

LATVIJAS BANKA

FINANCIAL STATEMENTS OF LATVIJAS BANKA
FOR THE YEAR ENDED 31 DECEMBER 2019

INDEPENDENT AUDITORS' REPORT TO THE COUNCIL
OF LATVIJAS BANKA

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ABBREVIATIONS

BIS	Bank for International Settlements
EC	European Commission
ECB	European Central Bank
ESCB	European System of Central Banks
EU	European Union
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
TLTRO	targeted longer-term refinancing operations

BALANCE SHEET

(at the end of the year; in thousands of euro)			
	Note ¹	2019	2018
ASSETS			
Gold and gold receivables	6	289 043	239 195
Claims on non-euro area residents denominated in foreign currency	7	3 688 972	3 566 027
Receivables from the International Monetary Fund		149 082	146 833
Balances with banks and security investments, external loans and other external assets		3 539 890	3 419 194
Claims on euro area residents denominated in foreign currency	8	460 415	326 308
Claims on non-euro area residents denominated in euro	9	90 139	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10	12 250	38 750
Longer-term refinancing operations		12 250	38 750
Other claims on euro area credit institutions denominated in euro	11	8	488
Securities of euro area residents denominated in euro	12	8 721 137	8 813 038
Securities held for monetary policy purposes		7 636 472	7 423 080
Other securities		1 084 665	1 389 958
Intra-Eurosystem claims	13	5 277 483	4 952 780
Participating interest in the European Central Bank		114 108	115 082
Claims equivalent to the transfer of foreign reserves		158 264	163 480
Other claims within the Eurosystem		5 005 111	4 674 218
Other assets	14	206 062	208 724
TOTAL ASSETS		18 745 509	18 247 147

¹ The accompanying Notes set out on pages 7 to 48 are an integral part of these financial statements.

<i>(continued)</i>	<i>(at the end of the year; in thousands of euro)</i>		
	Note	2019	2018
LIABILITIES			
Banknotes in circulation	15	4 666 799	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	16	5 660 676	5 050 101
Current accounts (covering the minimum reserve system)		5 660 676	5 050 101
Other liabilities to euro area credit institutions denominated in euro	17	11 871	13 847
Liabilities to other euro area residents denominated in euro	18	1 506 709	1 449 237
General government		442 044	129 113
Other liabilities		1 064 665	1 320 124
Liabilities to non-euro area residents denominated in euro	19	307 239	16 524
Liabilities to euro area residents denominated in foreign currency	20	153 351	150 535
Liabilities to non-euro area residents denominated in foreign currency	21	1 642 368	115 284
Intra-Eurosystem liabilities	13	3 833 540	6 212 645
Liabilities related to TARGET2 and correspondent accounts (net)		3 826 452	6 212 645
Other liabilities within the Eurosystem		7 088	–
Other liabilities	22	329 326	251 877
Capital and reserves	23	633 630	450 368
TOTAL LIABILITIES		18 745 509	18 247 147

PROFIT AND LOSS STATEMENT

(in thousands of euro)


	Note	2019	2018
Net interest income	33	95 946	79 494
Interest income		198 804	180 907
Interest expense		−102 858	−101 413
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions		−37 821	−42 387
Realised gains or losses arising from financial operations	34	46 253	−49 690
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	−3 856	−47 903
Provisions for market risk and credit risk	36	−80 218	55 206
Net expense from fees and commissions		−3 607	−2 783
Fees and commissions income		811	644
Fees and commissions expense		−4 418	−3 427
Income from equity securities and participating interest	37	14 884	6 922
Net result of pooling of monetary income	38	−6 801	122
Other operating income	39	1 300	9 270
NET INCOME		63 901	50 638
Remuneration	40	−17 660	−17 515
Social security costs and solidarity tax	40	−3 941	−4 031
Banknote and coin acquisition costs	41	−1 791	−2 104
Depreciation of fixed assets and amortisation of intangible assets	14	−4 129	−4 189
Other operating expenses	42	−9 225	−8 233
PROFIT OF THE REPORTING YEAR		27 155	14 566

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

(in thousands of euro)			
	Note	2019	2018
Profit of the reporting year		27 155	14 566
Revaluation	23	169 433	-26 962
Realisation of the accumulated revaluation result	23	-6 986	-10 139
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	3 856	47 903
Total changes in the valuation account	23	166 303	10 802
TOTAL		193 458	25 368

The financial statements, which are set out on pages 3 to 48, were authorised by the Board of Latvijas Banka on 27 February 2020.

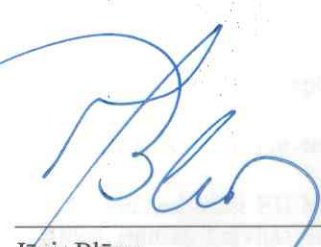
BOARD OF LATVIJAS BANKA



Māris Kālis
Chairman of the Board



Ilze Pošuma
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 branch in Riga.

Proceeding with the implementation of cost efficiency improvement measures, inter alia upgrading the cash processing equipment of the Riga Branch and centralising the cash circulation process, in 2019 Latvijas Banka decided to close its Liepāja Branch as of 30 January 2020, with services to customers being provided until 30 December 2019.

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 2019 and the year ended 31 December 2018 are as follows:

		(at the end of the year)	
	2019	2018	Changes (%)
US dollar (USD)	1.1234	1.1450	-1.9
Japanese yen (JPY)	121.94	125.85	-3.1
Canadian dollar (CAD)	1.4598	1.5605	-6.5
British pound sterling (GBP)	0.85080	0.89453	-4.9
Gold (XAU)	1354.104	1120.961	20.8

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: accounting policy for securities held to maturity (see Note 2.9), the useful life of fixed

assets and intangible assets (see Notes 2.17 and 2.18), impairment of assets (see Note 2.19), 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 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), the method for establishing the fair value of the BIS shares (see Note 14.2), 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 and gold 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 other entities 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 2019, the useful lives set for fixed assets were not changed. In 2019 and 2018, the useful lives set for fixed assets were as follows:

	(years)	
	2019	2018
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 (see Note 36).

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 (see Note 22.1).

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 (e.g. 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 securities, loans granted and 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 financial risks. 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 2019, Latvijas Banka's assets grew by 498.4 million euro.

In 2019, the balance sheet item "Securities held for monetary policy purposes" increased by 213.4 million euro, the amounts of securities purchases under the asset purchase programme were smaller vis-à-vis 2018 as the ECB's Governing Council made a decision to discontinue net purchases of securities under the asset purchase programme starting from 2019 and in the future merely reinvest the principal payments from maturing securities. As of 1 November 2019, the Governing Council of the ECB decided to resume securities purchases under the asset purchase programme.

In 2019, the amount of loans granted to credit institutions by Latvijas Banka as a result of longer-term refinancing operations decreased by 26.5 million euro (see also Note 10.2).

Other claims related to other operational requirements within the Eurosystem grew by 330.9 million euro, mostly due to a rise in claims on banknote allocation in the Eurosystem (see also Note 13.4).

In 2019, banknotes in circulation increased by 130.1 million euro, in line with the pickup in the overall amount of banknotes in circulation of the euro area NCBs.

The increase by 290.7 million euro under balance sheet item "Liabilities to non-euro area residents denominated in euro" is mostly related to concluded repurchase agreements.

