# RIETUMU BANK GROUP

## Consolidated and Bank Financial Statements
## and Auditor's Report
## for the year ended 31 December 2007

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## REPORT OF COUNCIL AND MANAGEMENT BOARD

### 1 Operating results

In 2007 Rietumu Bank celebrated the 15th anniversary of its founding. During the year, the bank continued to develop successfully and demonstrated impressive growth. Net profit of the bank reached EUR 50 million – a historical record result for Rietumu, confirming the bank's position as one of the most profitable and efficient banks in the Baltics. Assets of the bank grew by 32% to EUR 1.74 billion (LVL 1.2 billion).

For further expanding its business activity further the bank attracted a 3 years EUR 120 million commercial syndicated loan with participation from 19 banks. This transaction was the first commercial three-years syndication in the Baltic States extended to a privately owned bank. The attracted funds authenticate the growing confidence of global investors in Rietumu and the bank's dynamic growth. The attracted funds are being used for lending and investment projects in Latvia and abroad. This transaction is the third syndicated loan for Rietumu Bank.

In 2007 , all major construction works at Rietumu Bank's new headquarters *Rietumu Capital Centre* were finished. Rietumu Capital Centre, located in the Riga downtown its dynamic and fast growing business district, is heralded as the first Class A+++ office development, having no equivalent in Latvia owing to its super functionality and hi-tech engineering solutions.

The bank continued to develop banking products and services, particularly in the investment realm. The bank has developed and introduced capital-protected structured notes, started to create its own new investment funds and collaborated with world-known international fund managers in creating efficient portfolios for its asset management clients.

The overall growth of the bank's operations allowed to offer its customers more favorable term deposit interest rates and advantageous conditions on all savings accounts.

Rietumu Bank also expanded the representative offices network by opening a new office in Romania's capital city – Bucharest .Rietumu Bank's worldwide representative offices are also located in Moscow, St. Petersburg, Minsk, Kiev, Alma-Ata, Vilnius and Prague.

In the sphere of technology Rietumu Bank introduced a new faster version of the Internet-banking platform - Rietumu BankWorld, which ensures even higher quality and enhanced malfunction protection, as well as upgraded its phone- banking system M-Bank.

In 2007 changes occurred on the Executive Board of the Bank. Mr. Rolf Fuls resigned from the position of First Vice-president and Member of the Executive Board .Mr. Fuls has started up his own business while retaining close links with Rietumu as its shareholder and advisor to the Board. The Vice-president Alexander Pankov was approved for the position of the First Vice-president. Thus, the Executive Board of Rietumu Bank currently consists of four members: Alexander Kalinovski (Chairman of the Board, President), Alexander Pankov (Member of the Board, First Vice-president), Dmitry Pyshkin (Member of the Board, Senior Vice-president) and Janis Muizhnieks (Member of the Board, Senior Vice-president).

Rietumu Bank continued its social commitment program focusing on supporting significant projects in the realm of arts and culture, as well as charity programs, concentrating on child healthcare and social welfare. In 2007 the bank established its own Charity Fund to further expand and develop its charity agenda.

## 2 Financial results of the Group

| | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|
| **At year end (LVL'000)** | | | | |
| Total assets | 1,216,241 | 921,507 | 704,197 | 603,209 |
| Loans and advances to customers | 599,436 | 374,695 | 256,276 | 192,011 |
| Other interest earning assets (bonds) | 98,595 | 90,308 | 78,671 | 80,381 |
| Due to customers | 876,791 | 659,943 | 602,578 | 539,585 |
| Total shareholders' equity | 121,331 | 96,158 | 71,942 | 44,380 |
| | | | | |
| **For the year (LVL'000)** | | | | |
| Net profit before tax | 40,199 | 33,937 | 22,052 | 14,565 |
| Net profit after tax | 34,607 | 29,584 | 18,960 | 14,568 |
| Operating income | 61,670 | 55,279 | 42,978 | 31,919 |

## 3 Ratios

| | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|
| Earnings per share (LVL) | | | | |
| After tax | 1.54 | 1.31 | 0.89 | 0.71 |
| Before tax | 1.79 | 1.51 | 1.06 | 0.80 |
| | | | | |
| Dividend per share (LVL) | 0.39 | 0.33 | 0.225 | 0.144 |
| Dividend growth | 18% | 47% | 56% | 52% |
| | | | | |
| Capital adequacy | | | | |
| Basle | 14.42% | 15.77 % | 16.14% | 14.35% |
| Financial & Capital Markets Commission | 14.04% | 14.85 % | 13.99% | 14.11% |
| | | | | |
| Return on equity | | | | |
| Before tax | 33,13% | 35.29% | 37.92% | 38.53% |
| After tax | 28,52% | 30.77% | 32.60% | 38.54% |
| | | | | |
| Return on assets | | | | |
| Before tax | 3.31% | 3.68% | 3.13% | 2.41% |
| After tax | 2.85% | 3.21% | 2.69% | 2.42% |
| | | | | |
| Profit margin (before tax) | 65.18% | 61.39% | 52.46% | 51.72% |
| | | | | |
| Number of employees | 631 | 657 | 648 | 578 |

## REPORT OF COUNCIL AND MANAGEMENT BOARD

During 2007, total assets of the Group grew by 32 % to LVL1,216 as at 31 December 2007 from LVL 922 million at December 31, 2006. .Customers' deposits increased by 33% from LVL 660 million at December 31, 2006 to LVL 877 million at December 31, 2007.

The Group's net profit before tax for 2007 was LVL 40 million (in 2006: LVL 34 million) representing an increase of LVL 6 million. Total shareholders' equity increased from LVL 96 million at December 31 2006 to LVL 121 million at December 31 2007.

The Bank has been paying annual dividends since 2001. For the financial year 2007 the Bank's management proposes to pay a dividend of LVL 0.39 per share (2006: LVL 0.33 per share) or LVL 8 million in total. (2006: LVL 7 million).

There have been no significant events with material effect on the results of the reporting period between the balance sheet date and the date of signing these financial statements.

We are looking forward to 2008 and beyond and we firmly believe that we will continue to offer our customers the best corporate banking services in the Baltic States, CEE and the CIS countries. We owe our success to our customers and business partners and we would like to express our appreciation to our customers and business partners for the trust that they have placed in us.

| | |
|---|---|
| Leonid Esterkin<br>Chairman of the Council | Alexander Kalinovsky<br>Chairman of the Executive Board |

Riga, March 20, 2008

## THE COUNCIL AND MANAGEMENT OF THE BANK

As of the date of the signing of the financial statements:

**The Council of Rietumu bank**
**16 September 2006 – 31 December 2007**

| *Name* | *Position* | *Date of appointment* |
|---|---|---|
| Leonid Esterkin | Chairman of the Council | 15/04/98 (15/09/06 – 15/09/09) |
| Arkady Syharenko | Deputy Council Chairman | 15/04/98 (15/09/06 – 15/09/09) |
| Murphy Brendan Thomas | Deputy Council Chairman | 16/09/05 (15/09/06 – 15/09/09) |
| Dermot Desmond | Member of the Council | 16/09/05 (15/09/06 – 15/09/09) |
| Vitali Lipanov | Member of the Council | 16/09/05 (15/09/06 – 15/09/09) |
| Michael Joseph Bourke | Member of the Council | 15/09/06 (15/09/06 – 15/09/09) |
| Valentin Bluger | Member of the Council | 15/04/98 (15/09/06 – 15/09/09) |

**The Board of Directors**
**1 January 2007 – 31 May 2007**

| *Name* | *Position* | *Date of appointment* |
|---|---|---|
| Alexander Kalinovsky | Chairman of the Executive Board, President | 20/07/06 (20/07/06 – 20/07/09) |
| Rolf Fuls | Member of the Executive Board, First Vice President | 20/07/06 (20/07/06 – 20/07/09) |
| Alexander Pankov | Member of the Executive Board, First Vice President | 20/07/06 (20/07/06 – 20/07/09) |
| Janis Muizhnieks | Member of the Executive Board, Senior Vice President | 20/07/06 (20/07/06 – 20/07/09) |
| Dmitry Pyshkin | Member of the Executive Board, Senior Vice President | 20/07/06 (20/07/06 – 20/07/09) |

**The Board of Directors**
**31 May 2007 – 31 December 2007**

| *Name* | *Position* | *Date of appointment* |
|---|---|---|
| Alexander Kalinovsky | Chairman of the Executive Board, President | 20/07/06 (20/07/06 – 20/07/09) |
| Alexander Pankov | Member of the Executive Board, First Vice President | 20/07/06 (20/07/06 – 20/07/09) |
| Janis Muizhnieks | Member of the Executive Board, Senior Vice President | 20/07/06 (20/07/06 – 20/07/09) |
| Dmitry Pyshkin | Member of the Executive Board, Senior Vice President | 20/07/06 (20/07/06 – 20/07/09) |

There were no changes in the Board of Directors of the Bank during the period beginning December 31, 2007 through to the date of the signing of these financial statements.

## STATEMENT OF MANAGEMENT RESPONSIBILITY

The Management of Rietumu Bank (Bank) is responsible for the preparation of the consolidated financial statements of the Bank and its subsidiaries (the Group) as well as for the preparation of the financial statements of the Bank.

The consolidated and the Bank's financial statements on pages 10 to 57 are prepared in accordance with the source documents and present fairly the financial position of the Bank and the Group as of December 31, 2007 and the results of its operations and cash flows for the year ended December 31, 2007 as well as the financial position of the Bank as of 1 December 31, 2007 and the results of its operations and cash flows for the year ended December 31, 2007.

The consolidated and the Bank's financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union on a going concern basis. Appropriate accounting policies have been applied on a consistent basis. Prudent and reasonable judgments and estimates have been made by the Management in the preparation of the financial statements.

The Management of Rietumu Bank is responsible for the maintenance of proper accounting records, the safeguarding of the Group's assets and the prevention and detection of fraud and other irregularities in the Group. The Management is also responsible for operating the Bank in compliance with the Law on Credit Institutions, regulations of the Finance and Capital Markets Commission and other legislation of the Republic of Latvia applicable to credit institutions.

On behalf of the Management of the Bank:

| | |
|---|---|
| Leonid Esterkin | Alexander Kalinovsky |
| Chairman of the Council | Chairman of the Executive Board |

Riga, March 20, 2008

KPMG Baltics SIA
Balasta dambis 1a
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Latvia

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# Independent Auditors' Report

## To the shareholders of AS "Rietumu Banka"

### Report on the Financial Statements

We have audited the accompanying financial statements of AS "Rietumu Banka", which comprise the unconsolidated balance sheet as at 31 December 2007, and the unconsolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 10 to 57. We have also audited the accompanying consolidated financial statements of AS "Rietumu Banka" and subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 10 to 57.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

*Opinion*

In our opinion, the unconsolidated AS "Rietumu Banka" financial statements give a true and fair view of the financial position of the Bank as at 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

## Report on Other Legal and Regulatory Requirements

In addition, our responsibility is to assess whether the accounting information included in the Report of Council and Management Board, as set out on pages 3 to 5, the preparation of which is the responsibility of management, is consistent with the financial statements. Our work with respect to the Management Report was limited to the aforementioned scope and did not include a review of any information other than drawn from the financial statements of the Bank. In our opinion, the management report is consistent with the financial statements.

KPMG Baltics SIA
License No 55

Stephen Young
Chairman of the Board
Riga, Latvia
20 March 2008

Inga Lipšāne
Sworn Auditor
Certificate No 112

This report is an English translation of the original Latvian. In the event of discrepancies between the two reports, the Latvian version prevails.

## INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

| | | 2007 | | 2006 | |
|---|---|---|---|---|---|
| | **Notes** | **Group LVL'000** | **Bank LVL'000** | **Group LVL'000** | **Bank LVL'000** |
| Interest income | 4 | 58,497 | 58,139 | 42,771 | 42,338 |
| Interest expense | 5 | (21,787) | (21,866) | (11,365) | (11,476) |
| **Net interest income** | | **36,710** | **36,273** | **31,406** | **30,862** |
| Commission and fee income | 6 | 16,065 | 15,869 | 14,300 | 13,764 |
| Commission and fee expense | 7 | (4,439) | (4,539) | (2,875) | (2,763) |
| **Net commission and fee income** | | **11,626** | **11,330** | **11,425** | **11,001** |
| Profit from trading with financial instruments, net | 8 | 12,140 | 11,779 | 11,504 | 10,994 |
| Dividends received | | 45 | 668 | 47 | 637 |
| Other operating income | | 1,149 | 994 | 897 | 893 |
| **Operating income** | | **61,670** | **61,044** | **55,279** | **54,387** |
| Administrative expenses | 9 | (19,998) | (19,981) | (17,869) | (17,405) |
| Amortisation and depreciation charges | | (1,909) | (1,896) | (2,202) | (2,186) |
| Other operating expense | | (519) | (82) | (471) | (64) |
| Net impairment loss | 10 | (2,648) | (2,398) | (561) | (561) |
| Goodwill impairment | | - | - | (194) | (194) |
| Provision for litigation | | (408) | (408) | - | - |
| Profit from sale of property | | 4,038 | 4,038 | - | - |
| Loss from disposal of assets | | (27) | (27) | (45) | (9) |
| **PROFIT BEFORE TAX** | | **40,199** | **40,290** | **33,937** | **33,968** |
| Income tax expense | 11 | (5,592) | (5,535) | (4,353) | (4,346) |
| **PROFIT FOR THE PERIOD** | | **34,607** | **34,755** | **29,584** | **29,622** |

*The accompanying notes on pages 16 to 57 are an integral part of these Consolidated and Bank financial statements.*

The consolidated and bank financial statements are authorized for approval by the Council and the Board of Directors of the Bank on March 20, 2008 and signed on their behalf by:

| | |
|---|---|
| Leonid Esterkin | Alexander Kalinovsky |
| Chairman of the Council | Chairman of the Executive Board |

## BALANCE SHEET AND MEMORANDUM ITEMS AS AT 31 DECEMBER 2007

| | Notes | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with the central bank | 13 | 66,310 | 66,310 | 61,953 | 61,913 |
| Balances due from credit institutions | 14 | 405,464 | 404,506 | 360,653 | 360,237 |
| *- demand deposits* | | *275,912* | *274,954* | *206,188* | *205,772* |
| *- other deposits* | | *129,552* | *129,552* | *154,465* | *154,465* |
| Financial assets held for trading | 15 | 78,046 | 77,168 | 36,901 | 36,454 |
| *- bonds and other fixed income securities* | | *75,125* | *74,247* | *32,802* | *32,801* |
| *- shares and other non-fixed income securities* | | *1,563* | *1,563* | *3,023* | *2,577* |
| *- derivative financial assets* | | *1,358* | *1,358* | *1,076* | *1,076* |
| Financial assets available-for-sale | 16 | 1,477 | 234 | 1,851 | 777 |
| *- bonds and other fixed income securities* | | - | - | *538* | *538* |
| *- shares and other non-fixed income securities* | | *1,477* | *234* | *1,313* | *239* |
| Loans and advances to non-banking customers | 17 | 599,436 | 598,699 | 374,695 | 373,633 |
| Held-to-maturity investments | 18 | 23,934 | 23,934 | 57,506 | 57,506 |
| Other accrued income and deferred expenses | 19 | 1,754 | 1,698 | 804 | 720 |
| Property, plant and equipment | 20 | 32,533 | 32,015 | 18,233 | 18,200 |
| Intangible assets | 21 | 2,978 | 2,977 | 3,361 | 3,358 |
| Investments in subsidiaries and associated entities | 22 | 52 | 14,304 | 310 | 13,955 |
| Other assets | 23 | 4,257 | 4,214 | 5,240 | 4,461 |
| **Total assets** | | **1,216,241** | **1,226,059** | **921,507** | **931,214** |

