled and received grew mainly due to an increase in the amount of securities purchased under the PSPP.

### 39. OTHER OPERATING INCOME

	(in thousands of euro)	
	2018	2017
Revaluation of liabilities for the issued lats banknotes and coins	7 200	10 300
Income from sale of collector coins	1 329	1 536
Other	741	546
Total	9 270	12 382

As a result of revaluation of liabilities for the issued lats banknotes and coins, income increased as the lats banknotes and coins, whose exchange probability is low, are not reported on the balance sheet pursuant to the "Financial Accounting Policy of Latvijas Banka" (see also Note 2.20). Revaluation of liabilities for the issued lats banknotes and coins is performed on an annual basis, taking into account the latest data on the exchange of lats banknotes and coins to euro banknotes and coins. In 2018, with the pace of exchange of the lats banknotes and coins moderating, the valuation of liabilities for the issued lats banknotes and coins decreased considerably (see also Note 22.1).

**40. REMUNERATION, SOCIAL SECURITY COSTS, AND SOLIDARITY TAX**

(in thousands of euro)

	<b>2018</b>	<b>2017</b>
Remuneration		
Remuneration for performance of duties of the Council and the Board	<b>-880</b>	-955
Remuneration of other personnel	<b>-16 635</b>	-16 661
Total remuneration	<b>-17 515</b>	-17 616
Social security costs and solidarity tax	<b>-4 031</b>	-3 962
Total remuneration, social security costs, and solidarity tax	<b>-21 546</b>	-21 578

At the end of 2018, the number of employees was 498 (528 at the end of 2017), representing 496 full-time equivalents in 2018 (511 in 2017).

**41. BANKNOTE AND COIN ACQUISITION COSTS**

(in thousands of euro)

	<b>2018</b>	<b>2017</b>
Acquisition of banknotes	<b>-1 271</b>	-3 148
Acquisition of collector coins	<b>-752</b>	-1 159
Acquisition of circulation coins	<b>-81</b>	-235
Total	<b>-2 104</b>	-4 542

**42. OTHER OPERATING EXPENSES**

(in thousands of euro)

	<b>2018</b>	<b>2017</b>
Maintenance and operation of information systems	<b>-3 773</b>	-3 404
Municipal services	<b>-830</b>	-837
Maintenance of buildings, territory and equipment	<b>-615</b>	-614
Disposal of material values	<b>-529</b>	-4
Business travel	<b>-440</b>	-516
Information and public relations	<b>-319</b>	-410
Personnel training	<b>-256</b>	-285
Telecommunication services and system maintenance	<b>-243</b>	-288
Tax on real estate	<b>-228</b>	-228
Acquisition of low value office supplies	<b>-173</b>	-322
Event services	<b>-170</b>	-102
Risk insurance	<b>-151</b>	-189
Transport provision	<b>-80</b>	-106
Other	<b>-426</b>	-468
Total	<b>-8 233</b>	-7 773

Other expenses also comprise the remuneration in the amount of 29 thousand euro paid to KPMG Baltics SIA for the audit of 2018 financial statements of Latvijas Banka (29 thousand euro in 2017). Expenses on disposal of material values comprise 484 thousand euro for transferring Latvijas Banka's real estate in the possession of the Ministry of Finance without any compensation due to closing the Training Centre of Latvijas Banka in 2018.

## OTHER NOTES

### 43. TRANSACTIONS WITH THE LATVIAN GOVERNMENT

Latvijas Banka, whose capital is wholly owned by the Republic of Latvia, carries out transactions with the Treasury, acting as the financial agent of the Latvian government. Performing this function, Latvijas Banka services the Treasury's accounts in euro and foreign currencies. Latvijas Banka is independent in making its own decisions on entering into the above transactions. The Treasury demand deposits are recorded under the balance sheet items "Liabilities to other euro area residents denominated in euro" and "Liabilities to euro area residents denominated in foreign currency".