The increase by 1527.1 million euro under balance sheet item "Liabilities to non-euro area residents denominated in foreign currency" is mostly related to concluded gold swaps arrangements and repurchase agreements to reduce the costs for hedging currency risks and increase return on financial investments.

At the end of 2019, credit institution deposits, reported under the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro", increased by 610.6 million 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 2386.2 million euro to 3826.5 million euro (6212.6 million euro at the end of 2018).

Capital and reserves of Latvijas Banka increased by 183.3 million euro due to net changes in the "Valuation account" balance (166.3 million euro) and the profits earned in 2019 (27.2 million euro), while the share of profits earned in 2018 and remitted to the state budget revenue (10.2 million euro) had a decreasing effect.

3.2 Financial performance

In 2019, Latvijas Banka's profit amounted to 27.2 million euro (14.6 million euro in 2018).

Net interest income in 2019 grew by 16.5 million euro as compared to 2018 and reached the amount of 95.9 million euro. 17.9 million euro growth in interest income mainly resulted from a rise in interest income on investment by 10.6 million euro on account of higher average yields. Interest income on monetary policy operations grew by 3.7 million euro under PSPP, while 3.6 million euro growth in interest income for deposits received was mostly a result of higher negative interest received on deposits from the Government and other financial institutions. Interest expense grew by 1.4 million euro.

The realised result from financial operations was positive (46.3 million euro) in contrast to the negative result of 49.7 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 3.9 million euro (47.9 million euro in 2018) due to a drop in interest rates in Latvijas Banka's major investment markets (see also Notes 34 and 35).

In 2019, additional provisions in the amount of 80.2 million euro were established for market risk and credit risk (in 2018, provisions had been cut by 55.6 million euro).

Income from equity securities and participating interest amounted to 14.9 million euro (6.9 million euro in 2018), the increase resulting from higher income from participating interest in the ECB as well as higher dividends due to the equity securities portfolio growth.

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 2019, Latvijas Banka's net result of pooling of monetary income was negative (6.8 million euro; positive at 0.1 million euro in 2018).

Other operating income (1.3 million euro; 9.3 million euro in 2018) decreased primarily on account of remeasurement of liabilities for the issued euro banknotes and coins in the amount of 7.2 million euro, whereas in 2019 the valuation of liabilities for the issued euro banknotes and coins remained unchanged.

Total recognised financial result, including changes in the "Valuation account" balance, increased by 168.1 million euro and reached the amount of 193.5 million euro on account of an increase of 196.4 million euro in the revaluation result and a 44.0 million euro fall in the negative result on revaluation of financial assets and positions in the profit and loss statement, while the profits of the reporting year grew by 12.6 million euro as compared to 2018.

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 accrued income on debt securities reported under the balance sheet item of other assets "Accrued interest on other securities" and 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 portfolio 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 expected 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 2019 and 2018 was as follows:

	Book value (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
1–10 year fixed income securities portfolios	3 535 151	3 502 941	62.5	61.8
Mortgage-backed securities portfolios	1 175 059	1 134 877	20.8	20.0
Equity securities portfolio	289 428	90 618	5.1	1.6
Gold portfolio	289 043	239 195	5.1	4.2
Long-term fixed income securities portfolio	168 099	502 397	3.0	8.9
Portfolios of borrowed funds	153 351	150 535	2.7	2.7
Latvian government securities portfolio	47 912	47 848	0.8	0.8
Total	5 658 043	5 668 411	100.0	100.0

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 equity securities portfolio benchmark is the equity securities index covering the developed markets across the world.

The gold portfolio comprises the gold of Latvijas Banka.

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

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

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 2019 and 2018, Latvijas Banka's assets carried at fair value were generally valued on the basis of a quoted market price.

At the end of 2019 and 2018, 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 2019 and 2018, 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 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
Forward exchange rate contracts	–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
As at 31 December 2019						
Gold	289 043	289 043	–	–	289 043	–
Securities in investment portfolios	5 151 246	4 552 682	610 900	–	5 163 582	12 336
Forward exchange rate contracts	24 649	–	24 043	–	24 043	–606
Interest rate swap arrangements	–533	–533	–	–	–533	–
Securities held for monetary policy purposes	7 703 471	8 155 588	–	–	8 155 588	452 117
Participating interest in the Bank for International Settlements	34 341	–	–	34 341	34 341	–
Total	13 202 217	12 996 780	634 943	34 341	13 666 064	463 847

The securities, including accrued interest 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 ICE Data Services (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 2017	213 384	230 856
During 2018		
Increase in gold market value	x	8 339
As at 31 December 2018	213 384	239 195
During 2019		
Increase in gold market value	x	49 749
Net change resulting from gold swaps arrangements	73	99
As at 31 December 2019	213 457	289 043

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

At the end of 2019, all gold in the amount of 289 043 thousand euro (117 701 thousand euro at the end of 2018) had been involved in gold swaps arrangements (see also Notes 21 and 44).

At the end of 2019 and 2018, 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 2019, the receivables from the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 149 082 thousand euro (146 833 thousand euro at the end of 2018), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 1035 thousand euro (1025 thousand euro at the end of 2018) held on its Accounts No. 1 and No. 2 (see also Note 19).

At the end of 2019 and 2018, Latvia's net receivables from the IMF were as follows:

	(in thousands of euro)		(in thousands of SDR)	
	2019	2018	2019	2018
Latvia's quota in the International Monetary Fund	410 025	403 877	332 300	332 300
International Monetary Fund holdings in euro	-409 967	-403 825	-332 253	-332 257
Promissory note of the Latvian government	-408 932	-402 800	-331 414	-331 414
Account No. 1	-1 025	-1 010	-831	-831
Account No. 2	-10	-15	-8	-12
Reserve position in the International Monetary Fund	68	67	55	55
SDR	149 082	146 833	120 822	120 811
General allocation	-115 984	-114 245	-93 998	-93 998
Special allocation	-33 098	-32 602	-26 824	-26 824
Latvia's net receivables from the International Monetary Fund	68	53	55	44

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)	
	2019	2018
Securities	3 501 497	3 320 051
Demand deposits	38 375	99 119
Foreign currency in cash	18	24
Total	3 539 890	3 419 194

8. CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

	(in thousands of euro)	
	2019	2018
Securities	460 047	326 081
Demand deposits	368	227
Total	460 415	326 308

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

	(in thousands of euro)	
	2019	2018
Securities	84 352	98 940
Demand deposits	5 787	2 897
Total	90 139	101 837

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

At the end of 2019, the total amount of Eurosystem loans in monetary policy operations reached 624 233 million euro (734 382 million euro at the end of 2018), including 12.3 million euro (38.8 million euro at the end of 2018) 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 2019 and 2018, 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. Such operations are conducted through monthly standard tenders with a 3-month maturity. In addition, following the decision of the Governing Council of the ECB, TLTROs were launched in 2014. They are liquidity providing reverse operations providing longer-term liquidity to credit institutions on attractive terms, so that they can continue easing the terms and conditions of lending to the private sector and to encourage their lending to the real economy. In 2016, the ECB's Governing Council introduced a new series of four targeted longer-term refinancing operations (TLTRO II). These operations have a four-year maturity, with a possibility of early repayment after two years. In 2019, the Governing Council introduced a new series of seven quarterly targeted longer-term refinancing operations (TLTRO III). These operations have a three-year maturity, with a possibility of early repayment after two years. The lowest interest rate applicable to the above operations will be equal to the average interest rate on the Eurosystem deposit facility prevailing over the life of the respective TLTRO III operation. In 2019, Latvijas Banka did not engage in operations under TLTRO III. At the end of 2019, the balance of the TLTRO conducted by Latvijas Banka stood at 12 250 thousand euro (year of maturity of these operations: 2020; at the end of 2018 the balance was 38 750 thousand euro), with credit institutions making an early repayment of the loans granted in the above operations.