*The accompanying notes on pages 16 to 57 are an integral part of these Consolidated and Bank financial statements.*

The consolidated and bank financial statements are authorized for approval by the Council and the Board of Directors of the Bank on March 20, 2008 and signed on their behalf by:

Leonid Esterkin
Chairman of the Council

Alexander Kalinovsky
Chairman of the Executive Board

## BALANCE SHEET AND MEMORANDUM ITEMS AS AT 31 DECEMBER 2007

| | Notes | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|---|
| **LIABILITIES** | | | | | |
| Balances due to credit institutions | 24 | 159,479 | 159,534 | 126,066 | 126,066 |
| *- demand deposits* | | *15,157* | *15,212* | *4,600* | *4,600* |
| *- term deposits* | | *144,322* | *144,322* | *121,466* | *121,466* |
| Balances due to customers | 25 | 876,791 | 885,879 | 659,943 | 670,016 |
| *- demand deposits* | | *635,974* | *645,062* | *523,495* | *533,583* |
| *- term deposits* | | *240,817* | *240,817* | *136,448* | *136,433* |
| Amounts payable under repurchase agreements | 26 | 51,037 | 51,037 | 32,321 | 32,321 |
| Held-for-trading financial liabilities | | | | | |
| *- derivative financial liabilities* | | 360 | 418 | - | - |
| Deferred income and accrued expense | 27 | 2,180 | 2,152 | 1,286 | 954 |
| Current tax liability | | 316 | 298 | 544 | 542 |
| Deferred tax liability | 28 | 1,291 | 1,287 | 1,809 | 1,809 |
| Other liabilities | | 3,078 | 2,866 | 3,380 | 3,355 |
| Provisions | 31 | 378 | 378 | - | - |
| **Total liabilities** | | **1,094,910** | **1,103,849** | **825,349** | **835,063** |
| **EQUITY** | | | | | |
| Share capital | 29 | 22,500 | 22,500 | 22,500 | 22,500 |
| Share premium | | 4,809 | 4,809 | 4,809 | 4,809 |
| Legal reserve | | 16 | 16 | 16 | 16 |
| Revaluation reserve – property | | 3,284 | 3,284 | 4,623 | 4,623 |
| Revaluation reserve – foreign currency translation | | - | - | 738 | - |
| Retained earnings | | 90,722 | 91,601 | 63,472 | 64,203 |
| **Total equity** | | **121,331** | **122,210** | **96,158** | **96,151** |
| **Total liabilities and equity** | | **1,216,241** | **1,226,059** | **921,507** | **931,214** |
| **MEMORANDUM ITEMS** | | | | | |
| Contingent liabilities (guarantees) | | 8,857 | 8,857 | 10,782 | 10,782 |
| Letters or credit | | 1,454 | 1,454 | 12,881 | 12,881 |
| Financial commitments (unutilized credit lines) | | 69,004 | 69,004 | 57,834 | 58,434 |
| | | **79,315** | **79,315** | **81,497** | **82,097** |

*The accompanying notes on pages 16 to 57 are an integral part of these Consolidated and Bank financial statements.*

The consolidated and bank financial statements are authorized for approval by the Council and the Board of Directors of the Bank on March 20,2008 and signed on their behalf by:

Leonid Esterkin
Chairman of the Council

Alexander Kalinovsky
Chairman of the Executive Board

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007

| GROUP | Share capital | Share premium | Legal reserve | Revaluation reserve – property | Revaluation reserve – foreign currency translation | Retained earnings | Total Shareholders' equity |
|---|---|---|---|---|---|---|---|
| | LVL'000 | LVL'000 | LVL'000 | LVL'000 | LVL'000 | LVL'000 | LVL'000 |
| **As of 31 December 2005** | **22,500** | **4,809** | **16** | **4,739** | **1,064** | **38,814** | **71,942** |
| Dividends paid | - | - | - | - | - | (5,063) | (5,063) |
| Net profit for the year | - | - | - | - | - | 29,584 | 29,584 |
| Foreign currency translation differences for foreign operations | - | - | - | - | (326) | - | (326) |
| Transfers (Note 2h) | - | - | - | (116) | - | 137 | 21 |
| **As of 31 December 2006** | **22,500** | **4,809** | **16** | **4,623** | **738** | **63,472** | **96,158** |
| Dividends paid | - | - | - | - | - | (7,425) | (7,425) |
| Net profit for the year | - | - | - | - | - | 34,607 | 34,607 |
| Foreign currency translation differences for foreign operations | - | - | - | - | (738) | - | (738) |
| Transfers (Note 2h) | - | - | - | (59) | - | 68 | 9 |
| Net result of revaluation and disposal of property | - | - | - | (1,280) | - | - | (1,280) |
| **As of 31 December 2007** | **22,500** | **4,809** | **16** | **3,284** | **-** | **90,722** | **121,331** |

*The accompanying notes on pages 16 to 57 are an integral part of these Consolidated and Bank financial statements.*

The consolidated and bank financial statements are authorized for approval by the Council and the Board of Directors of the Bank on March 20, 2008 and signed on their behalf by:

Leonid Esterkin
Chairman of the Council

Alexander Kalinovsky
Chairman of the Executive Board

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007

| BANK | Share capital LVL'000 | Share premium LVL'000 | Legal reserve LVL'000 | Revaluation reserve – property LVL'000 | Retained earnings LVL'000 | Total Shareholders' equity LVL'000 |
|---|---|---|---|---|---|---|
| **As of 31 December 2005** | **22,500** | **4,809** | **16** | **4,739** | **39,507** | **71,571** |
| Dividends paid | - | - | - | - | (5,063) | (5,063) |
| Net profit for the period | - | - | - | - | 29,622 | 29,622 |
| Transfers (Note 2h) | - | - | - | (116) | 137 | 21 |
| **As of 31 December 2006** | **22,500** | **4,809** | **16** | **4,623** | **64,203** | **96,151** |
| Dividends paid | - | - | - | - | (7,425) | (7,425) |
| Net profit for the period | - | - | - | - | 34,755 | 34,755 |
| Transfers (Note 2h) | - | - | - | (59) | 68 | 9 |
| Net result of revaluation and disposal of property | - | - | - | (1,280) | - | (1,280) |
| **As of 31 December 2007** | **22,500** | **4,809** | **16** | **3,284** | **91,601** | **122,210** |

*The accompanying notes on pages 16 to 57 are an integral part of these Consolidated and Bank financial statements.*

The consolidated and bank financial statements are authorized for approval by the Council and the Board of Directors of the Bank on March 20, 2008 and signed on their behalf by:

Leonid Esterkin
Chairman of the Council

Alexander Kalinovsky
Chairman of the Executive Board

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007

| | | 2007 | | 2006 | |
|---|---|---|---|---|---|
| | | Group | Bank | Group | Bank |
| | LVL' 000 | LVL'000 | LVL'000 | LVL'000 | LVL'000 |
| **CASH INFLOW FROM OPERATING ACTIVITIES** | | | | | |
| Profit before income tax | | 40,199 | 40,290 | 33,937 | 33,968 |
| Amortisation and depreciation | | 1,910 | 1,895 | 2,202 | 2,186 |
| Profit from sale of property | | (4,039) | (4,039) | - | - |
| Impairment losses (recoveries) | | 2,648 | 2,398 | 800 | 764 |
| **Increase in cash and cash equivalents before changes in assets and liabilities, as a result of ordinary operations** | | **40,718** | **40,544** | **36,939** | **36,918** |
| (Increase)/decrease in balances due from banks | | 24,913 | 24,913 | (95,794) | (95,794) |
| Increase in loans and advances to non-banking customers and receivables | | (226,883) | (227,208) | (117,072) | (124,073) |
| (Increase)/decrease in assets available-for-sale investments | | 374 | 543 | (210) | 17 |
| Increase in assets held-for-trading securities | | (41,601) | (40,432) | (33,978) | (33,619) |
| (Increase) in derivative assets and liabilities | | 78 | 136 | (350) | (350) |
| Increase in provisions | | 378 | 378 | - | - |
| Increase in accrued income and deferred expenses | | (950) | (978) | (2,931) | (2,058) |
| (Increase)/decrease in other assets | | 832 | 88 | (461) | (1,559) |
| Increase in balances due to credit institutions | | 22,856 | 22,856 | 114,876 | 114,876 |
| Increase in balances due to customers | | 216,848 | 215,863 | 89,137 | 96,303 |
| Increase in amounts payable under repurchase agreements | | 18,716 | 18,716 | - | - |
| Increase in deferred income and accrued expenses | | 894 | 1,198 | (97) | (154) |
| Increase in other liabilities | | (302) | (489) | (226) | 2,071 |
| **Increase in cash and cash equivalents from operating activities before corporate income tax** | | **56,871** | **56,128** | **(10,167)** | **(7,422)** |
| Corporate income tax paid | | (6,079) | (6,024) | (3,745) | (3,737) |
| **Net cash and cash equivalents from/(used in) operating activities** | | **50,792** | **50,104** | **(13,912)** | **(11,159)** |
| **CASH OUTFLOW FROM INVESTING ACTIVITIES** | | | | | |
| Purchase of property, plant and equipment | | (19,855) | (19,358) | (7,157) | (7,101) |
| Purchase of equity investments in other entities and acquisition of subsidiaries | | - | (349) | (164) | (3,048) |
| Sale of equity investments in other entities and acquisition of subsidiaries | | - | - | (62) | 246 |
| Decrease in held-to-maturity investments | | 33,572 | 33,572 | 20,674 | 20,674 |
| Proceeds from sale of property, plant and equipment | | 6,440 | 6,423 | 276 | 209 |
| **Increase in cash and cash equivalents from investing activities** | | **20,157** | **20,288** | **13,567** | **10,980** |
| **CASH INFLOW FROM FINANCING ACTIVITIES** | | | | | |
| Dividends paid | | (7,425) | (7,425) | (5,063) | (5,063) |
| **Decrease in cash and cash equivalents from financing activities** | | **(7,425)** | **(7,425)** | **(5,063)** | **(5,063)** |
| **Net cash inflow for the period** | | **63,524** | **62,967** | **(5,408)** | **(5,242)** |
| **Cash and cash equivalents at the beginning of the year** | | **263,541** | **263,085** | **268,949** | **268,327** |
| **Cash and cash equivalents at the end of the year** | 32 | **327,065** | **326,052** | **263,541** | **263,085** |

*The accompanying notes on pages 16 to 57 are an integral part of these Consolidated and Bank financial statements.*

## NOTES TO THE CONSOLIDATED AND BANK FINANCIAL STATEMENTS

### 1 INCORPORATION AND PRINCIPAL ACTIVITIES

A/s Rietumu Banka (the Bank) was established on May 13, 1992 and incorporated in the Republic of Latvia as a joint stock company, in which the shareholders have limited liability. The main areas of operation of the Bank and subsidiaries (the Group) include granting loans, transferring payments and exchanging foreign currencies both for its customers and for trading purposes. The Bank's legal address is 54 Brīvības street, Riga LV 1011, Latvia. The subsidiaries of the Bank are disclosed in Note 22.

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the principal accounting policies all of which have been applied consistently (unless otherwise stated), is set out below:

*a) Presentation and functional currency*

The accompanying financial statements are presented in thousands of lats (LVL 000's), unless otherwise stated, being the Group and Bank's functional currency. Subsidiaries of the Bank operate in the functional currency of LVL and USD.

*b) Statement of compliance*

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, and regulations of the Financial and Capital Market Commission in force as at the reporting date.

In preparing these financial statements, the Bank and Group has adopted *IFRS 7 Financial Instruments: Disclosures* and *IAS 1 Presentation of Financial Statements – Capital Disclosures* applicable for periods starting from 1 January 2007. The adoption of IFRS 7 and the amendments to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Bank and Group.

*Basis of preparation*

The financial statements have been prepared on the historical cost basis except for the following items which are carried at fair value. Derivative financial instruments, financial assets and liabilities carried at fair value through profit and loss account, and available for sale assets are measured at fair value except those whose fair value cannot be reliably estimated. Other financial assets and liabilities and non-financial assets and liabilities are carried at amortised cost in accordance with the effective interest rate method.

The accounting policies used in the preparation of the financial statements are consistent with those used in the annual financial statements for the year ended 31 December 2006.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period, in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year relate to loan loss impairment allowances and valuation of shares held as financial assets available for sale.

*New International Financial Reporting Standards and interpretations not yet effective*

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007, and have not been applied in preparing these consolidated and banks financial statements:

- IFRS 8 Operating Segments requires segment disclosure based on the components of the entity that management monitors in making decisions about operating matters. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. IFRS 8 is not relevant to the Bank and Group.
- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity-instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments needed are obtained. It also provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent should be accounted for as cash-settled or equity-settled in the entity's financial statements. IFRIC 11 is not relevant to the Group and Bank's operations as the Group and Bank have not entered into any share-based payments

arrangements.

- IFRS 2 Share-based Payment - the revised Standard will clarify the definition of vesting conditions and non-vesting conditions. The revised IFRS 2 is not relevant to the Group and Bank's operations as the Group and Bank do not have any share-based compensation plans.

- IFRIC 12 Service Concession Arrangements provides guidance to private sector entities on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12 is not relevant to the Group and Bank's operations as the Group and Bank have not entered into any service concession arrangements.

- IFRIC 13 Customer Loyalty Programmes addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13 is not relevant to the Group and Bank's operations as the Group and Bank do not have such customer loyalty programmes.

- Revised IAS 23 Borrowing Costs removes the option to expense borrowing costs borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Revised IAS 23 is not relevant to the Group and Bank's operations as the Group and Bank have not entered and is not expected to enter into any acquisition, construction or production transactions, for which specific borrowing would be attracted.

- IFRIC 14 IAS 19 – The limit on a defined Benefit Asset, Minimum funding Requirements and their interaction clarifies when refunds or reductions in future contributions in relation to defined assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. IFRIC 14 is not relevant to the Group and Bank's operations as the Group and Bank have not entered into long term employee benefit plans.

- IFRS 3 Business Combinations – has been amended and the definition of a business has been expanded, while introducing also other significant changes to the standard for accounting of business combinations. Revised IFRS 3 is not relevant to the Group and Bank's operations as the Group and Bank do not have any interests in subsidiaries that will be affected by the revisions to the Standard.

- IAS 1 Presentation of Financial Statements - revised Standard requires information in financial statements to be aggregated on the basis of shared characteristics and introduces a statement of comprehensive income. The Group and Bank are currently evaluating whether to present a single statement of comprehensive income, or two separate statements.