The interest rates and foreign exchange rates used in the transactions with the Latvian government are market-based according to the ECB's decisions. No commission fees are applied to transactions with the Latvian government.

Pursuant to Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU), Latvijas Banka applies the euro overnight index average (EONIA) rate (it was negative at the end of both 2018 and 2017 (–0.356% and –0.346% respectively) to the amount of the Treasury's deposits in euro up to 200 million euro. As regards the total outstanding amount of the Treasury's settlement accounts in euro and foreign currencies exceeding 200 million euro, Latvijas Banka applies the deposit facility rate set by the ECB (it was negative at the end of both 2018 and 2017 – –0.40%).

At the end of 2018 and 2017, the breakdown of Latvijas Banka's claims and liabilities to the Latvian government were as follows:

	(in thousands of euro)	
	2018	2017
Claims		
Securities held for monetary policy purposes	1 186 436	982 537
Other securities	46 990	48 629
Accrued interest on debt securities	13 220	13 984
Total claims	1 246 646	1 045 150
Liabilities		
Demand deposits in euro	129 113	29 516
Demand deposits in foreign currencies	150 535	144 324
Tax liabilities	66	75
Total liabilities	279 714	173 915

In 2018 and 2017, the breakdown of Latvijas Banka's income and expense related to the Latvian government, as well as Latvijas Banka's profit of the previous reporting year appropriated to the state budget was as follows (see also Notes 22.2 and 23):

	(in thousands of euro)	
	2018	2017
Income (–)/expense and Latvijas Banka's profit appropriated to the state budget		
Interest on debt securities	–7 466	–4 459
Negative interest on government deposits	–544	–263
Taxes	10 513	10 589
Profit appropriated to the state budget	15 524	7 653
Total net expense and Latvijas Banka's profit appropriated to the state budget	18 027	13 520

### 44. PLEDGED ASSETS

Debt securities, gold and other financial instruments purchased by Latvijas Banka with the market value of 137 040 thousand euro, as at the end of 2018 (28 671 thousand euro at the end of 2017), have been pledged to provide collateral for gold swap arrangements, forward exchange rate contracts, interest rate and currency future

contracts, and to ensure payment system operation. At the end of 2018, the pledged assets mostly consisted of the gold involved in gold swap arrangements in the amount of 117 701 thousand euro (0 at the end of 2017).

#### **45. SECURITIES LENDING**

On behalf of Latvijas Banka its agents conclude securities lending transactions, as part of an automated security lending programme, where securities held by Latvijas Banka are lent against cash or other securities collateral. Securities lending transactions provide additional income without any material impact on investment liquidity as the securities lent are readily available to Latvijas Banka. The above agents administer the securities lending transactions and monitor the eligibility of the securities lending transactions and related collateral. The fair value of collateral provided in securities lending transactions is higher than that of the securities lent.

To improve securities market liquidity, Latvijas Banka, simultaneously with other euro area NCBs, lends securities purchased under the PSPP; Latvijas Banka conducts the above lending under the automated security lending programme.

At the end of 2018, the fair value of the securities lent, determined using quoted prices in an active market, was 27 886 thousand euro (7 427 thousand euro at the end of 2017); inter alia, the fair value of securities purchased and lent under the PSPP stood at 14 824 thousand euro at the end of 2018 (2 073 thousand euro at the end of 2017).

Foreign currency cash or securities received in the agent account of Latvijas Banka's automated security lending programme as collateral for securities lending transactions is not recognised in Latvijas Banka's balance sheet (see also Note 2.12).

#### **46. CONTINGENT LIABILITIES AND COMMITMENTS**

The uncalled portion of the BIS shares held by Latvijas Banka is 75% of their nominal value; these shares are callable following a respective decision of the BIS Board. At the end of 2018, the uncalled portion of the BIS shareholding was 4 012 thousand SDR (4 877 thousand euro; 4 012 thousand SDR (4 766 thousand euro) at the end of 2017; see also Note 14.2).