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 (8 thousand euro at the end of 2019; 488 thousand euro at the end of 2018).

12. SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

At the end of 2019, the amount of securities held by the Eurosystem for monetary policy purposes totalled 2632 billion euro (2651 billion euro at the end of 2018). Of them, Latvijas Banka held 7636 million euro (7423 million euro at the end of 2018). 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 2019 the amount of government securities purchased by the euro area NCBs under the PSPP totalled 1681 billion euro (1681 billion euro at the end of 2018); of them, Latvijas Banka held securities in the amount of 1448 million euro (1186 million euro at the end of 2018).

In accordance with the ECB Governing Council decision, from January 2018 to December 2018 the monthly average net securities purchases were gradually reduced from 30 billion euro to 15 billion euro, continuing the respective purchases by the end of 2018. Between January 2019 and October 2019, the Eurosystem fully reinvested the principal payments from maturing securities. As of 1 November 2019, the ECB Governing Council decided to restart its net purchases of securities under the APP at a monthly pace of 20 billion euro. The ECB Governing Council expects them to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before ECB starts raising the key ECB interest rates.

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	
	2019	2018
Securities held for monetary policy purposes	7 636 472	7 423 080
Latvian government securities	1 447 653	1 186 436
Debt securities issued by international institutions	6 188 819	6 236 644
Other securities	1 084 665	1 389 958
Securities not held to maturity	916 566	887 561
Securities held to maturity	168 099	502 397
Total	8 721 137	8 813 038

13. INTRA-EUROSISTEM CLAIMS/LIABILITIES (–)

	(in thousands of euro)		
	Note	2019	2018
Participating interest in the European Central Bank	13.1	114 108	115 082
Claims in respect of foreign reserves transferred to the European Central Bank	13.2	158 264	163 480
Claims for the allocation of banknotes in the Eurosystem	13.4	4 999 497	4 669 321
Claims related to other operational requirements within the Eurosystem	13.5	5 614	4 897
Total intra-Eurosystem claims		5 277 483	4 952 780
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	13.3	–3 826 452	–6 212 645
Other liabilities within the Eurosystem	13.5	–7 088	–
Total intra-Eurosystem liabilities		–3 833 540	–6 212 645
Intra-Eurosystem claims/liabilities (–) (net)		1 443 943	–1 259 865

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 the share of Latvia's population and gross domestic product in the EU. 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 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 slightly decreased to 0.2731%, equivalent to 29 563 thousand euro. As a result of the departure of the United Kingdom from the European Union and consequent withdrawal of the Bank of England from the ESCB, the weightings assigned to the remaining NCBs in the key for subscription to the ECB's capital were adjusted with effect from 1 February 2020. The Bank of England's share in the ECB's subscribed capital (14.3374%) was reallocated among other NCBs; hence the capital key of Latvijas Banka increased from 0.2731% to 0.3169%, equivalent to 34 305 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. After Latvijas Banka's weighting in the ECB capital subscription key changed in 2019, the paid-up share in the ECB's capital decreased by 974 thousand euro, claims equivalent to the transfer of foreign reserves to the ECB shrank by 5216 thousand euro (see also Note 13.2), and the share of transfers to the financial instrument revaluation account contracted by 2757 thousand euro, recognised as realised gains (see also Note 37). At the end of 2019, participating interest in

the ECB consisted of the paid up shares in the amount of 29 563 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.

	2019	2018
Total amount of the European Central Bank's subscribed capital (in thousands of euro)	10 825 007	10 825 007
The subscribed and paid-up share of Latvijas Banka in the European Central Bank's capital (in thousands of euro)	29 563	30 537
The percentage share of Latvijas Banka in the European Central Bank's capital (capital key; %)	0.2731	0.2821

At the end of 2019 and 2018, the percentage shares of NCBs in the ECB's capital (capital key) were as follows:

	(%)	
	2019	2018
Nationale Bank van België/Banque Nationale de Belgique	2.5280	2.4778
Deutsche Bundesbank	18.3670	17.9973
Eesti Pank	0.1968	0.1928
Banc Ceannais na hÉireann/Central Bank of Ireland	1.1754	1.1607
Bank of Greece	1.7292	2.0332
Banco de España	8.3391	8.8409
Banque de France	14.2061	14.1792
Banca d'Italia	11.8023	12.3108
Central Bank of Cyprus	0.1503	0.1513
Latvijas Banka	0.2731	0.2821
Lietuvos bankas	0.4059	0.4132
Banque centrale du Luxembourg	0.2270	0.2030
Bank Ċentrali ta' Malta/Central Bank of Malta	0.0732	0.0648
De Nederlandsche Bank	4.0677	4.0035
Oesterreichische Nationalbank	2.0325	1.9631
Banco de Portugal	1.6367	1.7434
Banka Slovenije	0.3361	0.3455
Národná banka Slovenska	0.8004	0.7725
Suomen Pankki – Finlands Bank	1.2708	1.2564
Subtotal for euro area NCBs	69.6176	70.3915
Българска народна банка (Bulgarian National Bank)	0.8511	0.8590
Česká národní banka	1.6172	1.6075
Danmarks Nationalbank	1.4986	1.4873
Hrvatska narodna banka	0.5673	0.6023
Magyar Nemzeti Bank	1.3348	1.3798
Narodowy Bank Polski	5.2068	5.1230
Banca Națională a României	2.4470	2.6024
Sveriges Riksbank	2.5222	2.2729
Bank of England	14.3374	13.6743
Subtotal for non-euro area NCBs	30.3824	29.6085
Total	100.0000	100.0000

In 2019, the subscribed and paid-up capital of the ECB remained unchanged, but the paid-up capital decreased by 80 633 thousand euro due to the overall reduction in the weightings of the euro area NCBs (with fully paid-up subscription) in the ECB's subscribed capital and the equivalent increase in the weightings of non-euro area NCBs (which have only paid up 3.75% of their subscriptions) in the ECB's subscribed capital.