- IAS 27 Consolidated and Separate Financial Statements - in the revised Standard the term minority interest has been replaced by non-controlling interest, and is defined as "the equity in a subsidiary not attributable, directly or indirectly, to a parent". Revised IAS 27 is not relevant to the Group and Bank's operations as the Group and Bank do not have any interests in subsidiaries that will be affected by the revisions to the Standard.

*c) Basis of consolidation*

Subsidiaries are those entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Intra-group balances, and any unrealised gains income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Investments in subsidiaries are accounted for at cost in the Bank's financial statements. Subsidiary undertakings, which are those companies and other entities in which the Group, directly or indirectly, has power to exercise control over financial and operating policies, have been consolidated.

Associates are those entities in which the Group has significant influence, but no control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in associate, the Group's carrying amount is reduced to nil and recognition of further losses is discounted except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities incurred or assumed at the date of acquisition, plus costs directly attributable to the acquisition. See Note *g)* for the accounting policy on goodwill. The financial statements of the subsidiaries are consolidated in the Group's financial statements on a line-by-line basis by adding together similar types of assets and liabilities as well as income and expenses.

Balances of the foreign subsidiary have been included in the consolidated financial statements at the exchange rate set by the Bank of Latvia as at the end of the reporting period. Statement of income and statement of cash flows of foreign entity are translated into lats at average exchange rates for the year.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into Latvian lats at exchange rates at the reporting date. The income and expenses of foreign operations are translated to lats at exchange rates at the dates of the transactions.

Foreign currency differences are recognized directly in equity as foreign currency translation differences of foreign operations. When a foreign operations is disposed of, in part or full, the relevant amount in the foreign currency translation reserve is transferred to profit or loss.

*d) Financial instruments*

*Recognition*

The Group and Bank initially recognize loans and advances, deposits, and debt on the date that they are originated. All other financial assets and liabilities are initially recognized on the settlement date.

*Derecognition*

The Group and Bank derecognize a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

The Group derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

*Amortised cost measurement*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment loss.

*Loans and advances*

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

For the purposes of these financial statements, loans and advances include regular loans, credit card balances, as well as any other outstanding credit balances from non-banking customers. All loans and advances are recognized when cash is advanced to borrowers.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method. Certain expenses, such as legal fees or sales commissions for employees acting as agents or are incurred in securing a loan are treated as part of the cost of the transaction.

An impairment loss allowance for credit losses is established. The level of the impairment loss allowances is based on the estimates of known relevant factors affecting the loan collectability and collateral values. The ultimate loss, however, may vary significantly from the current estimates. These estimates are reviewed on a monthly basis, and, as adjustments become necessary, they are reported in the statement of income in the period in which they become known.

At each balance sheet date, Group and Bank assess on a case-by-case basis whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining impairment losses on these loans, the following factors are considered:

- Aggregates exposure to a customer;
- The viability of customer's business model and their capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- The amount and timing of expected receipts and recoveries;
- The likely dividend available on liquidation or bankruptcy;
- The extent of other creditors' commitments ranking ahead of, or *pari passu* with, the Group and Bank and the likelihood of other creditors continuing to support the company;
- The complexity of determining the aggregate amount an ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- The realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- The likely deduction of any costs involved in recovery of amounts outstanding;

When a loan is uncollectible, it is written off against the related impairment provision; subsequent recoveries are credited to the allowance expense in the statement of income.

*Held-to-maturity investments*

Investment securities where the management has both the intent and ability to hold to maturity are classified as held-to-maturity. Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity and are carried at amortised cost using the effective interest method, less impairment. Held-to-maturity securities are initially measured at fair value plus incremental direct transaction costs. Any sale or reclassification of a significant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale, and prevent the Group and Bank from classifying investment securities as held-to-maturity for the current and the following two financial years.

*Financial assets available-for-sale*

Securities intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices are classified as available-for-sale. Management determines the appropriate classification at the date of purchase. Available-for-sale assets are non-derivative investments and are carried at fair value except for unquoted equity securities whose fair value cannot be reliably measured and are carried at cost. The fair value is based on quoted bid prices or amounts derived from cash flow models. Available-for-sale financial instruments are initially measured at fair value plus incremental direct transaction costs. Unrealized gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognized in equity. Equity securities for which fair values cannot be measured reliably are recognized at cost less impairment loss. When the securities are disposed of or impaired, the related accumulated fair value adjustments are included in the statement of income as gains and losses from investment securities.

Interest income for fixed income securities is recognized in profit or loss using the effective interest method.

*Financial assets held for trading*

Trading securities are marketable securities that are acquired and sold with the intention of gaining profit on their short-term price fluctuation.

Financial assets held for trading are initially recognized and subsequently measured at fair value based on quoted bid prices in the balance sheet with transaction costs recognized directly in profit or loss statement. All related realized and unrealized gains and losses from changes in fair value are included in net trading income. Interest earned whilst holding trading securities is reported as interest income. Dividends received are included in dividend income. Trading securities are not reclassified subsequent to their initial recognition.

*e) Derivative financial instruments*

Derivative financial instruments including foreign exchange contracts, interest rate futures, forward rate agreements, currency and interest rate swaps, currency and interest rate options (both written and purchased) and other derivative financial instruments are initially recognized and subsequently are measured at their fair value. Fair values are obtained from quoted market prices, discounted cash flow models and options pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Changes in the fair value of derivatives held for trading are included in net trading income.

*f) Sale and repurchase agreements and lending of securities*

Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to other banks or customers as appropriate and separately disclosed in the respective balance sheet categories. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Securities borrowed are not recognized in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities is recorded at fair value as a trading liability.

*Identification and measurement of impairment*

At each balance sheet date the Group and Bank assess whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

The Group and Bank consider evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has occured but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets carried at amortised cost with similar risk characteristics.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against assets carried at amortised cost. Interest on impaired assets continues to be recognised through the unwinding of the discount.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

The determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations for financial instruments traded in active markets. For all other financial instruments fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist, and valuation models. The Group uses widely recognized valuation models for determining the fair value of common and more simple financial instruments like interest rate and currency swaps. For these financial instruments, inputs into models are market observable.

Loans are stated in the balance sheet at amortised cost, less any impairment allowances. Impairment losses and recoveries are recognized monthly based on regular loan reviews. Allowances during the period are reflected in the income statement.

*g) Goodwill*

Goodwill represents the excess of the cost of a business combination over the Bank's interest in the fair value of the net identifiable assets and contingent liabilities of the acquired subsidiary at the date of acquisition. Goodwill is measured at cost less accumulated impairment losses.

At each balance sheet date the Bank assesses whether there is any indication of impairment. If such indications exist, an analysis is performed to assess whether the carrying amount of goodwill is fully recoverable. An impairment is recognized if the carrying amount exceeds the recoverable amount. Please refer to *i)* for the estimation of the recoverable amount.

*h) Property, plant and equipment*

All property, plant and equipment is stated at historical cost or revalued amount less accumulated depreciation.

Depreciation is provided in equal monthly instalments over the expected useful lives, which have been estimated by the management as follows:

| | |
|---|---|
| Buildings and constructions | 50 years |
| Office equipment | 4 - 5 years |
| Vehicles | 5 years |
| Other property, plant and equipment | 2 - 5 years |

The buildings were revalued as at 31 December 2007. Depreciation methods, useful lives, and residual values are reviewed at each reporting date. Revaluation is made on the basis of valuations performed by independent external valuer biannually. Increases in the carrying amount arising on revaluation of property are credited to the revaluation reserve in shareholders equity. Decreases that offset previous increases of the same asset are charged against that reserve; all other decreases are charged to the statement of income. Each year the difference between the depreciation based on the revalued carrying amount of the asset (the depreciation charged to the statement of income) and depreciation based on the asset's original cost is transferred from revaluation reserve to retained earnings.

Leasehold improvements are capitalized and depreciated over the lesser of their useful life and the remaining lease contract period on a straight-line basis.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewal are charged to the statement of income when the expenditure is incurred.

*i) Impairment of non-financial assets*

The carrying amounts of the Group and Bank's assets, other than deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated. The recoverable amount of goodwill is estimated at each reporting date.

An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognized in the income statement. Impairment losses recognized in respect of cash-generating units are allocated first to reduce carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a *pro rata* basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed unless the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

*j) Interest bearing liabilities*

Interest-bearing borrowings are recognised initially at fair value, net of any transaction costs incurred. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowing according to the effective interest rate method.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

*k) Funds under trust management*

Funds managed by the Group and Bank on behalf of its customers, funds and other institutions are not regarded as assets of the Bank and, therefore, are not included in its balance sheet.

*l) Income and expense recognition*

All interest income and expense items are recognized on an accrual basis using the effective interest rate method based on actual purchase price. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis. No interest income is recognized on non-performing loans and advances in which interest is unlikely to be collected. The recognition of interest income ceases when the payment of interest or principal is in doubt and accrued interest is automatically provided for applying the effective interest rate. Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against assets carried at amortised cost. Interest on impaired assets continues to be recognised through the unwinding of the discount. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other instruments.

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

Commissions and fee income, except for loan origination fees, is generally recognized on an accruals basis when the service has been provided. Loan origination fees for loans, which are probable of being drawn down, are deferred, together with related direct costs, and recognized using the effective interest rate on the loan.

Finance lease income is recognized over the term of the lease using the net investment method, which reflects a constant periodic rate of return on the net investment amount outstanding on the finance leases.

Operating lease income is recognized on a straight-line basis over the lease term.

*m) Foreign currency translation*

Transactions denominated in foreign currency are translated into LVL at the official Bank of Latvia exchange rate on the date of the transaction, which approximates the prevailing market rates. Any gain or loss resulting from the change in rates of exchange subsequent to the date of transaction is included in the statement of income as a profit or loss from the revaluation of foreign currency positions. Monetary assets and liabilities, including outstanding commitments to deliver or acquire foreign currencies under spot exchange transactions, are translated at the official rate of exchange at the balance sheet date.

All translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses. Thus, underlying translation differences on available-for-sale equities are included in the revaluation reserve in equity.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value or cost are translated at the exchange rate at the date that the fair value or cost was determined.

The principal rates of exchange (LVL to 1 foreign currency unit) set forth by the Bank of Latvia and used in the preparation of the Group's and Bank's balance sheet as of 31 December 2007 and 31 December 2006 were as follows:

| **31.12.2007** | | **31.12.2006** | |
|---|---|---|---|
| USD | 0.4840 | USD | 0.5360 |
| EUR | 0.7028 | EUR | 0.7028 |
| RUB | 0.0197 | RUB | 0.0203 |
| UAH | 0.0958 | UAH | 0.1060 |

*n) Corporate income tax*

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the income statement except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. The charge for current taxation is based on computations made by management separately for each of the Group companies in accordance with respective tax legislation.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor tax profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

The principal temporary differences arise from depreciation on property and equipment, allowances for loan loss impairment, tax losses carried forward and revaluation of properties and certain financial assets and liabilities, including derivative contracts.

The amount of deferred tax related to fair value re-measurement of available-for-sale investments, which is charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognized in the statement of income together with the deferred gain or loss.

A deferred tax asset is recognized only to the extent that is probable that future taxable profits will be available against which the assets can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that is no longer probable that the related tax benefit will be realized.

*o) Cash and cash equivalents*

For the purpose of presentation in the statement of cash flows, cash and cash equivalents are defined as the following:
+ Cash and balances with central banks;
+ Demand deposits due from other banks;
- Demand deposits due to other banks.

*p) Treasury shares*

Where the Bank or its subsidiaries purchase the Bank's share capital or obtains rights to purchase its share capital, the consideration paid including any attributable transaction costs is shown as a deduction from total shareholders' equity.

*q) Provisions*

Provisions are recognized when there is a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

*r) Leases*

*Finance lease*

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

When assets are leased out under a finance lease, the net investment in finance lease is recognized as a receivable. The net investment in finance lease represents the difference between the gross receivable and unearned finance income.

*Operating lease*

An operating lease is a lease other than a finance lease.

Assets leased out under an operating lease, are presented within property, plant and equipment in the balance sheet, less accumulated depreciation. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment.

*s) Short-term employee benefits*

Short-term employee benefits are measured on an undiscounted basis and are expensed as the related service is provided.

Employee entitlements to annual leave and long service leave are recognized when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

A provision is recognized for the amount expected to be paid under short-term cash bonus of profit sharing plans if the Group and Bank have a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

*t) Regulatory requirements*

The Bank is subject to the regulatory requirements of the Bank of Latvia and the Finance and Capital Market Commission. The major requirements relate to credit risk concentration, capital adequacy, liquidity and foreign currency exposure.

## 3 FINANCIAL RISK MANAGEMENT

### A Strategy in using financial instruments

By its nature the Group and Bank's activities are principally related to the use of financial instruments including derivatives. The Group and Bank accept deposits from customers at both fixed and floating rates and for various periods and seek to earn interest margins by investing these funds in high quality assets. The Group and Bank seek to increase these margins by consolidating short-term funds and lending for longer periods at higher rates whilst maintaining sufficient liquidity to meet all claims that might fall due.

The Group and Bank also seek to raise its interest margins by obtaining above market margins through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances but the Group and Bank also enter into guarantees and other commitments such as letters of credit and performance, and other bonds.

The Group and Bank also trade in financial instruments where they take positions in traded and over the counter instruments including derivatives to take advantage of short-term market movements in the equity and bond markets and in currency, interest rate and commodity prices. The Board places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. With the exception of specific hedging arrangements, foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions. The Group and Bank do not apply hedge accounting.

### B Capital management and capital adequacy

The Group and Bank's objectives when managing capital, which is a broader concept than the "equity" on the face of balance sheet, are:

- To comply with the capital regulatory requirements;
- To safeguard the Group and Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders;
- To maintain the strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Group and Bank's management, employing techniques based on the guidelines developed by the Basle Committee and the European Community directives, as implemented by the Financial and Capital Market Commission. The required information is filed with the Financial and Capital Market Commission on a monthly basis. The Credit Institution Law and regulations developed by the Financial and Capital Market Commission for application of the norms of this law, require Latvian banks to maintain a capital adequacy ratio of 8%, i.e., Group and Bank's capital ratio against the risk weighted assets and memorandum items and the sum of notional risk weighted assets and memorandum items. The sum of notional risk weighted assets and memorandum items is determined as the sum of capital requirements of market risks, multiplied by 12.5

To monitor the adequacy of its capital the Group and Bank use ratios established by the Bank for International Settlements (BIS) and Financial and Capital Markets Commission. These ratios measure capital adequacy (minimum 8% as required by BIS and, as from November 2004 also by the Financial and Capital Markets commission ) by comparing the Group and Bank's eligible capital with its balance sheet assets, off-balance-sheet commitments and market and other risk positions at weighted amounts to reflect their relative risk.

The market risk approach covers the general market risk and the risk of open positions in currencies and debt and equity securities. Assets are weighted according to broad categories of notional risk, being assigned a risk weighting according to the amount of capital deemed to be necessary to support them. Four categories of risk weights (0%, 20%, 50%, 100%) are applied; cash and money market instruments have a zero risk weighting which means that no capital is required to support the holding of these assets. Property and equipment carries a 100% risk weighting, meaning that it must be supported by capital equal to 8% of the carrying amount.