At the end of 2018, Latvijas Banka had issued euro collector coins, lats collector coins and precious metal circulation coins in the nominal value of 6 878 thousand euro (6 703 thousand euro at the end of 2017). These coins may be represented to Latvijas Banka at a nominal value. In the opinion of management of Latvijas Banka, the probability that Latvijas Banka will be required to repurchase these coins from their holders is considered low and no provisions have been made.

At the end of 2018, Latvijas Banka had issued lats banknotes and coins with the face value of 124 514 thousand euro (126 931 thousand euro at the end of 2017), reported on the balance sheet in the amount of 28 915 thousand euro (38 531 thousand euro at the end of 2017). Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited. In the opinion of the management of Latvijas Banka, the probability that Latvijas Banka would be required to exchange lats banknotes and coins in the amount of 95 600 thousand euro (88 400 thousand euro at the end of 2017) at face value, is low.

#### **47. EVENTS AFTER THE REPORTING PERIOD**

From 19 February 2018 to 25 February 2019, a prohibition to execute the functions of decision-making, control and supervision in Latvijas Banka was imposed on Ilmārs Rimšēvičs, Governor of Latvijas Banka. According to Latvijas Banka's management, the above factor had no effect on the financial position of Latvijas Banka and its financial performance results, or Latvijas Banka's capability to perform its tasks. Pursuant to the Judgement of the European Court of Justice of 26 February 2019 in the Joined Cases C-202/18 and C-238/18, the above prohibition was annulled and Ilmārs Rimšēvičs, Governor of Latvijas Banka, resumed his duties as the Governor of Latvijas Banka on 26 February 2019. In view of the fact that Ilmārs Rimšēvičs, the Governor of Latvijas Banka, is currently involved in an investigation, the Council of Latvijas Banka has defined appropriate work procedures, including information circulation, in order to prevent any potential conflict of interest in the actions of Ilmārs Rimšēvičs, the Governor of Latvijas Banka, and to ensure protection of official secrets.



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## **Independent Auditors' Report**

### **To the Council of Latvijas Banka**

#### *Our Opinion on the Financial Statements*

We have audited the accompanying financial statements of Latvijas Banka ("the Bank") set out on pages 3 to 45, which comprise:

- the balance sheet as at 31 December 2018,
- the profit and loss statement for the year then ended,
- the statement of total recognised gains and losses for the year then ended,
- the notes to the financial statements, which include a summary of principal accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Latvijas Banka as at 31 December 2018, and of its financial performance for the year then ended in accordance with the Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), 'Financial Accounting Policy of Latvijas Banka' approved by the Council of the Bank, and the requirements of the Law 'On Latvijas Banka' governing financial reporting.

#### *Basis for Opinion*

In accordance with the 'Law on Audit Services' of the Republic of Latvia we conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibility for the Audit of the Financial Statements* section of our report.

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and independence requirements included in the 'Law on Audit Services' of the Republic of Latvia that are relevant to our audit of the financial statements. We have also fulfilled our other professional ethics responsibilities and objectivity requirements in accordance with the IESBA Code and the 'Law on Audit Services' of the Republic of Latvia.

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

#### *Responsibilities of Board and Those Charged with Governance for the Financial Statements*

The Board of the Bank is responsible for the preparation of the financial statements that give a true and fair view in accordance with the Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the Law "On Latvijas Banka" governing financial reporting. The Board of the Bank is also responsible 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.





Based on the law “On Latvijas Banka”, the Board of the Bank is responsible for the preparation of the financial statements using the going concern basis of accounting.

Those charged with the Bank’s governance are responsible for overseeing the Bank’s financial reporting process.

#### *Auditors’ Responsibility for the Audit of the Financial Statements*

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

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

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



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

KPMG Baltics SIA  
Licence No. 55

A handwritten signature in blue ink, consisting of a stylized 'A' followed by a cursive flourish.

Armine Movsisjana  
Chairperson of the Board  
Latvian Certified Auditor  
Certificate No. 178  
Riga, Latvia  
7 March 2019