The subscribed and paid-up NCB shares in the ECB's capital at the end of 2019 and 2018 were as follows:

(in thousands of euro)

	Subscribed capital		Paid-up capital	
	2019	2018	2019	2018
Nationale Bank van België/ Banque Nationale de Belgique	273 656	268 222	273 656	268 222
Deutsche Bundesbank	1 988 229	1 948 209	1 988 229	1 948 209
Eesti Pank	21 304	20 871	21 304	20 871
Banc Ceannais na hÉireann/Central Bank of Ireland	127 237	125 646	127 237	125 646
Bank of Greece	187 186	220 094	187 186	220 094
Banco de España	902 708	957 028	902 708	957 028
Banque de France	1 537 811	1 534 899	1 537 811	1 534 899
Banca d'Italia	1 277 600	1 332 645	1 277 600	1 332 645
Central Bank of Cyprus	16 270	16 378	16 270	16 378
Latvijas Banka	29 563	30 537	29 563	30 537
Lietuvos bankas	43 939	44 729	43 939	44 729
Banque centrale du Luxembourg	24 573	21 975	24 573	21 975
Bank Ċentrali ta' Malta/Central Bank of Malta	7 924	7 015	7 924	7 015
De Nederlandsche Bank	440 329	433 379	440 329	433 379
Oesterreichische Nationalbank	220 018	212 506	220 018	212 506
Banco de Portugal	177 173	188 723	177 173	188 723
Banka Slovenije	36 383	37 400	36 383	37 400
Národná banka Slovenska	86 643	83 623	86 643	83 623
Suomen Pankki – Finlands Bank	137 564	136 005	137 564	136 005
Subtotal for euro area NCBs	7 536 110	7 619 885	7 536 110	7 619 885
Българска народна банка (Bulgarian National Bank)	92 132	92 987	3 455	3 487
Česká národní banka	175 062	174 012	6 565	6 525
Danmarks Nationalbank	162 224	161 000	6 083	6 038
Hrvatska narodna banka	61 410	65 199	2 303	2 445
Magyar Nemzeti Bank	144 492	149 363	5 418	5 601
Narodowy Bank Polski	563 636	554 565	21 136	20 796
Banca Națională a României	264 888	281 710	9 933	10 564
Sveriges Riksbank	273 028	246 042	10 239	9 227
Bank of England	1 552 025	1 480 244	58 201	55 509
Subtotal for non-euro area NCBs	3 288 897	3 205 122	123 334	120 192
Total ²	10 825 007	10 825 007	7 659 444	7 740 077

² The total amount and the sum of the components may differ due to rounding.

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 capital key weighting 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. After Latvijas Banka's weighting in the ECB capital subscription key changed this claim decreased to the amount of 158 264 thousand euro. 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 2019, 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 and a result of Latvijas Banka's investment management.

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/liabilities 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 pooled by Latvijas Banka in 2019 was higher than its monetary income to be received. This resulted in a liability to the ECB associated with the net result of pooling of monetary income, standing at 7088 thousand euro at the end of 2019 (122 thousand euro claim at the end of 2018; see also Notes 2.27 and 38).

Claims for the ECB's interim profit distribution in the amount of 5614 thousand euro are set as per Latvijas Banka's percentage share in the ECB's capital (4775 thousand euro at the end of 2018; see also Notes 2.26 and 37).

14. OTHER ASSETS

(in thousands of euro)

	Note	2019	2018
Accrued interest on securities held for monetary policy purposes		66 999	63 088
Participating interest in the Bank for International Settlements	14.2	34 341	31 321
OTC financial derivative contracts and spot exchange rate contracts	24	32 492	38 999
Fixed assets	14.1	35 319	37 790
Accrued interest on other securities		20 146	22 602
Claims on collateral for the use of the instant payment service	17	11 581	10 017
Intangible assets	14.1	2 263	2 406
Other accrued income		1 491	1 159
Prepaid expenses		951	704
Other		479	638
Total		206 062	208 724

14.1 Fixed assets and intangible 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	Other fixed assets	Total fixed assets	Intangible assets
As at 31 December 2017							
Cost	61 455	6 358	5 935	7 086	10 155	90 989	7 258
Accumulated depreciation/amortisation	-29 566	-3 950	-4 426	-5 393	-7 989	-51 324	-4 895
Net book value	31 889	2 408	1 509	1 693	2 166	39 665	2 363
During 2018							
Additions	995	95	235	48	990	2 363	543
Disposals and write-offs	-1 101	-138	-1 575	-88	-1 235	-4 137	-1
Net change in cost	-106	-43	-1 340	-40	-245	-1 774	542
Depreciation/amortisation charge	-1 961	-269	-619	-375	-465	-3 689	-500
Accumulated depreciation/amortisation on disposals and write-offs	656	121	1 573	84	1 154	3 588	1
Net change in accumulated depreciation/amortisation	-1 305	-148	954	-291	689	-101	-499
As at 31 December 2018							
Cost	61 349	6 315	4 595	7 046	9 910	89 215	7 800
Accumulated depreciation/amortisation	-30 871	-4 098	-3 472	-5 684	-7 300	-51 425	-5 394
Net book value	30 478	2 217	1 123	1 362	2 610	37 790	2 406
During 2019							
Additions	616	35	431	1 540	202	2 824	387
Change in classification	-3	-	-	-	3	-	-
Disposals and write-offs	-3 664	-119	-259	-3 253	-285	-7 580	-77
Net change in cost	-3 051	-84	172	-1 713	-80	-4 756	310
Depreciation/amortisation charge	-1 982	-264	-564	-310	-479	-3 599	-530
Change in classification	3	-	-	-	-3	-	-
Accumulated depreciation/amortisation on disposals and write-offs	2 269	116	258	2 963	278	5 884	77
Net change in accumulated depreciation/amortisation	290	-148	-306	2 653	-204	2 285	-453
As at 31 December 2019							
Cost	58 298	6 231	4 767	5 333	9 830	84 459	8 110
Accumulated depreciation/amortisation	-30 581	-4 246	-3 778	-3 031	-7 504	-49 140	-5 847
Net book value	27 717	1 985	989	2 302	2 326	35 319	2 263

At the end of 2019, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 11 thousand euro (209 thousand euro at the end of 2018).

14.2 Participating interest in the Bank for International Settlements

At the end of 2019 and 2018, Latvijas Banka owned 1070 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 5350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1338 thousand SDR or 25% (see also Note 46). At the end of 2019 and 2018, 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, 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 2019, the estimated fair value of BIS shares was 34 341 thousand euro (31 321 thousand euro at the end of 2018).

15. BANKNOTES IN CIRCULATION

	(in thousands of euro)	
	2019	2018
Euro banknotes	4 666 799	4 536 729
Net issuance of euro banknotes by Latvijas Banka	-332 698	-132 592
Adjustment for banknote allocation in the Eurosystem	4 99 497	4 669 321
Total	4 666 799	4 536 729

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 2019 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 332 698 thousand euro. At the end of 2019, the total amount of euro banknotes in circulation in the Eurosystem grew to 1293 billion euro (1231 billion euro at the end of 2018); 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. On 12 September 2019, the ECB's Governing Council decided to introduce a two-tier system for reserve remuneration, which exempts part of credit institutions' excess liquidity holdings (i.e. reserve holdings in excess of minimum reserve requirements) from the negative remuneration rate applicable on the deposit facility.

At the end of 2019, balance on the current accounts with Latvijas Banka was 5 660 676 thousand euro (5 050 101 thousand euro at the end of 2018), including the minimum reserves in the amount of 156 304 thousand euro (156 079 thousand euro at the end of 2018).

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 2019 and 2018.

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 (11 871 thousand euro at the end of 2019; 13 847 thousand euro at the

end of 2018). Collateral received from credit institutions for the use of the instant payment service has been deposited with the ECB and is held by the respective payment system operator (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).

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

Liabilities to other financial institutions mostly comprise funds received under repurchase agreements concluded in 2019.