Off-balance-sheet credit related commitments and forwards and options based derivative instruments are taken into account by applying different categories of conversion factors, designed to convert these items into balance sheet equivalents. The resulting equivalent amounts are then weighted for risk using the same percentages as for on-balance-sheet assets.

A detailed analysis of the Group Capital Adequacy is presented in Note 35.

### C Credit risk

The Group and Bank take on exposure to credit risk which is the risk of a financial loss to the Group and Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's and Bank's loans and advances to customers and other banks and investment securities. The Group and Bank structure the levels of credit risk undertaken by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved quarterly by the Board of Directors. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily. Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

**Derivatives**

The Group and Bank maintain strict control limits on net open derivative positions, i.e. the difference between purchase and sale contracts, by both amount and term. At any one time the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group and Bank (i.e. assets), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group and Bank require margin deposits from counterparties.

**Credit related commitments**

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group and Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group and Bank on behalf of a customer authorizing a third party to draw drafts on the Group and Bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to make loans at a specific rate of interest during a fixed period of time are accounted for as derivatives and accounted for as such unless these commitments do not extend beyond the period expected to be needed to perform appropriate underwriting, in which case they considered to be “regular way” transactions.

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group and Bank are potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group and Bank monitor the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

**D Market risk**

The Group and Bank take on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Group applies a real-time centralized routine process, which enables the Group and Bank to be sufficiently flexible to sudden changes in the financial markets. The system of limits established for market risk management in the Group and Bank evaluates such risks on a nominal basis as well as through a ‘value at risk’ methodology to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions. The Board of Directors sets limits, which are monitored on a daily basis.

**E Currency risk**

The Group and Bank take on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The Group and Bank’s exposure to foreign currency risk is presented in Note 34.

**F Interest rate risk**

The Group and Bank take on exposure to the effects of fluctuations in the prevailing levels of market interest rates on the future cash flows or fair values of financial instruments. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily. The Group and Bank’s exposure to interest rate risk is presented in Note 37.

**G Liquidity risk**

The Group and Bank are exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash settled derivatives. The Group and Bank do not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

Note 36 analyses assets and liabilities of the Group and Bank into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

**Maturities of assets and liabilities**

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group and Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest–bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and Bank and their exposure to changes in interest rates and exchange rates.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group and Bank do not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

**H Fiduciary activities**

The Group and Bank provide custody, trustee, corporate administration, investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements. Risks and benefits associated with these assets is borne by the clients of the Group and Bank. Some of these arrangements involve the Group and Bank accepting targets for benchmark levels of returns for the assets under the Group and Bank's care. These services give rise to the risk that the Group and Bank will be accused of mal-administration or under-performance.

**I Reputation risk**

The Bank recognises risks resulting from the committed and possible acts of terrorism worldwide, legalisation of illegally obtained funds and organised crime. To eliminate such risks the Bank sets a target to perform its activity in a way to secure itself against the risk to get involved in possible money laundering and deals that finance terrorism. The objective of the policy of the Bank's activity is to provide business activities in conformity with the legislation and international requirements regulating actions and conduct, securing itself against the risk to get involved in money laundering deals, to minimise the possibility to co-operate with customers whose activities fail to comply with laws and the policy of the Bank, to protect the Bank from possible losses, to prevent damage to the Bank's reputation and not to permit the loss of confidence in the Bank.

**J Operational risk management**

The Group and Bank implements Operational Risk Management Policy in compliance with the effective legislation of the European Union and the Republic of Latvia. The Policy is developed in accordance with the strategic development plan of the Bank. The aim of the Operational Risk Management Policy is defining and implementing a complex of measures regarding the identification of significant operational risk typical for the main directions of the Bank's business, as well as prevention against losses caused by significant operational risk. The task of Operational Risk Management Policy is creation of conditions at the Bank for effective management of significant operational risk including:

- creation of environment appropriate for significant operational risk management;
- usage of adequate methods for disclosing and evaluating significant operational risk;
- regular monitoring of operational risk management;
- adequate control and minimisation of significant operational risk;
- provision of the Bank's business continuity.

## 4 INTEREST INCOME

Interest income is comprised of the following:

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| Interest income from loans and receivables: | | | | |
| On balances due from credit institutions | 15,063 | 15,063 | 14,102 | 14,091 |
| On loans granted to customers | 40,263 | 39,905 | 24,697 | 24,275 |
| On trade securities | 1,887 | 1,887 | 869 | 869 |
| On AFS securities | 22 | 22 | 34 | 34 |
| On HTM securities | 1,262 | 1,262 | 3,069 | 3,069 |
| **Total** | **58,497** | **58,139** | **42,771** | **42,338** |

## 5 INTEREST EXPENSE

Interest expense is comprised of the following:

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| Interest expense on liabilities at amortised cost: | | | | |
| On balances due to other banks | 7,291 | 7,291 | 2,925 | 2,921 |
| On due to customers | 13,046 | 13,125 | 7,177 | 7,292 |
| Other | 1,450 | 1,450 | 1,263 | 1,263 |
| **Total** | **21,787** | **21,866** | **11,365** | **11,476** |

## 6 COMMISSION AND FEE INCOME

Commission and fee income is comprised of the following:

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| Money transfers | 8,545 | 8,545 | 6,704 | 6,704 |
| Commission income from payment cards | 3,024 | 3,024 | 2,584 | 2,584 |
| Revenue from customer asset management and brokerage commissions | 1,532 | 1,532 | 2,022 | 710 |
| Cash withdrawals | 320 | 320 | 352 | 352 |
| Account opening and closing | 274 | 274 | 373 | 373 |
| Fees for guarantees and trade finance operations | 657 | 657 | 589 | 589 |
| Remote systems fee | 617 | 617 | 612 | 612 |
| Corporate finance services | - | - | 108 | 883 |
| Other | 1,096 | 900 | 956 | 957 |
| **Total** | **16,065** | **15,869** | **14,300** | **13,764** |

## 7 COMMISSION AND FEE EXPENSE

Commission and fee expense is comprised of the following:

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| Banks | 1,294 | 1,294 | 751 | 751 |
| Credit card expenses | 1,058 | 1,058 | 937 | 937 |
| Commission fee expense for debt | 841 | 841 | 504 | 504 |
| Brokerage commission | 466 | 420 | 221 | 135 |
| Cash withdrawals | 9 | 9 | 17 | 17 |
| Other commission | 771 | 917 | 445 | 419 |
| **Total** | **4,439** | **4,539** | **2,875** | **2,763** |

## 8 PROFIT FROM TRADING WITH FINANCIAL INSTRUMENTS, NET

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| Foreign exchange profit from conversion of currencies | 10,904 | 10,952 | 10,060 | 10,001 |
| Loss from foreign currency revaluation | (94) | (198) | (1,287) | (1,218) |
| Profit from transactions with trading securities | 1,949 | 1,610 | 1,186 | 666 |
| Profit/(loss) from revaluation of securities and financial instruments | (2,343) | (2,305) | 655 | 655 |
| Profit from deals with other financial instruments | 1,724 | 1,720 | 890 | 890 |
| **Total net gain from trading with securities and foreign currencies** | **12,140** | **11,779** | **11,504** | **10,994** |

**Foreign currency contracts**

The table below summarizes the contractual amounts of the Bank's forward exchange contracts outstanding at December 31, 2007. The resultant unrealized gains and losses on these unmatured contracts, along with the amounts payable and receivable on the matured but unsettled contracts, have been recognized in the income statement and in prepaid expenses and accrued income and other liabilities.

| | Notional amount | | Fair value | | | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | | 2006 | |
| | | | Assets | Liabilities | Assets | Liabilities |
| | LVL '000 | LVL '000 | LVL '000 | LVL '000 | LVL '000 | LVL '000 |
| Forward contracts | 61,137 | 29,638 | 192 | (377) | 79 | (141) |

As of December 31, 2007 there were 74 outstanding foreign exchange agreements (in 2006: 80).

## 9 ADMINISTRATIVE EXPENSES

Salaries, wages and related social security contributions represent the basic remuneration of employees. During the years ended December 31, 2007 and 2006, the Bank employed on average 631 and 657 employees, respectively.

Administrative expense comprises of the following:

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| Staff salaries | 8,408 | 7,904 | 7,169 | 7,039 |
| Social tax | 1,714 | 1,594 | 1,428 | 1,396 |
| Salaries to Board of Directors and Council | 1,694 | 1,679 | 2,877 | 2,604 |
| Communications | 941 | 931 | 997 | 989 |
| Utilities and maintenance | 697 | 696 | 189 | 189 |
| Rent | 765 | 719 | 350 | 298 |
| Charitable donations | 590 | 1,348 | 1,226 | 1,226 |
| Advertising and marketing | 526 | 233 | 381 | 381 |
| Travel | 312 | 309 | 319 | 315 |
| Professional fees | 186 | 143 | 156 | 105 |
| Change in provision for annual leave | 135 | 135 | (23) | (23) |
| Representation | 115 | 114 | 103 | 103 |
| Training | 107 | 94 | 88 | 80 |
| Stationary | 106 | 98 | 82 | 76 |
| Property tax | 52 | 52 | 167 | 167 |
| Other | 3,650 | 3,932 | 2,360 | 2,460 |
| **Total** | **19,998** | **19,981** | **17,869** | **17,405** |

## 10 NET IMPAIRMENT LOSS

| | 2007 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| **Impairment losses:** | | | | |
| Loans and advances to non-banking customers | (2,400) | (2,400) | (631) | (631) |
| Investment in associates | - | - | (258) | (258) |
| Property, plant and equipment | (97) | (97) | - | - |
| Other assets | (409) | (159) | (127) | (127) |
| | **(2,906)** | **(2,656)** | **(1,016)** | **(1,016)** |
| **Reversal of impairment losses:** | | | | |
| Loans and advances to non-banking customers | 258 | 258 | 455 | 455 |
| **Net impairment losses** | **(2,648)** | **(2,398)** | **(561)** | **(561)** |

The following table reflects the total of the Bank's allowance account for impairment losses on loans at the end of the reporting years:

| | Loans | Investments | Property, plant and equipment | Other | Total |
|---|---|---|---|---|---|
| **Allowance for impairment losses as of 31 December 2005** | **1,182** | **1,516** | **-** | **11** | **2,709** |
| Reversal of impairment losses | (455) | - | - | - | (455) |
| Impairment losses | 631 | - | - | 385 | 1,016 |
| Written off assets | (391) | - | - | (5) | (396) |
| Currency revaluation | (25) | (145) | - | - | (170) |
| **Allowance as of 31 December 2006** | **942** | **1,371** | **-** | **391** | **2,704** |
| Reversal of impairment losses | (258) | - | - | - | (258) |
| Impairment losses | 2,400 | - | 97 | 159 | 2,656 |
| Written off assets | (120) | - | - | (258) | (378) |
| Currency revaluation | (51) | (133) | - | - | (184) |
| **Allowance as of 31 December 2007** | **2,913** | **1,238** | **97** | **292** | **4,540** |

The following table reflects the total of the Group's allowance account for impairment losses on loans at the end of the reporting years:

| | Loans | Investments | Property, plant and equipment | Other | Total |
|---|---|---|---|---|---|
| **Allowance for impairment losses as of 31 December 2005** | **1,182** | **1,516** | **-** | **11** | **2,709** |
| Reversal of impairment losses | (455) | - | - | - | (455) |
| Impairment losses | 631 | - | - | 385 | 1,016 |
| Written off assets | (391) | - | - | (5) | (396) |
| Currency revaluation | (25) | (145) | - | - | (170) |
| **Allowance as of 31 December 2006** | **942** | **1,371** | **-** | **391** | **2,704** |
| Reversal of impairment losses | (258) | - | - | - | (258) |
| Impairment losses | 2,400 | - | 97 | 409 | 2,906 |
| Written off assets | (120) | - | - | (258) | (378) |
| Currency revaluation | (51) | (133) | - | - | (184) |
| **Allowance as of 31 December 2007** | **2,913** | **1,238** | **97** | **542** | **4,790** |

## 11 TAXATION

The tax on the operating profit differs from the theoretical amount that would arise using the basic tax rate for the Parent as follows:

| | 2006 Group LVL'000 | 2007 Bank LVL'000 | 2006 Group LVL'000 | 2006 Bank LVL'000 |
|---|---|---|---|---|
| **Profit before income tax** | **40,199** | **40,290** | **33,937** | **33,968** |
| Theoretically calculated tax at tax rate of 15% | 6,030 | 6,043 | 5, 091 | 5,095 |
| Expenses not deductible for tax purposes | 800 | 716 | 280 | 281 |
| Non-taxable income | (100) | (100) | (98) | (98) |
| Relief for donations | (1,140) | (1,140) | (932) | (932) |
| Prior year tax adjustment | 16 | 16 | - | - |
| Effect of different tax rates in other countries | (14) | - | 12 | - |
| **Tax charge** | **5,592** | **5,535** | **4,353** | **4,346** |
| Corporate income tax expense | 5,835 | 5,764 | 4,061 | 4,054 |
| Prior year tax adjustment | 16 | 16 | - | - |
| Deferred tax expense | (259) | (245) | 292 | 292 |
| **Income tax expense** | **5,592** | **5,535** | **4,353** | **4,346** |

Corporate income tax expense according to tax return was LVL 5,591 thousand (2006: LVL 3,974 thousand). Tax paid outside Latvia was LVL 173 thousand (2006: LVL 80 thousand).