	(in thousands of euro)	
	2019	2018
Other financial institutions	306 195	4 423
International Monetary Fund	1 035	1 025
European Commission	9	11 076
Total	307 239	16 524

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 153 351 thousand euro at the end of 2019 (150 535 thousand euro at the end of 2018; see also Note 43).

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

	(in thousands of euro)	
	2019	2018
Liabilities for repurchase agreements	1 363 337	–
Liabilities for gold swap arrangements	279 031	114 323
Liabilities for collateral for forward exchange rate contracts	–	961
Total	1 642 368	115 284

22. OTHER LIABILITIES

		(in thousands of euro)	
	Note	2019	2018
Provisions for market risk and credit risk	36	203 900	123 970
Euro coins in circulation	22.1	79 496	73 513
Lats banknotes in circulation	22.1	23 719	25 798
Accrued expense and similar liabilities		9 805	6 533
OTC financial derivative contracts and spot exchange rate contracts	24	7 837	17 003
Lats coins in circulation	22.1	2 855	3 116
Tax liabilities	22.2	13	66
Other		1 701	1 878
Total		329 326	251 877

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 6960 thousand euro at the end of 2019 (6878 thousand euro at the end of 2018). The above coins in circulation have not been reported under the balance sheet item "Other liabilities" (see also Notes 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; 95 600 thousand euro, including lats banknotes in the amount of 35 791 thousand euro and lats coins in the amount of 59 809 thousand euro at the end of 2018) have not been reported as a liability on the balance sheet at the end of 2019 and 2018 (see also Note 46).

22.2 Tax liabilities

At the end of 2019 and 2018, 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 2017	–	–	4	–	71	–	75
During 2018							
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
Liabilities as at 31 December 2018	–	–	–	–	65	1	66
During 2019							
Calculated	3 076	3 941	1 843	225	1 349	1	10 435
Increase in deferred liabilities	–	101	–	–	–	–	101
Paid	–3 076	–4 042	–1 843	–225	–1 401	–2	–10 589
Liabilities as at 31 December 2019	–	–	–	–	13	–	13

In addition to the tax payments indicated herein, in 2019 Latvijas Banka transferred to the state budget 70% of the profit for the previous year (10 196 thousand euro in 2019) but in 2018 65% of the profit for 2017 (15 524 thousand euro in 2018; 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 2017	100 000	228 003	88 637	23 884	440 524
During 2018					
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
As at 31 December 2018	100 000	236 363	99 439	14 566	450 368
During 2019					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	166 303	x	166 303
Profit appropriated to the state budget	x	x	x	–10 196	–10 196
Profit transferred to the reserve capital	x	4 370	x	–4 370	–
Profit of the reporting year	x	x	x	27 155	27 155
As at 31 December 2019	100 000	240 733	265 742	27 155	633 630

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 corporate income tax rate set 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 2019 and 2018 the corporate income tax rate was 20%. Therefore, unless the Council of Latvijas Banka decides otherwise, 70% of Latvijas Banka's profit of the reporting year or 19 009 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 2019 and 2018, changes in the valuation account were as follows:

	(in thousands of euro)				
	2019	Recognition in profit and loss statement	Revaluation	Realisation	2018
Initial valuation account	–	x	x	–2 859	2 859
Revaluation reserve for participating interest	31 832	–	3 020	–	28 812
Result on revaluation of foreign currencies and gold	91 419	145	45 994	–	45 280
Result on revaluation of interest rate swap arrangements	62	431	–369	–	–
Result on revaluation of securities	142 429	3 280	120 788	–4 127	22 488
Total	265 742	3 856	169 433	–6 986	99 439
	2018	Recognition in profit and loss statement	Revaluation	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

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. In 2019, the above six-year transition period following Latvijas Banka's joining the Eurosystem came to an end/ended.

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 2019 and 2018, the contract or notional amounts and book value of the above transactions were as follows:

(in thousands of euro)

	Contract or		Book value			
	notional amount		Assets		Liabilities	
	2019	2018	2019	2018	2019	2018
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	2 524 378	4 183 931	31 570	35 347	6 477	13 880
Spot exchange rate contracts	396 631	378 896	–	–	444	525
Forward transactions in securities	788 442	881 305	843	3 500	304	2 068
Interest rate swap arrangements	36 229	52 838	79	152	612	530
Total	x	x	32 492	38 999	7 837	17 003
Derivative OTC gold swap arrangements	279 031	114 323	289 043	117 701	279 419	114 480
Traded financial derivative contracts						
Interest rate future contracts	1 374 836	1 938 588	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 engages in gold swap arrangements (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 expected 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 and in case of any departure from the provisions of the Procedure of the Council of Latvijas Banka duly notifies the Council and the Board of Latvijas Banka.

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 risk of 1–10 year fixed income securities portfolios, mortgage-backed securities portfolios, and the equity securities portfolio (see Note 4) is managed by determining the tracking error limit. Tracking error in 2019 and 2018 is disclosed in Note 28.

The equity securities portfolio is exposed to the market price risk (a risk that the value of investment might decrease due to price changes). As the equity securities portfolio is highly diversified, it is mostly exposed to the risk of systematic share price movements.

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 2019 and 2018) 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. 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. To hedge the credit risk associated with the counterparties of repurchase agreements and reverse repurchase agreements, Latvijas Banka and the respective counterparties enter into Global Master Repurchase Agreements of Securities Industry and Financial Markets Association (SIFMA) and International Capital Market Association (ICMA), whereas 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 2019 and 2018, 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 2019 and 2018) is disclosed in Notes 30–32.

25.1.3 Liquidity risk

Liquidity risk is associated with a failure to dispose of 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 2019 and 2018 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 ensure efficient attainment of quality result of a process or project as scheduled/within the specified time frame as well as continuous, adequate and safe implementation of the process, mitigating such a potential negative impact on Latvijas Banka's capability to accomplish its tasks, on its reputation or financial position and financial performance, that could be triggered by an inadequate or erroneous implementation of Latvijas Banka's processes, acts or omissions on the part of an employee, or unavailability 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 classifying processes and risks, evaluating the impact of risks on the results of processes or projects and, depending on the risk classification, defining and implementing the most appropriate actions to ensure adequate risk management. In order to improve the operational risk management of Latvijas Banka and strengthen the internal control system, the Operational Risk Management Department was established on 1 February 2019, combining the existing competence and expertise in the field of operational risk management at Latvijas Banka's disposal. The Department is in charge of maintaining a common operational risks management framework, organising incident management as well as providing regular information on operational risk management pursuant to the legal acts of Latvijas Banka. The improved risk management process is based on the best practice in the field of risk management and concentrates the resources allocated to operational risk management, thereby increasing the effectiveness of this management model. In 2019, the operational risk management was overseen by the Operational Risk Management Committee of Latvijas Banka.

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, the premises of Latvijas Banka, transportation of its valuables and the events organised by Latvijas Banka with a priority focus on protecting the life and health of individuals.

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.

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 2019, 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 did not substantially hamper Latvijas Banka's operation.

26. CURRENCY STRUCTURE

(in thousands of euro)

	EUR	USD	CAD	GBP	Gold	Other	Total
As at 31 December 2019							
Total assets	14 338 668	3 264 840	386 768	360 716	289 043	105 474	18 745 509
Total liabilities	16 986 997	1 274 718	346 416	109 526	–	27 852	18 745 509
Net position on balance sheet	–2 648 329	1 990 122	40 352	251 190	289 043	77 622	0
Net position on financial instruments' off-balance sheet accounts	2 131 383	–1 811 033	–28 960	–235 321	–	–31 414	24 655
Net position on balance sheet and off-balance sheet accounts	–516 946	179 089	11 392	15 869	289 043	46 208	24 655
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–2.8	1.0	0.1	0.1	1.5	0.2	0.1
As at 31 December 2018							
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
Net position on balance sheet and off-balance sheet accounts	–304 148	63 066	3 975	4 953	239 195	14 955	21 996
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–1.6	0.3	0.0	0.0	1.3	0.1	0.1

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
As at 31 December 2019							
Gold and gold receivables	–	–	–	–	–	289 043	289 043
Claims on non-euro area residents denominated in foreign currency	31 972	24 540	125 046	746 551	2 315 288	445 575	3 688 972
Claims on euro area residents denominated in foreign currency	–	–	148 724	158 393	148 076	5 222	460 415
Claims on non-euro area residents denominated in euro	–	–	134	6 061	78 120	5 824	90 139
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	–	–	12 250	–	–	12 250
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	8	8
Securities of euro area residents denominated in euro	–	–	–	185 186	8 535 951	–	8 721 137
Intra-Eurosystem claims	–	–	–	–	–	5 277 483	5 277 483
Other assets	146	–	1 860	5 013	79 906	119 137	206 062
Total assets	32 118	24 540	275 764	1 113 454	11 157 341	6 142 292	18 745 509
Banknotes in circulation	–	–	–	–	–	4 666 799	4 666 799
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 660 676	–	–	–	–	–	5 660 676
Other liabilities to euro area credit institutions denominated in euro	11 871	–	–	–	–	–	11 871
Liabilities to other euro area residents denominated in euro	1 506 709	–	–	–	–	–	1 506 709
Liabilities to non-euro area residents denominated in euro	306 204	–	–	–	–	1 035	307 239
Liabilities to euro area residents denominated in foreign currency	153 351	–	–	–	–	–	153 351
Liabilities to non-euro area residents denominated in foreign currency	1 642 368	–	–	–	–	–	1 642 368
Intra-Eurosystem liabilities	3 833 540	–	–	–	–	–	3 833 540
Other liabilities	3 016	–	–	–	–	326 310	329 326
Capital and reserves	–	–	–	–	–	633 630	633 630
Total liabilities	13 117 735	–	–	–	–	5 627 774	18 745 509
Net position on balance sheet	–13 085 617	24 540	275 764	1 113 454	11 157 341	514 518	–
Assets on financial instruments' off- balance sheet accounts	3 700 161	7 922	637 084	23 431	807 984	–	5 176 582
Liabilities on financial instruments' off-balance sheet accounts	4 495 103	130 374	93 564	101 122	331 764	–	5 151 927
Net position on balance sheet and off-balance sheet accounts	-13 880 559	- 97 912	819 284	1 035 763	11 633 561	514 518	24 655

(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 2018							
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
Total assets	66 902	219 280	1 478 431	3	10 837 972	5 644 559	18 247 147
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
Total liabilities	13 007 305	–	–	–	–	5 239 842	18 247 147
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
Net position on balance sheet and off-balance sheet accounts	–14 124 472	509 236	2 159 970	–287 341	11 359 886	404 717	21 996

28. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in 1–10 year government fixed income securities portfolios, mortgage-backed securities portfolios and the equity securities portfolio 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 2019 and 2018, the actual (ex-post) tracking error of the 1–10 year fixed income securities portfolios were identical (30 basis points). At the end of 2019 and 2018, the actual (ex-post) tracking errors of the mortgage-backed securities portfolios were 75 basis points and 61 basis points respectively.

The expected (ex-ante) tracking error of the equity securities portfolio does not exceed 30 basis points during the year and compliance with this limit is monitored by the respective external investment manager. The expected (ex-ante) tracking error in 1–10 year government fixed income securities portfolios and mortgage-backed securities portfolios 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
During 2019				
1–10 year fixed income securities portfolios	3 535 151	250	–	–
Mortgage-backed securities portfolios	1 175 059	166	84	–
During 2018				
1–10 year fixed income securities portfolios	3 502 941	252	–	–
Mortgage-backed securities portfolios	1 134 877	220	32	–

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
As at 31 December 2019				
Assets				
Gold and gold receivables	289 043	–	–	289 043
Claims on non-euro area residents denominated in foreign currency	3 688 972	–	–	3 688 972
Claims on euro area residents denominated in foreign currency	460 415	–	–	460 415
Claims on non-euro area residents denominated in euro	90 139	–	–	90 139
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	12 250	–	12 250
Other claims on euro area credit institutions denominated in euro	8	–	–	8
Securities of euro area residents denominated in euro	8 553 038	168 099	–	8 721 137
Intra-Eurosystem claims	5 614	–	5 271 869	5 277 483
Other assets	132 709	–	73 353	206 062
Total assets	13 219 938	180 349	5 345 222	18 745 509
Liabilities				
Banknotes in circulation	–	–	4 666 799	4 666 799
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 660 676	–	–	5 660 676
Other liabilities to euro area credit institutions denominated in euro	11 871	–	–	11 871
Liabilities to other euro area residents denominated in euro	1 506 709	–	–	1 506 709
Liabilities to non-euro area residents denominated in euro	307 239	–	–	307 239
Liabilities to euro area residents denominated in foreign currency	153 351	–	–	153 351
Liabilities to non-euro area residents denominated in foreign currency	1 642 368	–	–	1 642 368
Intra-Eurosystem liabilities	3 833 540	–	–	3 833 540
Other liabilities	223 228	–	106 098	329 326
Total liabilities	13 338 982	–	4 772 897	18 111 879
Net position on balance sheet	–119 044	180 349	572 325	x

(continued)

(in thousands of euro)

	Up to 3 months	Over 3 months	No fixed maturity	Total
As at 31 December 2018				
Assets				
Gold and gold receivables	239 195	–	–	239 195
Claims on non-euro area residents denominated in foreign currency	3 566 027	–	–	3 566 027
Claims on euro area residents denominated in foreign currency	326 308	–	–	326 308
Claims on non-euro area residents denominated in euro	101 837	–	–	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	8 310 641	502 397	–	8 813 038
Intra-Eurosystem claims	4 897	–	4 947 883	4 952 780
Other assets	135 865	–	72 859	208 724
Total assets	12 685 258	541 147	5 020 742	18 247 147
Liabilities				
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	16 524	–	–	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	149 424	–	102 453	251 877
Total liabilities	13 157 597	–	4 639 182	17 796 779
Net position on balance sheet	–472 339	541 147	381 560	x

30. SECTORAL STRUCTURE OF ASSETS

	Amount (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
International institutions	5 207 114	5 240 794	27.8	28.7
European Central Bank	5 277 483	4 952 780	28.2	27.1
Central governments and other governmental institutions	3 945 280	3 864 866	21.0	21.2
Other financial institutions	3 126 037	3 147 598	16.7	17.2
Central banks and credit institutions	662 329	732 836	3.5	4.0
Non-financial corporations	246 393	88 566	1.3	0.5
Local governments	218 538	168 883	1.2	0.9
Unclassified assets	62 335	50 824	0.3	0.4
Total	18 745 509	18 247 147	100.0	100.0