The table below represents movement of deferred tax liability:

| | Group LVL'000 | Bank LVL'000 |
|---|---|---|
| **Deferred tax liability as of 31 December 2005** | 1,538 | 1,538 |
| Increase/(release) of deferred tax liability recognised in Statement of Profit and Loss | 292 | 292 |
| Increase/(release) of deferred tax liability recognized directly in equity | - | - |
| Transfer to retained earnings | (21) | (21) |
| Net chage in deferred tax liability for the period | 271 | 271 |
| **Deferred tax liability as of 31 December 2006** | **1,809** | **1,809** |
| Increase/(release) of deferred tax liability recognised in Statement of Profit and Loss | (259) | (245) |
| Increase/(decrease) of deferred tax liability recognised directly in equity | (250) | (268) |
| Transfer to retained earnings | (9) | (9) |
| Net chage in deferred tax liability for the period | (518) | (522) |
| **Deferred tax liability as of 31 December 2007** | **1,291** | **1,287** |

## 12 CLASSIFICATION OF FINANCIAL INSTRUMENTS

The table presents the analysis of financial assets and liabilities and non-financial assets and liabilities by measurement basis as at December 31, 2007:

**Group**

| LVL '000 | Loans and receivables/ financial liabilities at amortised cost | | Held-to-maturity investments | | Financial instruments at fair value through profit or loss | | Financial assets available-for-sale | | Non-financial assets/ liabilities | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Assets | | | | | | | | | | | | |
| Cash and balances with central bank | 66,310 | 61,953 | - | - | - | - | - | - | - | - | 66,310 | 61,953 |
| Balances due from credit institutions | 405,464 | 360,653 | | | - | - | - | - | - | - | 405,464 | 360,653 |
| Financial assets held for trading | - | - | - | - | 78,046 | 36,901 | - | - | - | - | 78,046 | 36,901 |
| Financial assets available-for-sale | - | - | - | - | - | - | 1,477 | 1,851 | - | - | 1,477 | 1,851 |
| Loans to non-banking customers | 599,436 | 374,695 | -- | | - | - | - | - | - | - | 599,436 | 374,695 |
| Held-to-maturity investments | - | - | 23,934 | 57,506 | - | - | - | - | - | - | 23,934 | 57,506 |
| Deferred expenses | - | - | - | - | - | - | - | - | 1,754 | 804 | 1,754 | 804 |
| Property, plant and equipment | - | - | - | - | - | - | - | - | 32,533 | 18,233 | 32,533 | 18,233 |
| Intangible assets | - | - | - | - | - | - | - | - | 2,978 | 3,361 | 2,978 | 3,361 |
| Investments in subsidiaries and associated entities | - | - | - | - | - | - | - | - | 52 | 310 | 52 | 310 |
| Other assets | 4,257 | 5,240 | - | - | - | - | - | - | - | - | 4,257 | 5,240 |
| Total assets | 945,915 | 648,076 | 153,486 | 211,971 | 78,046 | 36,901 | 1,477 | 1,851 | 37,317 | 22,708 | 1,216,241 | 921,507 |
| | - | - | - | - | | | | | - | - | - | |
| Liabilities | | | | | | | | | | | | |
| Balances due to credit institutions | 159,479 | 126,066 | - | - | - | - | - | - | - | - | 159,479 | 126,066 |
| Balances due to customers | 876,791 | 659,943 | - | - | - | - | - | - | - | - | 876,791 | 659,943 |
| Amounts payable under repurchase agreements | 51,037 | 32,321 | - | - | - | - | - | - | - | - | 51,037 | 32,321 |
| Held-for-trading financial liabilities – derivatives | - | - | - | - | 360 | - | - | - | - | - | 360 | - |
| Deferred income and accrued expenses | 2,180 | 1,286 | - | - | - | - | - | - | - | - | 2,180 | 1,286 |
| Current tax liabilities | 316 | 544 | - | - | - | - | - | - | - | - | 316 | 544 |
| Deferred tax liabilities | - | - | - | - | - | - | - | - | 1,291 | 1,809 | 1,291 | 1,809 |
| Other liabilities | 3,078 | 3,380 | - | - | - | - | - | - | - | - | 3,078 | 3,380 |
| Provisions | - | - | - | - | - | - | - | - | 378 | - | 378 | - |
| Total liabilities | 1,092,881 | 823,540 | - | - | - | - | - | - | 1,669 | 1,809 | 1,094,910 | 825,349 |
| Total shareholders' equity | - | - | - | - | - | - | - | - | 121,331 | 96,158 | 121,331 | 96,158 |
| Total liabilities and shareholder's equity | 1,092,881 | 823,540 | - | - | 360 | - | - | - | 123,000 | 97,967 | 1,216,241 | 921,507 |

## 12 CLASSIFICATION OF FINANCIAL INSTRUMENTS (CONTINUED)

**Bank**

| LVL'000 | Loans and receivables/ financial liabilities at amortised cost | | Held-to-maturity investments | | Financial instruments at fair value through profit or loss | | Financial assets available-for-sale | | Non-financial assets/ liabilities | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** | **2007** | **2006** |
| **Assets** | | | | | | | | | | | | |
| Cash and balances with central bank | 66,310 | 61,913 | - | - | - | - | - | - | - | - | 66,310 | 61,913 |
| Balances due from credit institutions | 404,506 | 360,237 | - | - | | | | | - | - | 404,506 | 360,237 |
| Financial assets held for trading | - | - | - | - | 77,168 | 36,454 | - | - | - | - | 77,168 | 36,454 |
| Financial assets available-for-sale | - | - | - | - | - | - | 234 | 777 | - | - | 234 | 777 |
| Loans to non-banking customers | 598,699 | 373,633 | - | - | - | - | - | - | - | - | 598,699 | 373,633 |
| Held-to-maturity investments | - | - | 23,934 | 57,506 | - | - | - | - | - | - | 23,934 | 57,506 |
| Deferred expenses | - | - | - | - | - | - | - | - | 1,698 | 720 | 1,698 | 720 |
| Property, plant and equipment | - | - | - | - | - | - | - | - | 32,015 | 18,200 | 32,015 | 18,200 |
| Intangible assets | - | - | - | - | - | - | - | - | 2,977 | 3,358 | 2,977 | 3,358 |
| Investments in subsidiaries and associated entities | - | - | - | - | - | - | - | - | 14,304 | 13,955 | 14,304 | 13,955 |
| Other assets | 4,214 | 4,461 | - | - | - | - | - | - | - | - | 4,214 | 4,461 |
| **Total assets** | **1,073,729** | **800,244** | **23,934** | **57,506** | **77,168** | **36,454** | **234** | **777** | **50,994** | **36,233** | **1,226,059** | **931,214** |
| **Liabilities** | | | | | | | | | | | | |
| Balances due to credit institutions | 159,534 | 126,066 | - | - | - | - | - | - | - | - | 159,534 | 126,066 |
| Balances due to customers | 885,879 | 670,016 | - | - | - | - | - | - | - | - | 885,879 | 670,016 |
| Amounts payable under repurchase agreements | 51,037 | 32,321 | - | - | - | - | - | - | - | - | 51,037 | 32,321 |
| Held-for-trading financial liabilities – derivatives | - | - | - | - | 418 | - | - | - | - | - | 418 | - |
| Deferred income and accrued expenses | 2,152 | 954 | - | - | - | - | - | - | - | - | 2,152 | 954 |
| Current tax liabilities | 298 | 542 | - | - | - | - | - | - | - | - | 298 | 542 |
| Deferred tax liabilities | - | - | - | - | - | - | - | - | 1,287 | 1,809 | 1,287 | 1,809 |
| Other liabilities | 2,866 | 3,355 | - | - | - | - | - | - | - | - | 2,866 | 3,355 |
| Provisions | - | - | - | - | - | - | - | - | 378 | - | 378 | - |
| **Total liabilities** | 1,101,766 | 833,254 | - | - | 418 | - | - | - | 1,665 | 1,809 | 1,103,849 | 835,063 |
| **Total shareholders' equity** | - | - | - | - | - | - | - | - | 122,210 | 96,151 | 122,210 | 96,151 |
| **Total liabilities and shareholder's equity** | **1,101,766** | **833,254** | **-** | **-** | **418** | **-** | **-** | **-** | **123,875** | **97,960** | **1,226,059** | **931,214** |

## 13 CASH AND BALANCES WITH THE CENTRAL BANK

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Cash | 3,832 | 3,832 | 3,606 | 3,566 |
| Deposits with the Bank of Latvia | 62,478 | 62,478 | 58,347 | 58,347 |
| **Total cash and deposits with the Bank of Latvia** | **66,310** | **66,310** | **61,953** | **61,913** |

Deposits with the Bank of Latvia represent the balance outstanding on correspondent account with the Bank of Latvia in LVL.

In accordance with the Bank of Latvia's regulations the Bank is required to maintain a compulsory reserve set at 8% of the average monthly balance (calculated at four intervals during the month) of the following items:

+ deposits from the public
- less liabilities against credit institutions
- less balance due to the State Treasury on its consolidated account with the Bank
+ bonds and other debt securities issued by the Bank.

The compulsory reserve is compared to the Bank's average monthly correspondent account balance in LVL. The Bank's average correspondent balance should exceed the compulsory reserve requirement. The Bank was in compliance with the aforementioned compulsory reserve requirement at the end of the reporting year.

## 14 BALANCES DUE FROM CREDIT INSTITUTIONS

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Demand placements with: | | | | |
| Latvian commercial banks | 2,207 | 2,207 | 4,500 | 4,500 |
| OECD credit institutions | 227,814 | 227,814 | 183,861 | 183,861 |
| Non-OECD credit institutions | 45,891 | 44,933 | 17,827 | 17,411 |
| **Total demand placements, net** | **275,912** | **274,954** | **206,188** | **205,772** |
| Term placements with: | | | | |
| Latvian commercial banks | 6,776 | 6,776 | 9,983 | 9,983 |
| OECD credit institutions | 111,714 | 111,714 | 104,458 | 104,458 |
| Non-OECD credit institutions | 11,062 | 11,062 | 40,024 | 40,024 |
| **Total term placements** | **129,552** | **129,552** | **154,465** | **154,465** |
| **Total balances due from credit institutions** | **405,464** | **404,506** | **360,653** | **360,237** |

During 2007 the average interest rate received on balances due from credit institutions was 5.00% per annum (during 2006 - 4.67%). For syndicated loans the average rate was 7.19% per annum.

| **Group and Bank** | Up to 1 month LVL'000 | 1 to 3 months LVL'000 | 3 to12 months LVL'000 | 1 – 5 years LVL'000 | Pledged LVL'000 | Total LVL'000 |
|---|---|---|---|---|---|---|
| **31 December 2007** | | | | | | |
| **Term placements with:** | | | | | | |
| Latvian commercial banks | 6,776 | - | - | - | - | 6,776 |
| OECD credit institutions | 111,320 | - | - | - | 394 | 111,714 |
| Non-OECD credit institutions | 2,420 | 3,536 | 4,114 | - | 992 | 11,062 |
| **Total term placements** | **120,516** | **3,536** | **4,114** | **-** | **1,386** | **129,552** |
| **31 December 2006** | | | | | | |
| **Term placements with:** | | | | | | |
| Latvian commercial banks | 9,200 | - | 100 | - | 683 | 9,983 |
| OECD credit institutions | 104,028 | - | - | - | 430 | 104,458 |
| Non-OECD credit institutions | - | 26,285 | 10,184 | 2,680 | 875 | 40,024 |
| **Total term placements** | **113,228** | **26,285** | **10,284** | **2,680** | **1,988** | **154,465** |

The largest balances due from credit institutions as of December 31, 2007 were as follows:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 |
|---|---|---|
| JP Morgan Chase Bank | 63,745 | 63,745 |
| Lloyds TSB Bank | 48,561 | 48,561 |
| Banco Bilbao Vizcaya Argentaria | 38,721 | 38,721 |
| Bank of Monreal Branch London | 38,720 | 38,720 |
| Bayrische Hypo Vereins Bank | 33,880 | 33,880 |
| Sudostroitelnij bank (Russia) | 23,830 | 23,830 |
| Nord/LB London | 21,780 | 21,780 |
| Other | 136,227 | 135,269 |
| **Total balances due from credit institutions** | **405,464** | **404,506** |
| **Of those:** | | |
| **Total demand placements** | **275,912** | **274,954** |
| **Total term placements** | **129,552** | **129,552** |

As at December 31, 2007, term deposits and balances from banks and other financial institutions which individually comprised more than 10 % of deposits and balances from banks and other financial institutions represented balances with 2 institutions and amounted to thousand LVL 112,306 (in 2006: 49,696).

## 15 FINANCIAL ASSETS HELD FOR TRADING

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| US corporate bonds | 16,144 | 16,144 | - | - |
| US government bonds | 48,576 | 48,576 | 32,440 | 32,440 |
| Russian government bonds | - | - | 20 | 20 |
| Brazilian government bonds | 1 | - | 1 | - |
| Russian corporate bonds | 2,245 | 1,756 | 341 | 341 |
| Holland corporate bonds | 3,534 | 3,534 | - | - |
| Kazakhstan corporate bonds | 684 | 684 | - | - |
| Ireland corporate bonds | 183 | - | - | - |
| Cyprus corporate bonds | 156 | - | - | - |
| Luxemburg corporate bonds | 49 | - | - | - |
| Spain corporate bonds | 3,535 | 3,535 | - | - |
| Russian fund's bonds | 18 | 18 | - | - |
| Shares listed on the Moscow stock exchange | 133 | 133 | 927 | 927 |
| Shares listed on the Riga stock exchange | 336 | 336 | 412 | 412 |
| Investments in shares fund | 1,094 | 1,094 | 1,684 | 1,238 |
| Derivative financial assets | 1,358 | 1,358 | 1,076 | 1,076 |
| **Total** | **78,046** | **77,168** | **36,901** | **36,454** |

Derivative financial assets

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Forward contracts | 192 | 192 | 79 | 79 |
| Derivative financial assets | 1,166 | 1,166 | 997 | 997 |
| **Total** | **1,358** | **1,358** | **1,076** | **1,076** |

## 16 FINANCIAL ASSETS AVAILABLE-FOR-SALE

Securities available-for-sale:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Debt securities at fair value | | | | |
| - US corporate bonds | - | - | 538 | 538 |
| Equity securities | | | | |
| - Unlisted | 1,597 | 234 | 1,313 | 239 |
| Specific impairment loss allowances (see Note 10) | (120) | - | - | - |
| **Total securities available-for-sale** | **1,477** | **234** | **1,851** | **777** |

Unlisted available for sale equity securities include SWIFT shares, shares of Riga Stock Exchange and shares of Latvian companies.

The fair value of SWIFT shares was determined based on the "transfer amount" approved for the respective year by the shareholders' meeting, that represents the price for new share allocation and participants quit price.

## 17 LOANS AND ADVANCES TO NON-BANKING CUSTOMERS

Loans and advances to non-banking customers are comprised of the following:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Private companies | 504,431 | 504,165 | 286,452 | 285,390 |
| Loans to private individuals | 97,918 | 97,447 | 89,185 | 89,185 |
| **Total gross loans and advances to non-banking customers** | **602,349** | **601,612** | **375,637** | **374,575** |
| Specific loan impairment allowances (see Note 10) | (2,913) | (2,913) | (942) | (942) |
| **Loans and advances to non-banking customers, net** | **599,436** | **598,699** | **374,695** | **373,633** |
| Loans and advances secured by cash deposits | (8,125) | (8,125) | (1,129) | (1,129) |
| **Loans and advances subject to credit risk, net** | **591,311** | **590,574** | **373,566** | **372,504** |

In 2007, the weighted average interest rates for loans were 8.71% (in 2006: 8.45%) and 8.31% (in 2006: 7.32%) for short-term and long-term loans, respectively.

**Significant credit exposures**

As at December 31, 2007 and 2006 the Bank and Group had no borrower or group of related borrowers, respectively, whose loan balances exceeded more than 10% of loans to customers.

According to regulatory requirements, the Bank is not allowed to have a credit exposure to one client or a group of related clients of more than 25% of its equity (see Note 35 for definition of equity). As of December 31, 2007 the Bank was in compliance with this requirement.

The loan maturity analysis, after allowance, for the Group is as follows:

| Group | Up to 1 months LVL'000 | 1 to 3 months LVL'000 | 3 to 12 months LVL'000 | 1 to 5 years LVL'000 | More than 5 years LVL'000 | Pledged LVL'000 | Total LVL'000 |
|---|---|---|---|---|---|---|---|
| **31 December 2007** | | | | | | | |
| Commercial & industrial companies | 131,938 | 6,100 | 60,875 | 134,428 | 161,994 | 6,304 | 501,639 |
| Individuals | 21,285 | 8,158 | 10,214 | 24,717 | 33,423 | - | 97,797 |
| **Total** | **153,223** | **14,258** | **71,089** | **159,145** | **195,417** | **6,304** | **599,436** |
| **31 December 2006** | | | | | | | |
| Commercial & industrial companies | 30,693 | 6,881 | 42,585 | 91,526 | 108,009 | 5,547 | 285,241 |
| Individuals | 2,576 | 8,321 | 13,586 | 25,568 | 39,403 | - | 89,454 |
| **Total** | **33,269** | **15,202** | **56,171** | **117,094** | **147,412** | **5,547** | **374,695** |

The following table presents information relating to the Bank and Group loans by major geographic areas:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Latvia | 310,460 | 309,223 | 248,800 | 248,309 |
| OECD countries | 167,759 | 167,759 | 79,248 | 79,248 |
| Non-OECD countries | 121,217 | 121,717 | 46,647 | 46,076 |
| **Total** | **599,436** | **598,699** | **374,695** | **373,633** |

The following table presents information relating to the Bank's and Group's loans by industries:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Real estate management | 271,058 | 270,822 | 117,839 | 116,777 |
| Financial services | 126,124 | 126,124 | 45,931 | 45,931 |
| Individuals | 48,359 | 48,359 | 91,793 | 91,793 |
| Wholesale and retailing | 45,959 | 45,959 | 30,022 | 30,022 |
| Manufacturing | 36,946 | 36,946 | 38,616 | 38,616 |
| Transport and communication | 32,600 | 32,600 | 20,712 | 20,712 |
| Food industry | 13,795 | 13,795 | 12,569 | 12,569 |
| Tourism | 3,241 | 3,241 | 4,491 | 4,491 |
| Other | 21,354 | 20,853 | 12,722 | 12,722 |
| **Total** | **599,436** | **598,699** | **374,695** | **373,633** |

Loan portfolio by collateral is as follows:

| | % | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | % | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|---|---|
| Commercial buildings | 33.36 | 199,981 | 199,981 | 12.87 | 48,224 | 48,224 |
| Land mortgage | 21.71 | 130,171 | 129,435 | 38.51 | 144,280 | 143,789 |
| Commercial movable assets pledge | 19.57 | 117,320 | 117,320 | 22.67 | 84,957 | 84,957 |
| Securities | 10.22 | 61,245 | 61,244 | 2.51 | 9,412 | 8,941 |
| Mortgage on residential properties | 8.45 | 50,655 | 50,655 | 14.84 | 55,586 | 55,586 |
| Guarantee | 2.28 | 13,639 | 13,639 | 4.76 | 17,844 | 17,844 |
| Deposit | 1.36 | 8,125 | 9,638 | 0.30 | 1,129 | 1,129 |
| Other | 3.05 | 18,300 | 16,787 | 3.54 | 13,263 | 13,163 |
| **Total** | **100 %** | **599,436** | **598,699** | **100%** | **374,695** | **373,633** |

The table below shows separate loan groups at their carrying amount. The Bank and Group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees.

| | Total carrying amount LVL'000 | Of which neither impaired nor past due on the reporting date | Of which not impaired on the reporting date and past due by the following terms | | | | | | Net carrying value of impaired loans |
|---|---|---|---|---|---|---|---|---|---|
| | | | Less than 30 days | 30-60 days | 61-90 days | 91-180 days | 181-360 days | More than 360 days | |
| | **As at 31 December 2006** | | | | | | | | |
| Net carrying amount | **374,695** | 353,046 | 18,685 | 2,750 | 180 | 7 | 27 | - | 21,649 |
| Assessed fair value of collateral held for financial assets that are past due but not impaired | 420,443 | 395,384 | 21,768 | 2,227 | 206 | 852 | 6 | - | 25,059 |
| | **As at 31 December 2007** | | | | | | | | |
| Net carrying amount | **599,439** | 539,833 | 30,433 | 2,912 | 1,910 | 16,810 | 6,469 | 685 | 59,219 |
| Assessed fair value of collateral held for financial assets that are past due but not impaired | **766,264** | 685,153 | 40,853 | 2,764 | 2,262 | 27,936 | 6,600 | 696 | 81,111 |

## 18 HELD-TO-MATURITY INVESTMENTS

Securities held-to-maturity:

| | 31 December 2007 Group LVL'000 | 31 December 2006 Group LVL'000 |
|---|---|---|
| Listed debt securities – at amortised cost | | |
| United States government bonds | 2,463 | 18,121 |
| *Argentina government bonds – cost* | *1,702* | *1,885* |
| *Impairment allowance of Argentina government bonds* | *(1,238)* | *(1,371)* |
| Carrying value of Argentina government bonds | 464 | 514 |
| US corporate bonds | 2,417 | 5,335 |
| IBRD | - | 1,091 |
| Great Britain corporate bonds | 4,807 | 12,960 |
| Luxemburg corporate bonds | 2,377 | 5,301 |
| Holland corporate bonds | 2,425 | 2,694 |
| Australian corporate bonds | 3,401 | 3,752 |
| France corporate bonds | 4,811 | 5,247 |
| Russian corporate bonds | 769 | 2,491 |
| **Total securities held-to-maturity** | **23,934** | **57,506** |

Maturity analysis of held-to-maturity investments:

| | Up to 1 month | 1 to 3 months | 3 to12 months | 1 – 5 years | Greater than 5 years | Total |
|---|---|---|---|---|---|---|
| **31 December 2007** | | | | | | |
| United States government bonds | - | 2,463 | - | - | - | 2,463 |
| Argentina government bonds | - | - | - | - | 464 | 464 |
| US corporate bonds | - | - | 2,417 | - | - | 2,417 |
| Great Britain corporate bonds | - | - | - | 2,312 | 2,495 | 4,807 |
| Luxemburg corporate bonds | - | - | - | 2,377 | - | 2,377 |
| Holland corporate bonds | - | - | - | - | 2,425 | 2,425 |
| Australian corporate bonds | - | - | - | - | 3,401 | 3,401 |
| French corporate bonds | - | - | - | 4,811 | - | 4,811 |
| Russian corporate bonds | - | - | - | 769 | - | 769 |
| **Total** | **-** | **2,463** | **2,417** | **10,269** | **8,785** | **23,934** |
| **31 December 2006** | | | | | | |
| United States government bonds | - | 1,898 | 13,505 | 2,718 | - | 18,121 |
| Argentina government bonds | - | - | - | - | 514 | 514 |
| International credit institutions (IBRD) | - | - | 1,091 | - | - | 1,091 |
| US corporate bonds | - | - | 2,670 | 2,665 | - | 5,335 |
| Great Britain corporate bonds | - | - | 4,621 | 2,931 | 5,408 | 12,960 |
| Luxemburg corporate bonds | - | - | 2,688 | 2,613 | - | 5,301 |
| Holland corporate bonds | - | - | - | - | 2,694 | 2,694 |
| Australian corporate bonds | - | - | - | - | 3,752 | 3,752 |
| French corporate bonds | - | - | - | 5,247 | - | 5,247 |
| Russian corporate bonds | - | - | 1,638 | 853 | - | 2,491 |
| **Total** | **-** | **1,898** | **26,213** | **17,027** | **12,368** | **57,506** |

## 19 OTHER ACCRUED INCOME AND DEFERRED EXPENSES

Prepayments and accrued income are comprised of the following:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Other accrued income | 36 | 36 | 80 | 79 |
| Prepaid expenses | 1,718 | 1,662 | 724 | 641 |
| **Total** | **1,754** | **1,698** | **804** | **720** |

## 20 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment (PPE) of the Group is comprised as follows:

| | Buildings | Unfinished construction | Vehicles | Office equipment | Leasehold improvements | Total PPE |
|---|---|---|---|---|---|---|
| **Historical cost or revalued amount** | | | | | | |
| **31 December 2005** | **11,169** | **690** | **1,734** | **6,256** | **295** | **20,144** |
| Additions | - | 3,803 | 125 | 544 | - | 4,472 |
| Disposals | - | (10) | (299) | (733) | (89) | (1,131) |
| Transfers | - | 208 | 292 | 236 | - | 736 |
| **31 December 2006** | **11,169** | **4,691** | **1,852** | **6,303** | **206** | **24,221** |
| Additions | 834 | 15,365 | 753 | 2,647 | - | 19,599 |
| Revaluation | 1,114 | - | - | - | - | 1,114 |
| Disposals | (5,065) | - | (411) | (636) | - | (6,112) |
| Impairment losses | (97) | - | - | - | - | (97) |
| **31 December 2007** | **7,955** | **20,056** | **2,194** | **8,314** | **206** | **38,725** |
| **Accumulated depreciation** | | | | | | |
| **31 December 2005** | **268** | **-** | **683** | **4,127** | **190** | **5,268** |
| Charge for the period | 254 | - | 361 | 815 | 36 | 1,466 |
| Disposals | - | - | (150) | (575) | (21) | (746) |
| **31 December 2006** | **522** | **-** | **894** | **4,367** | **205** | **5,988** |
| Charge for the period | 158 | - | 378 | 734 | 1 | 1,271 |
| Revaluation | (347) | - | - | - | - | (347) |
| Disposals | (181) | - | (337) | (202) | - | (720 ) |
| **31 December 2007** | **152** | **-** | **935** | **4,899** | **206** | **6,192** |
| **Net book value** | | | | | | |
| **31 December 2005** | **10,901** | **690** | **1,051** | **2,129** | **105** | **14,876** |
| **31 December 2006** | **10,647** | **4,691** | **958** | **1,936** | **1** | **18,233** |
| **31 December 2007** | **7,803** | **20,056** | **1,259** | **3,415** | **-** | **32,533** |

## 20 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Property, plant and equipment (PPE) of the Bank is comprised as follows:

| | Buildings | Unfinished construction | Vehicles | Office equipment | Leasehold improvements | Total PPE |
|---|---|---|---|---|---|---|
| **Historical cost or revaluation** | | | | | | |
| **31 December 2005** | **11,169** | **681** | **1,705** | **5,799** | **210** | **19,564** |
| Additions | - | 3,803 | 125 | 492 | - | 4,420 |
| Disposals | - | - | (269) | (618) | (48) | (935) |
| Transfers | - | 208 | 292 | 236 | - | 736 |
| **31 December 2006** | **11,169** | **4,692** | **1,853** | **5,909** | **162** | **23,785** |
| Additions | 834 | 14,891 | 734 | 2,643 | - | 19,102 |
| Revaluation | 1,114 | - | - | - | - | 1,114 |
| Impairment losses (Note 10) | (97) | - | - | - | - | (97) |
| Disposals | (5,065) | - | (411) | (637) | - | (6,113) |
| **31 December 2007** | **7,955** | **19,583** | **2,176** | **7,915** | **162** | **37,791** |
| **Accumulated depreciation** | | | | | | |
| **31 December 2005** | **268** | **-** | **674** | **3,772** | **146** | **4,860** |
| Charge for the period | 254 | - | 357 | 803 | 36 | 1,450 |
| Disposals | - | - | (132) | (572) | (21) | (725) |
| **31 December 2006** | **522** | **-** | **899** | **4,003** | **161** | **5,585** |
| Charge for the period | 158 | - | 375 | 724 | 1 | 1,258 |
| Revaluation | (347) | - | - | - | - | (347) |
| Disposals | (181) | - | (337 ) | (202) | - | (720) |
| **31 December 2007** | **152** | **-** | **937** | **4,525** | **162** | **5,776** |
| **Net book value** | | | | | | |
| **31 December 2005** | **10,901** | **681** | **1,031** | **2,027** | **64** | **14,704** |
| **31 December 2006** | **10,647** | **4,692** | **954** | **1,906** | **1** | **18,200** |
| **31 December 2007** | **7,803** | **19,583** | **1,239** | **3,390** | **-** | **32,015** |

The assets stated above are primarily held for the Group and Bank's own use.

## NOTES TO THE CONSOLIDATED AND BANK FINANCIAL STATEMENTS

### 21 INTANGIBLE ASSETS

Intangible assets of the Group are comprised as follows:

| | Goodwill | Software | Work in progress | Trade marks | Total |
|---|---|---|---|---|---|
| **Historical Cost** | | | | | |
| **Balance at 31 December 2005** | **987** | **4,852** | **181** | **5** | **6,025** |
| Additions | - | 130 | 53 | 1 | 184 |
| Disposals | (42) | (157) | - | - | (199) |
| Transfers | - | 223 | - | 6 | 229 |
| Impairment loss | (194) | - | - | - | (194) |
| **Balance at 31 December 2006** | **751** | **5,048** | **234** | **12** | **6,045** |
| Additions | - | 134 | 113 | 9 | 256 |
| Disposals | - | (16) | - | - | (16) |
| **Balance at 31 December 2007** | **751** | **5,166** | **347** | **21** | **6,285** |
| **Amortisation** | | | | | |
| **Balance at 31 December 2005** | **-** | **2,104** | **-** | **-** | **2,104** |
| Amortisation charge for the year | - | 734 | - | 2 | 736 |
| Disposals | - | (156) | | | (156) |
| **Balance at 31 December 2006** | **-** | **2,682** | **-** | **2** | **2,684** |
| Amortisation charge for the period | - | 636 | - | 3 | 639 |
| Disposal | - | (16) | - | - | (16) |
| **Balance at 31 December 2007** | **-** | **3,302** | **-** | **5** | **3,307** |
| **Net book value** | | | | | |
| **At 31 December 2005** | **987** | **2,748** | **181** | **5** | **3,921** |
| **At 31 December 2006** | **751** | **2,366** | **234** | **10** | **3,361** |
| **At 31 December 2007** | **751** | **1,864** | **347** | **16** | **2,978** |

## 21 INTANGIBLE ASSETS (CONTINUED)

Intangible assets of the Bank are comprised as follows:

| | Goodwill | Software | Work in progress | Trade marks | Total |
|---|---|---|---|---|---|
| **Historical Cost** | | | | | |
| **Balance at 31 December 2005** | **987** | **4,851** | **181** | **5** | **6,024** |
| Additions | - | 128 | 53 | 1 | 182 |
| Disposals | (42) | (157) | - | - | (199) |
| Transfers | - | 223 | - | 6 | 229 |
| Impairment loss | (194) | - | - | - | (194) |
| **Balance at 31 December 2006** | **751** | **5,045** | **234** | **12** | **6,042** |
| Additions | - | 134 | 113 | 9 | 256 |
| Disposals | - | (16) | - | - | (16) |
| **Balance at 31 December 2007** | **751** | **5,163** | **347** | **21** | **6,282** |
| | | | | | |
| **Amortisation** | | | | | |
| **Balance at 31 December 2005** | **-** | **2,104** | **-** | **-** | **2,104** |
| Amortisation charge for the year | - | 734 | - | 2 | 736 |
| Disposals | - | (156) | - | - | (156) |
| **Balance at 31 December 2006** | **-** | **2,682** | **-** | **2** | **2,684** |
| Amortisation charge for the period | - | 634 | - | 3 | 637 |
| Disposals | | (16) | - | - | (16) |
| **Balance at 31 December 2007** | **-** | **3,300** | **-** | **5** | **3,305** |
| | | | | | |
| **Net book value** | | | | | |
| **At 31 December 2005** | **987** | **2,747** | **181** | **5** | **3,920** |
| **At 31 December 2006** | **751** | **2,363** | **234** | **10** | **3,358** |
| **At 31 December 2007** | **751** | **1,863** | **347** | **16** | **2,977** |