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

	Amount (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
International institutions	5 207 114	5 240 794	27.8	28.7
European Central Bank	5 277 483	4 952 780	28.2	27.1
Euro area countries	4 386 728	4 397 379	23.4	24.1
US	2 106 897	1 914 927	11.2	10.5
UK	658 809	600 132	3.5	3.3
Canada	595 578	569 508	3.2	3.1
Other European Union countries	168 590	174 396	0.9	1.0
Japan	86 384	118 417	0.5	0.6
Other countries	257 926	278 814	1.3	1.6
Total	18 745 509	18 247 147	100.0	100.0

32. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Amount (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
European Central Bank	5 277 483	4 952 780	28.2	27.1
AAA	6 721 962	6 798 753	35.9	37.3
AA	4 119 413	4 026 575	22.0	22.1
A	1 866 878	1 889 665	10.0	10.4
BBB	378 991	376 603	2.0	2.1
Assets without counterparty credit rating	19 431	40 636	0.1	0.2
Assets not exposed to credit risk	361 351	162 135	1.8	0.8
Total	18 745 509	18 247 147	100.0	100.0

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above 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 without counterparty credit rating mostly comprise securities purchased in longer-term refinancing operations with Latvian credit institutions. Assets not exposed to credit risk mostly comprise securities in the equity securities portfolio, participating interest in the BIS, fixed assets and intangible assets.

PROFIT AND LOSS STATEMENT NOTES

33. NET INTEREST INCOME

	(in thousands of euro)	
	2019	2018
Interest income	198 804	180 907
Interest on investments	127 405	116 817
Interest on customer deposits	7 689	4 077
Interest on monetary policy operations	63 710	60 013
Interest expense	–102 858	–101 413
Interest on investments	–100 505	–98 771
Interest on monetary policy operations	–2 353	–2 642
Net interest income	95 946	79 494

Net interest income was mainly derived from debt securities investments in debt securities as well as interest income on monetary policy operations.. In 2019, net interest income increased by 16 452 thousand euro in comparison with 2018. This was mainly a result of a higher average yield of securities and an increase in the amount of monetary policy operations. The costs of hedging currency risks continued to have a negative effect on net interest income in 2019, with the spreads between the interest rates of the euro and other investment currencies of Latvijas Banka remaining wide.

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 2019 and 2018, 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 ended in 2019 and in the course of these six years was as follows:

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

In 2019, interest income on monetary policy operations mainly increased due to the implementation of the PSPP and larger negative interest received on deposits from the Government and other financial institutions.

The application of the interest on deposits is stipulated in the Guideline (EU) 2019/671 of the ECB of 9 April 2019 on domestic asset and liability management operations by the national central banks (recast) (ECB/2019/7).

34. REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	(in thousands of euro)	
	2019	2018
Derivative financial instruments	-19 903	-36 668
Debt securities	54 186	-25 306
Foreign exchange transactions	11 970	12 284
Total	46 253	-49 690

The result on derivative financial instruments posted an improvement of 16 765 thousand euro in comparison with 2018, mostly on account of a smaller negative result on interest rate future contracts due to a positive contribution from falling interest rates in the course of 2019, as well as the negative result on currency future contracts concluded for the purpose of hedging currency risk exposure, affected by the US dollar appreciation against the euro. The negative result of the currency future contracts concluded for the purpose of hedging currency risk exposure is offset in an equal value by the positive revaluation result of the balance sheet items hedged for foreign currency risk.

The result on the disposal of debt securities increased by 79 492 thousand euro in comparison with 2018, mostly due to a decrease in interest rates and disposal of securities held in the long-term fixed income securities portfolio.

In 2019 and 2018, the realised gains on foreign exchange transactions also included the recognition of the initial valuation account in profit and loss statement (see also Note 23). In 2019, the realised gains on foreign exchange transactions were positively affected by the appreciation of the US dollar against the euro.

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

	(in thousands of euro)	
	2019	2018
Securities	-3 280	-47 150
Interest rate swap arrangements	-431	-407
Foreign currency positions	-145	-346
Total	-3 856	-47 903

The revaluation result of several debt securities, foreign currency positions, and interest rate swap arrangements at the end of 2019 and 2018 was negative, and it has been recognised in the profit and loss statement.

At the end of 2019, net revaluation result on the equity securities portfolio was positive and has been reported under the balance sheet item "Capital and reserves" as the securities' revaluation result, whereas 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 decrease in the negative result on revaluation of securities is related to a decrease in interest rates in Latvijas Banka's major investment markets in 2019, as well as the positive net revaluation result on the equity securities portfolio.

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, equity securities portfolio and Eurosystem monetary operations 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 2019 was 310 000 thousand euro (190 000 thousand euro in 2018). In 2019, the increase in the targeted amount of provisions for market risk and credit risk resulted from inclusion of Eurosystem monetary operations in the risk assessment. 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 2019, due to the above mentioned risk assessment, the Council of Latvijas Banka decided to increase the provisions for market risk and credit risk related to the financial investments managed by Latvijas Banka, by 80 218 thousand euro or a percentage of the positive total financial performance result included in the profit and loss statement before establishment of provisions for financial risks as laid down in the above-mentioned methodology (in 2018 the respective provisions were reduced by 55 576 thousand euro). In addition to the above, provisions for credit risk, associated with the Eurosystem monetary policy operations, in the amount of 288 thousand euro were reduced (370 thousand euro increase in 2018); as a result, the total outstanding amount of provisions reached 203 900 thousand euro at the end of 2019 (123 970 thousand euro at the end of 2018).

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 322 thousand euro (305 thousand euro in 2018; see also Note 14.2) and income from the ECB's interim profit distribution for the reporting year, the remainder of the ECB's annual profit of the previous year, and realised gains on a decrease in the participating interest in the ECB (see also Note 13.1) in the amount of 9910 thousand euro (5925 thousand euro in 2018, see also Note 2.26).

Income from equity securities comprises the accrued and received dividends of the equity securities portfolio in the amount of 4652 thousand euro (692 thousand euro in 2018). Income grew on account of higher dividends due to an increase in the equity securities portfolio.

38. NET RESULT OF POOLING OF MONETARY INCOME

	(in thousands of euro)	
	2019	2018
Monetary income pooled	-51 356	-50 208
Monetary income received	44 555	50 330
Net result of pooling of monetary income	-6 801	122

Net result of pooling monetary income decreased on account of smaller monetary income received, primarily due to redemptions of securities held for monetary policy purposes within the framework of the discontinued asset purchase programmes.

39. OTHER OPERATING INCOME

	(in thousands of euro)	
	2019	2018
Income from sale of collector coins	675	1 329
Revaluation of liabilities for the issued lats banknotes and coins	-	7 200
Other	625	741
Total	1 300	9 270

As a result of revaluation of liabilities for the issued lats banknotes and coins, income is recognised because 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). Reassessment 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 2019, the valuation of liabilities for the issued lats banknotes and coins remained unchanged (see also Note 22.1).

40. REMUNERATION, SOCIAL SECURITY COSTS, AND SOLIDARITY TAX

	(in thousands of euro)	
	2019	2018
Remuneration		
Remuneration for performance of duties of the Council and the Board	-984	-880
Remuneration of other personnel	-16 676	-16 635
Total remuneration	-17 660	-17 515
Social security costs and solidarity tax	-3 941	-4 031
Total remuneration, social security costs, and solidarity tax	-21 601	-21 546

At the end of 2019, the number of employees was 479 (498 at the end of 2018), representing 465 full-time equivalents in 2019 (496 in 2018).

41. BANKNOTE AND COIN ACQUISITION COSTS

	(in thousands of euro)	
	2019	2018
Acquisition of banknotes	-1 140	-1 271
Acquisition of collector coins	-363	-752
Acquisition of circulation coins	-288	-81
Total	-1 791	-2 104

42. OTHER OPERATING EXPENSES

	(in thousands of euro)	
	2019	2018
Maintenance and operation of information systems	-3 850	-3 773
Disposal of material values	-1 695	-529
Municipal services	-734	-830
Maintenance of buildings, territory and equipment	-621	-615
Business travel	-462	-440
Information and public relations	-245	-319
Tax on real estate	-226	-228
Personnel training	-225	-256
Acquisition of low value office supplies	-225	-173
Risk insurance	-217	-151
Telecommunication services and system maintenance	-183	-243
Event services	-151	-170
Transport provision	-53	-80
Other	-338	-426
Total	-9 225	-8 233

Other operating expenses also comprise remuneration in the amount of 29 thousand euro paid to KPMG Baltics AS for the audit of 2019 financial statements of Latvijas Banka (29 thousand euro in 2018 to KPMG Baltics SIA). Expenses on disposal of material values comprise the write-off of the residual book value of capital investment in the building of the Liepāja Branch of Latvijas Banka in the amount of 1401 thousand euro due to the closure of the said Branch. The building of the Liepāja Branch of Latvijas Banka is to be transferred in the possession of the Ministry of Finance of the Republic of Latvia without any compensation (see also Note 43).

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 and in line with the ECB's decisions. No commission fees are applied to transactions with the Latvian government.

Pursuant to Guideline (EU) 2019/671 of the ECB of 9 April 2019 on domestic asset and liability management operations by the national central banks (recast) (ECB/2019/7), Latvijas Banka applies the euro overnight index average (EONIA) rate (it was negative at the end of both 2019 and 2018 (-0.446% and -0.356% 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, by 30 September 2019 Latvijas Banka applied the deposit facility rate set by the ECB, but as of 1 October 2019 the lower of the following rates: the ECB's deposit facility rate or the euro overnight index average (EONIA) rate (the ECB's deposit facility rate was negative at the end of both 2019 and 2018 at -0.50% and -0.40% respectively).

At the end of 2019 and 2018, the breakdown of Latvijas Banka's claims and liabilities to the Latvian government were as follows:

	(in thousands of euro)	
	2019	2018
Claims		
Securities held for monetary policy purposes	1 447 653	1 186 436
Other securities	47 057	46 990
Accrued interest on debt securities	17 485	13 220
Total claims	1 512 195	1 246 646
Liabilities		
Demand deposits in euro	442 044	129 113
Demand deposits in foreign currencies	153 351	150 535
Tax liabilities	13	66
Total liabilities	595 408	279 714

In 2019 and 2018, 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)	
	2019	2018
Income (-)/expense and Latvijas Banka's profit appropriated to the state budget		
Interest on debt securities	-10 381	-7 466
Negative interest on government deposits	-2 478	-544
Taxes	10 435	10 513
Profit appropriated to the state budget	10 196	15 524
Disposal of the real estate	1 401	484
Total net expense and Latvijas Banka's profit appropriated to the state budget	9 173	18 511

Expenses on disposal of real estate comprise the transfer of the real estate of the Liepāja Branch of Latvijas Banka (decision on its closure was made in 2019) and that of the Training Centre of Latvijas Banka closed in 2018 in the possession of the Ministry of Finance without any compensation pursuant to the Law on Public Entity's Property Disposal.

44. PLEDGED ASSETS

Debt securities, gold and other financial instruments purchased by Latvijas Banka with the market value of 1 977 786 thousand euro, as at the end of 2019 (137 040 thousand euro at the end of 2018), have been pledged to provide repurchase agreement deals, 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 2019, the pledged assets mostly consisted of securities pledged under repurchase agreements in the amount of 1 670 109 thousand euro (0 at the end of 2018).

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 2019, the fair value of the securities lent, determined using quoted prices in an active market, was 1460 thousand euro (27 886 thousand euro at the end of 2018); inter alia, the fair value of securities purchased and lent under the PSPP stood at 16 thousand euro at the end of 2019 (14 824 thousand euro at the end of 2018).

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 2019, the uncalled portion of the BIS shareholding was 4012 thousand SDR (4951 thousand euro; 4012 thousand SDR (4877 thousand euro) at the end of 2018; see also Note 14.2).

At the end of 2019, Latvijas Banka had issued euro collector coins, lats collector coins and precious metal circulation coins in the nominal value of 6960 thousand euro (6878 thousand euro at the end of 2018). 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 2019, Latvijas Banka had issued lats banknotes and coins with the face value of 122 174 thousand euro (124 514 thousand euro at the end of 2018), reported on the balance sheet in the amount of 26 574 thousand euro (28 915 thousand euro at the end of 2018). 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 (95 600 thousand euro at the end of 2018) at face value, is low.

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. 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. Ilmārs Rimšēvičs' term of office as the Governor of Latvijas Banka expired on 20 December 2019, and Mārtiņš Kazāks became Governor of Latvijas Banka on 21 December 2019. According to Latvijas Banka's management, the factors associated with Ilmārs Rimšēvičs, former Governor of Latvijas Banka, had no effect on the financial position of Latvijas Banka and its financial performance results and will have no future effect either.

47. EVENTS AFTER THE REPORTING PERIOD

As a result of the departure of the United Kingdom from the EU on 30 January and the withdrawal of the Bank of England from the ESCB, the weightings of the remaining NCBs in the key for subscription to the ECB's capital were adjusted with effect from 1 February 2020. The Bank of England's share in the ECB's subscribed capital (14.3374%) was reallocated among other NCBs; hence the capital key of Latvijas Banka increased from 0.2731% to 0.3169%. The total subscribed capital of the ECB remained unchanged at 10.8 billion euro; therefore, the share of Latvijas Banka in the ECB's subscribed capital increased by 4742 thousand euro, to 34 305 thousand euro.

Proceeding with the implementation of cost efficiency improvement measures, inter alia upgrading the cash processing equipment of the Riga Branch and centralising the cash circulation process, in 2019 Latvijas Banka decided to close its Liepāja Branch as of 30 January 2020, with services to customers being provided until 30 December 2019. As a consequence, the number of employees of Latvijas Banka decreased from 479 employees at the end of 2019 to 448 employees on 30 January 2020.



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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 48, which comprise:

- the balance sheet as at 31 December 2019,
- 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 2019, 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 AS
Licence No. 55

A handwritten signature in blue ink, appearing to read 'Vilāns'.

Rainers Vilāns
Partner
Latvian Certified Auditor
Certificate No. 200
Riga, Latvia
27 February 2020