## 22 INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED ENTITIES

As of December 31, 2007 and 2006, the Bank's investments in subsidiaries and associated companies are comprised of the following:

| Company | Industry | Legal address | Amount of ownership (%) | Amount of investment | Amount of ownership (%) | Amount of investment |
|---|---|---|---|---|---|---|
| | | | 31 December 2007 | | 31 December 2006 | |
| RB Securities Ltd | Financial Services | Stasinou Street,1 Mitsi Building, 2nd floor, office 5, Plateia Elefttherias, P.C. 1060, Nicosia, Cyprus | 99.99% | 7,700 | 99.99% | 7,700 |
| SIA "RB Investments" | Investments | Brivibas iela 39, 7th floor, Riga, Latvia | 100% | 5,000 | 100% | 5,000 |
| A/s "RB Securities Latvia" IBS | Financial Services | Brivibas iela 54-412 . Riga, Latvia | 100% | 804 | 100% | 455 |
| A/s "RB Asset management" IPS | Financial Services | Brivibas iela 54-406. Riga, Latvia | 100% | 700 | 100% | 700 |
| SIA "RB Drošība" | Security services | Brivibas iela 54. Riga, Latvia | 100% | 50 | 100% | 50 |
| SIA "RB Vidzeme" | Investments | Brivibas iela 39, 7th floor. Riga, Latvia | 100% | 50 | 100% | 50 |
| Rietumu bankas Labdarības fonds | Charity | Brivibas 54,Riga,Latvia | - | - | - | - |
| **Total investments in subsidiaries** | | | | **14,304** | | **13,955** |
| Alphyra Rietumu Financial Services Limited | Financial services | 4 Heather Road, Sandyford Industrial Estate, Dublin 18, Ireland | - | - | *49%* | *258* |
| *Impairment loss allowance on investment in Alphyra Financial Services Limited* | | | | - | | *(258)* |
| SIA "Dzelzceļu tranzīts" | Transport services | Rankas street 11, Riga, Latvia | 45.61% | 32 | 45,61% | 32 |
| SIA "AED Real Services" | Transport services | Katoļu street 22/24, Riga, Latvia | 43% | 20 | 43% | 20 |
| SIA "Eco Diesel" | | Aleksandra Čaka steert 72, Riga, Latvia | 52.90% | 258 | 52.90% | 258 |
| *Impairment loss allowance on investment in SIA Eco Diesel Limited* | | | | *(258)* | | - |
| **Total investments in associated companies** | | | | **52** | | **310** |
| **Investments in subsidiaries and associated entities** | | | | **14,356** | | **14,265** |

In 2007 the Bank increased the share capital of RB Securities Latvia IBS by LVL 350 thousand.

“RB Securities” ( Moscow), subsidiary of RB Securities Ltd., Interrent OOO, subsidiary of RB Investments and RB Vidzeme and Rietumu Bank charitably foundation are consolidated in the Group accounts.
The following table presents summarised financial information of associates that are not accounted for using the equity method as the amounts are insignificant:

| | 31 December 2007 SIA “Dzelzceļu tranzīts” LVL’000 | 31 December 2007 SIA ”AED Real Services” LVL’000 | 31 December 2006 SIA “Dzelzceļu tranzīts” LVL’000 | 31 December 2006 SIA ”AED Real Services” LVL’000 |
|---|---|---|---|---|
| Assets | 175 | 49 | 107 | 37 |
| Turnover | 483 | 147 | 328 | 109 |
| Profit | 63 | 10 | 24 | 8 |

## 23 OTHER ASSETS

Other assets are comprised of the following:

| | 31 December 2007 Group LVL’000 | 31 December 2007 Bank LVL’000 | 31 December 2006 Group LVL’000 | 31 December 2006 Bank LVL’000 |
|---|---|---|---|---|
| Advances for property and intangible assets | 2,201 | 2,201 | 1,878 | 1,877 |
| Recoverable VAT | 1,215 | 1,215 | 609 | 609 |
| Advances for goods and services | 96 | 96 | 94 | 94 |
| Traveller cheques | 46 | 46 | 56 | 56 |
| Cash advances to employees | 9 | 9 | 27 | 27 |
| Other assets | 1,112 | 939 | 2,709 | 1,931 |
| | **4,679** | **4,506** | **5,373** | **4,594** |
| Allowance on other assets (Note 10) | (422) | (292) | (133) | (133) |
| **Total** | **4,257** | **4,214** | **5,240** | **4,461** |

## 24 BALANCES DUE TO CREDIT INSTITUTIONS

Demand balances due to banks are comprised of the following:

| | 31 December 2007 Group LVL’000 | 31 December 2007 Bank LVL’000 | 31 December 2006 Group LVL’000 | 31 December 2006 Bank LVL’000 |
|---|---|---|---|---|
| Balances due to credit institutions registered in Latvia | 2,786 | 2,841 | 94 | 94 |
| Balances due to credit institutions registered in OECD countries | 6,493 | 6,493 | 1,114 | 1,114 |
| Balances due to credit institutions registered in non-OECD countries | 5,878 | 5,878 | 3,392 | 3,392 |
| **Total demand deposits** | **15,157** | **15,212** | **4,600** | **4,600** |
| **Total term deposits** | **144,322** | **144,322** | **121,466** | **121,466** |
| **Total balances due to other banks** | **159,479** | **159,534** | **126,066** | **126,066** |

The largest amounts due to banks were as follows:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 |
|---|---|---|
| EBRD | 42,168 | 42,168 |
| LRP Landesbank | 14,056 | 14,056 |
| Commerzbank AG | 7,497 | 7,497 |
| DZ Bank AG | 7,497 | 7,497 |
| HSH Nordbank Copenhagen | 7,497 | 7,497 |
| Banca Intesa SPA London branch | 7,028 | 7,028 |
| Raiffeisen Vienna | 7,028 | 7,028 |
| JP Morgan Chase bank | 5,547 | 5,547 |
| Dresdner Bank Luxembourg | 5,271 | 5,271 |
| **Total** | **103,589** | **103,589** |

## 25 BALANCES DUE TO CUSTOMERS

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| **Demand deposits from** | | | | |
| State enterprises | 83 | 83 | 52 | 52 |
| Private companies | 29,017 | 33,249 | 33,581 | 37,448 |
| Individuals | 41,969 | 41,969 | 45,485 | 45,485 |
| Private companies non-residents | 520,674 | 525,530 | 403,052 | 409,273 |
| Individuals non-residents | 44,231 | 44,231 | 41,325 | 41,325 |
| **Total demand deposits** | **635,974** | **645,062** | **523,495** | **533,583** |
| | | | | |
| **Term deposits** | | | | |
| State enterprises | 230 | 230 | - | - |
| Private companies | 1,854 | 1,854 | 6,815 | 6,815 |
| Individuals | 27,651 | 27,651 | 26,896 | 26,895 |
| Private companies non-residents | 177,331 | 177,331 | 77,243 | 77,229 |
| Individuals non-residents | 33,751 | 33,751 | 25,494 | 25,494 |
| **Total term deposits** | **240,817** | **240,817** | **136,448** | **136,433** |
| **Total balances due to customers** | **876,791** | **885,879** | **659,943** | **670,016** |

The maturity profile of term deposits due to customers was follows:

| | Up to 1 month LVL'000 | 1 to 3 months LVL'000 | 3 to12 months LVL'000 | 1 to 5 years LVL'000 | Greater than 5 year LVL'000 | Total LVL'000 |
|---|---|---|---|---|---|---|
| **31 December 2007** | | | | | | |
| Private companies | 609 | 492 | 770 | 103 | 111 | 2,085 |
| Individuals | 4,811 | 5,506 | 7,673 | 2,204 | 7,457 | 27,651 |
| Non-residents | 150,773 | 27,333 | 27,648 | 5,327 | - | 211,081 |
| | **156,193** | **33,331** | **36,091** | **7,634** | **7,568** | **240,817** |
| **31 December 2006** | | | | | | |
| Private companies | 2,614 | 3,138 | 589 | 360 | 114 | 6,815 |
| Individuals | 5,403 | 8,526 | 9,762 | 2,775 | 429 | 26,895 |
| Non-residents | 45,626 | 9,940 | 41,945 | 5,227 | - | 102,738 |
| | **53,643** | **21,604** | **52,296** | **8,362** | **543** | **136,448** |

In 2007 the weighted average interest rate on term deposits was 4.47 % and 5.42% (2006: 2.30% and 3.98%) for short and long-term deposits respectively.

As of December 31, 2007, the Group maintained customer deposit balances of LVL 11,624 thousand (2006: LVL 16,036 thousand) which were blocked by the Group as collateral for loans and off-balance sheet credit instruments granted by the Bank.

## 26 AMOUNTS PAYABLE UNDER REPURCHASE AGREEMENTS

As of 31 December 2007 the following amounts are payable under repurchase agreements:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Amounts payable under repurchase agreements | 51,037 | 51,037 | 32,321 | 32,321 |
| **Total** | **51,037** | **51,037** | **32,321** | **32,321** |

The carrying amount of securities pledged as collateral under repurchase agreement are US Treasuries in the amount of LVL 51,039 thousand (in 2006: LVL 32,440 thousand).

## 27 DEFERRED INCOME AND ACCRUED EXPENSE

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Deferred income | 22 | 22 | 30 | 29 |
| Provision for annual leave | 639 | 639 | 519 | 503 |
| Provision for management bonus | 636 | 636 | - | - |
| Accrued expenses for Deposits Guarantee Funds | 337 | 337 | 305 | 305 |
| Other accrued expenses | 546 | 518 | 432 | 117 |
| **Total** | **2,180** | **2,152** | **1,286** | **954** |

## 28 DEFERRED TAX LIABILITIES

Deferred tax has been calculated using the following temporary differences between book value and taxable value of assets and liabilities:

| | 31December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Temporary difference on depreciation of property, plant and equipment | 949 | 945 | 1,037 | 1,037 |
| Revaluation reserve – property | 579 | 579 | 710 | 710 |
| Temporary difference on provision for vacations and bonuses | (213) | (213) | (130) | (130) |
| Temporary differences from revaluation of other financial assets and liabilities | (24) | (24) | 192 | 192 |
| **Deferred tax liability** | **1,291** | **1,287** | **1,809** | **1,809** |

## 29 SHARE CAPITAL

As of December 31, 2007 the authorized, issued and paid share capital comprised of 22,500,000 (2006: 22,500,000) shares with a par value of LVL 1 per share. The holders of ordinary shares are entitled to receive dividends as declared from time to time are entitled to one vote per share at meetings of the shareholders of the Bank and are entitled to residual assets. The shares are distributed as follows:

| | 31 December 2007 LVL'000 | 31 December 2006 LVL'000 |
|---|---|---|
| Companies non-residents | 7,450 | 7,450 |
| Private persons | 15,050 | 15,050 |
| **Total** | **22,500** | **22,500** |

No changes in the structure of major shareholders have occurred since December 31, 2006. The largest shareholders of the Bank as of December 31, 2007:

| | 31 December 2007 Paid capital LVL' 000 | 31 December 2007 Percentage holding |
|---|---|---|
| Leonid Esterkin | 7,450 | 33.11 |
| Boswell (International) Consulting Limited | 7,450 | 33.11 |
| Arkady Suharenko | 3,900 | 17.33 |
| Others | 3,700 | 16.45 |
| **Total** | **22,500** | **100.00** |

## 30 DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS

| | Carrying amount 31 December 2007 Group LVL'000 | Fair value 31 December 2007 Group LVL'000 | Carrying amount 31 December 2006 Group LVL'000 | Fair value 31 December 2006 Group LVL'000 |
|---|---|---|---|---|
| **Financial Assets** | | | | |
| Cash in hand and demand deposits with central bank | 66,310 | 66,310 | 61,953 | 61,953 |
| Due from credit institutions | 405,464 | 405,464 | 360,653 | 360,653 |
| Trading portfolio assets | 78,046 | 78,046 | 36,901 | 36,901 |
| Held-to-maturity investments | 23,934 | 23,872 | 57,506 | 57,121 |
| Loans to non-banking customers | 599,436 | 599,436 | 374,695 | 374,695 |
| **TOTAL** | **1,173,190** | **1,173,128** | **891,708** | **891,323** |
| | | | | |
| **Financial liabilities** | | | | |
| Balances due to other banks | 159,479 | 159,479 | 126,066 | 126,066 |
| Balances due to customers | 876,791 | 876,791 | 659,943 | 659,943 |
| Amounts payable under repurchase agreements | 51,037 | 51,037 | 32,321 | 32,321 |
| **TOTAL** | **1,087,307** | **1,087,307** | **818,330** | **818,330** |

## 31 MEMORANDUM ITEMS

*Legal Proceedings*

As of December 31, 2007 there were 4 legal proceedings outstanding against the Group. Total amount disputed in these proceedings is LVL 855 thousand. A provision of 378 thousand LVL or 50% of the amount disputed has been made in these financial statements for claims where management on the basis of professional advice to the Group, considers it is likely that a loss may eventuate. (2006: 3 outstanding legal proceedings against the Bank; impairment allowance: Nil). No other amounts have been provided for.

*Funds under trust management*

Funds under trust management represent securities and other assets managed and held by the Group and Bank on behalf of customers. The Group and Bank earn commission income for holding such securities. The Group and Bank are not subject to interest, credit, liquidity and currency risk with respect of these securities in accordance with the agreements with customers. All securities are stated at their market value. As at December 31, 2007 the Group and Bank held securities and other assets on behalf of customers as custodian and assets under management in the amount of LVL 236,079 thousand.

*Credit related commitments*

The primary purpose of credit commitments issued to customers is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group and Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group and Bank do not generally expect the third party to draw funds under the agreement.

As at December 31, 2007 and 2006 the Group had credit related commitments in the amount of LVL 79,315 thousand (2006: LVL 81,497 thousand).

## 32 CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

| | 31 December 2007 Group LVL'000 | 31 December 2007 Bank LVL'000 | 31 December 2006 Group LVL'000 | 31 December 2006 Bank LVL'000 |
|---|---|---|---|---|
| Cash | 3,832 | 3,832 | 3,606 | 3,566 |
| Balances due from the Bank of Latvia | 62,478 | 62,478 | 58,347 | 58,347 |
| Demand deposits due from other banks | 275,912 | 274,954 | 206,188 | 205,772 |
| (Demand deposits due to other banks) | (15,157) | (15,212) | (4,600) | (4,600) |
| **Total** | **327,065** | **326,052** | **263,541** | **263,085** |

## 33 RELATED PARTY TRANSACTIONS

Related parties are defined as shareholders who have significant influence over the Bank, companies in which they have a controlling interest, members of the Council and Board of Directors, key management personnel, their close relatives and companies in which they have a controlling interest, as well as associated companies.

Loans and advances issued to related parties were as follows:

| | 31 December 2007 Amount LVL'000 | 31 December 2006 Amount LVL'000 |
|---|---|---|
| **Loans**: | | |
| Loans at the beginning of year | 3,866 | 6,144 |
| Loans issued during year | 119,339 | 132,178 |
| Transfers | (120) | 461 |
| Loan repayment during the year | (117,402) | (134,917) |
| **Loans at end of year** | **5,683** | **3,866** |
| **Interest income earned** | **345** | **366** |
| **Deposits** | | |
| Deposits at the beginning of year | 10,257 | 4,926 |
| Deposits received during year | 74,441 | 1,816,608 |
| Transfers | 476 | (8) |
| Deposits repaid during the year | (72,303) | (1,811,269) |
| **Deposits at the end of year** | **12,871** | **10,257** |
| **Interest expense on deposits** | **516** | **506** |
| **Guarantees and credit lines issued by the Group for management and Directors** | **1,288** | **1,477** |
| **Guarantees received from related parties** | **827** | **643** |

No impairment losses have been recognized in respect of loans or guarantees given to related parties (2006: nil ).

One loan where an impairment loss has been recognized is guaranteed by a member of the Bank's Council.
All transactions with related parties have been carried out at length arm's principle.

As of December 31, 2007, the Bank was in compliance with the regulations under the Law On Credit Institutions requiring that the total of non-zero risk credit exposures to related parties may not exceed 15% of the Bank's equity, as defined in Note 35.

## 34 FOREIGN EXCHANGE EXPOSURES

The following table provides an analysis of the Bank's assets, liabilities and applicable memorandum items by currency as of December 31, 2007:

**Group**

| | | | | 31 December 2007 | | 31 December 2006 | |
|---|---|---|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Net future and spot open position** | **Open position** | **Percent of share capital** | **Open position** | **Percent of share capital** |
| USD | 628,741 | 632,696 | 7,177 | 3,222 | 2.94 | 518 | 0.61 |
| EUR | 459,638 | 409,778 | (40,587) | 9,273 | 8.47 | - | - |
| RUB | 13,249 | 12,777 | (918) | (446) | (0.41) | 788 | 0.93 |
| GBP | 6,039 | 5,850 | (154) | 35 | 0.03 | 104 | 0.12 |
| LTL | 141 | 8 | - | 133 | 0.12 | 162 | 0.19 |
| Other (short) | 1,968 | 2,555 | 451 | (136) | (0.12) | (67) | (0.08) |
| Other (long) | 1,444 | 1,197 | (77) | 170 | 0.26 | 175 | 0.21 |
| **Total** | **1,111,220** | **1,064,861** | **(34,108)** | **12,251** | **11.29** | **1,680** | **1.98** |

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| **Total short position** | **(581)** | **(67)** |
| **Total long position** | **12,832** | **1,747** |
| **Total open position** | **11.72%** | **2.07%** |
| **Capital requirement for foreign currency exchange risk** | **1,027** | **478** |

The Bank seeks to match assets and liabilities denominated in foreign currencies in order to avoid foreign currency exposures.

As of December 31, 2007, the Bank was in compliance with the Law on Credit Institutions regulatory requirements requiring that open positions in any individual foreign currency may not exceed 10% of Bank's equity (see Note 35 for the definition of Bank's equity under the Finance and Capital Markets Commission guidelines), and that the total foreign currency open position may not exceed 20% of the Bank's equity.

## 35 CAPITAL ADEQUACY

Capital adequacy refers to the sufficiency of the Group and Bank's capital resources to cover the credit risks and similar risks arising from the portfolio of assets of the Bank and the memorandum items exposures of the Bank.
Based on the requirements set forth by the Finance and Capital Market Commission in respect to share capital of banks, the Bank's share capital to be utilized in the capital adequacy ratio as of December 31, 2007 has been calculated as follows:

| | |
|---|---|
| **Tier 1** | |
| - paid-in share capital | 22,500 |
| - share premium | 4,809 |
| - reserve capital | 16 |
| - accumulated profit | 56,846 |
| - profit of the year 2007 | 34,755 |
| **Deductions from the capital base** | |
| Intangible assets | (2,977) |
| Dividends declared | (8,775) |
| **Total Tier 1** | **107,174** |
| 70% of property revaluation reserve | 2,299 |
| **Total Tier 2** | **2,299** |
| **Equity to be utilized for the capital adequacy calculation in accordance with the guidelines of the Finance and Capital Market Commission** | **109,473** |

## 35 CAPITAL ADEQUACY (CONTINUED)

Based on the requirements set forth by the Basle agreement in respect to share capital, the Group's share capital to be utilized in the capital adequacy ratio as of December 31, 2007 has been calculated as follows:

| | |
|---|---:|
| **Tier 1** | |
| - paid-in share capital | 22,500 |
| - share premium | 4,809 |
| - reserve capital | 16 |
| - accumulated profit | 56,115 |
| - profit of the year 2007 | 34,607 |
| **Deductions from the capital base** | |
| Intangible assets | (2,978) |
| Dividends declared | (8,775) |
| **Total Tier 1** | **106,294** |
| 70% of property revaluation reserve | 2,299 |
| **Total Tier 2** | **2,299** |
| **Equity to be utilized for the capital adequacy calculation under the Basle Agreement** | **108,593** |

As of December 31, 2007, the Bank was in compliance with the Law On Latvian Credit Institutions and the requirements of the Finance and Capital Market Commission in respect to capital adequacy and the minimum equity level. The calculation of capital adequacy according to the Finance and Capital Market Commission requirements is presented in the following table:

| | Assets 31 December 2007 | Risk weighting % | Risk weighted assets |
|---|---:|---:|---:|
| **Balance sheet items** | | | |
| Cash and deposits with the Bank of Latvia | 66,310 | 0% | - |
| Balances due from governments and central banks within A zone countries | 2,463 | 0% | - |
| Loans and advances secured by deposits and A zone government bonds | 71,141 | 0% | - |
| Balances due from credit institutions within A zone countries | 365,062 | 20% | 73,012 |
| Loans fully secured by mortgage on occupied residential property which is rented or is occupied by the borrower | 18,925 | 50% | 9,463 |
| Accrued income and prepayments | 542 | 100% | 542 |
| Balances due from governments and central banks within B zone countries | 465 | 100% | 465 |
| Balances due from credit institutions within B zone countries | 21,709 | 100% | 21,709 |
| Claims on other borrowers, which are not credit institutions, central governments, central banks, municipalities, EU international development banks, excluding claims with lower risk | 548,530 | 100% | 548,530 |
| Shares and other non-fixed income securities and investments in subsidiaries | 14,538 | 100% | 14,538 |
| Property and equipment | 32,015 | 100% | 32,015 |
| Other assets | 4,214 | 100% | 4,214 |
| **Total assets** | **1,145,914** | | **704,488** |
| **Memorandum items** | | | |
| Letters of credit | 676 | 50% | 338 |
| Letters of credit with zero risk weighted | 778 | 0% | - |
| Credit commitments | 68,302 | 50% | 34,151 |
| Credit commitments with zero risk weighted | 702 | 0% | - |
| Outstanding guarantees with 100% risk weighted | 7,328 | 100% | 7,328 |
| Outstanding guarantees with zero risk weighted | 1,529 | 0% | - |
| **Total assets and memorandum items for capital adequacy** | | | **746,305** |
| **Capital requirement for credit risk of banking book** | | | **59,704** |
| **Capital requirement for position risk of trading book** | | | **1,637** |
| **Capital requirement for deal partners** | | | **14** |
| **Capital requirement for foreign currency exchange risk** | | | **1,027** |
| **Capital charges covered by own funds** | | | **47,091** |
| **Capital adequacy ratio** | | | **14.04%** |

## 35 CAPITAL ADEQUACY (CONTINUED)

A zone comprises countries which are full members of the OECD and which had not restructured their external debt during the last 5 years and which have concluded special lending arrangements with the IMF associated with the Fund's General Arrangements to Borrow.

As of December 31, 2006 Group's capital adequacy according to the Finance and Capital Market Commission's requirements was 14.85%. The Law On Credit Institutions and Finance and Capital Market Commission's requirements in respect of minimum capital adequacy are 8%.

The capital adequacy of the Group under the Basle agreement as of December 31, 2007 is calculated as follows:

| | Assets As of 31 December 2007 | Weighted Risk % | Risk Weighted Assets |
|---|---|---|---|
| **Balance sheet items** | | | |
| Cash and deposits with the Bank of Latvia | 66,310 | 0% | - |
| Claims on OECD central governments and central banks | 2,463 | 0% | - |
| Loans and advances secured by deposits and OECD countries government bonds | 71,141 | 0% | - |
| Balances due from credit institutions within OECD area | 365,062 | 20% | 73,012 |
| Balances due from credit institutions within non-OECD area | 21,898 | 20% | 4,380 |
| Loans fully secured by mortgage on occupied residential property which is rented or is occupied by the borrower | 18,925 | 50% | 9,463 |
| Claims on other borrowers, which are not credit institutions, central governments, central banks, municipalities, EU international development banks, excluding claims with lower risk | 549,267 | 100% | 549,267 |
| Claims on central governments outside the OECD (unless denominated in national currency) | 465 | 100% | 465 |
| Balances due from credit institutions within non OECD area (with term 1 year and more) | 769 | 100% | 769 |
| Shares and other non-fixed income securities and investments in subsidiaries | 1,529 | 100% | 1,529 |
| Property and equipment | 32,533 | 100% | 32,533 |
| Accrued income and prepayments | 598 | 100% | 598 |
| Other assets | 4,257 | 100% | 4,257 |
| **Total assets** | **1,135,217** | | **676,273** |
| **Memorandum items** | | | |
| Letters of credit | 676 | 50% | 338 |
| Letters of credit with zero risk weighted | 778 | 0% | - |
| Credit commitments | 68,302 | 50% | 34,151 |
| Credit commitments with zero risk weighted | 702 | 0% | - |
| Outstanding guarantees with 100% risk weighted | 7,328 | 100% | 7,328 |
| Outstanding guarantees with zero risk weighted | 1,529 | 0% | - |
| **Total assets and memorandum items for capital adequacy** | | | **718,090** |
| **Capital requirement for credit risk of banking book** | | | **57,445** |
| **Capital requirement for position risk of trading book** | | | **1,657** |
| **Capital requirement for deal partners** | | | **14** |
| **Capital requirement for foreign currency exchange risk** | | | **1,123** |
| **Capital charges covered by own funds** | | | **48,352** |
| **Capital adequacy ratio** | | | **14.42%** |

The Group's risk based capital adequacy as of December 31, 2007 was 14.42 %, which is above the minimum ratio of 8% recommended under the Basle agreement.

## 36 ASSETS, LIABILITIES AND SHAREHOLDER'S EQUITY BY MATURITY PROFILE

The table below allocates the Group's assets, liabilities and shareholder's equity to maturity groupings based on the time remaining from the balance sheet date to the contractual maturity dates. The Bank's residual contractual maturities of financial liabilities has not been presented as the difference to the Group analysis is insignificant. The maturity profile based on the balances as of December 31, 2007 was the following:

| LVL'000 | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | More than 5 years | Pledged | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with central banks | 66,310 | - | - | - | - | - | 66,310 |
| Balances due from credit institutions | 396,428 | 3,536 | 4,114 | - | - | 1,386 | 405,464 |
| Financial assets held for trading | 29,470 | - | - | - | - | 48,576 | 78,046 |
| Financial assets available-for-sale | 14 | - | - | - | 1,463 | - | 1,477 |
| Loans to non-banking customers | 153,223 | 14,258 | 71,089 | 159,145 | 195,417 | 6,304 | 599,436 |
| Held-to-maturity investments | - | - | 2,417 | 10,269 | 8,785 | 2,463 | 23,934 |
| Accrued income and deferred expenses | 1,754 | - | - | - | - | - | 1,754 |
| Property, plant and equipment | - | - | - | - | 32,533 | - | 32,533 |
| Intangible assets | - | - | - | - | 2,978 | - | 2,978 |
| Investments in subsidiaries | - | - | - | - | 52 | - | 52 |
| Other assets | 2,677 | 1,417 | 23 | 140 | - | - | 4,257 |
| **Total assets** | **649,876** | **19,211** | **77,643** | **169,554** | **241,228** | **58,729** | **1, 216,241** |
| **Liabilities** | | | | | | | |
| Balances due to other banks | 28,040 | 3,897 | - | 127,542 | - | - | 159,479 |
| Balances due to customers | 792,167 | 33,331 | 36,091 | 7,634 | 7,568 | - | 876,791 |
| Amounts payable under repurchase agreements | 51,037 | - | - | - | - | - | 51,037 |
| Held-for-trading financial liabilities- *derivative financial liabilities* | 360 | - | - | - | - | - | 360 |
| Deferred income and accrued expense | 2,180 | - | - | - | - | - | 2,180 |
| Current tax liability | - | 316 | - | - | - | - | 316 |
| Deferred tax liability | - | - | - | - | 1,291 | - | 1,291 |
| Other liabilities | 3,078 | - | - | - | - | - | 3,078 |
| Provisions | - | - | - | 378 | - | - | 378 |
| Total shareholders' equity | - | - | - | - | 121,331 | - | 121,331 |
| **Total liabilities and shareholders' equity** | **876,862** | **37,544** | **36,091** | **135,554** | **130,190** | **-** | **1,216,241** |
| **Net liquidity** | **(228,704)** | **(18,333)** | **41,552** | **34,000** | **111,038** | **58,729** | **-** |

## 36 ASSETS, LIABILITIES AND SHAREHOLDER'S EQUITY BY MATURITY PROFILE (CONTINUED)

The table below allocates the Group's assets, liabilities and shareholder's equity to maturity groupings based on the time remaining from the balance sheet date to the contractual maturity dates. The Bank's residual contractual maturities of financial liabilities has not been presented as the difference to the Group analysis is insignificant. The comparative figures in this disclosure as of December 31, 2006 have not been adjusted to conform to changes in presentation in the current year. The maturity profile based on the balances as of December 31, 2006 was the following:

| LVL'000 | Up to 1 month | 1 to 3 months | 3 to 12 months | 1 to 5 years | More than 5 years | Pledged | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and deposits with the Bank of Latvia | 61,953 | - | - | - | - | - | 61,953 |
| Balances due from credit institutions | 319,430 | 26,226 | 10,315 | 2,688 | - | 1,994 | 360,653 |
| Financial assets held for trading | 4,461 | - | - | - | - | 32,440 | 36,901 |
| Financial assets available-for- sale | 1,313 | - | - | - | - | 538 | 1,851 |
| Loans and advances to non-banking customers | 33,269 | 15,202 | 56,171 | 117,094 | 147,412 | 5,547 | 374,695 |
| Held-to-maturity investments | - | 1,898 | 23,484 | 19,756 | 12,368 | - | 57,506 |
| Deferred expenses | 804 | - | - | - | - | - | 804 |
| Property and equipment | - | - | - | - | 18,233 | - | 18,233 |
| Intangible assets | - | - | - | - | 3,361 | - | 3,361 |
| Investments in subsidiaries and associated entities | - | - | - | - | 310 | - | 310 |
| Other assets | 5,148 | 22 | 1 | 69 | - | - | 5,240 |
| **Total assets** | **426,378** | **43,348** | **89,971** | **139,607** | **181,684** | **40,519** | **921,507** |
| **Liabilities** | | | | | | | |
| Balances due to other banks | 4,621 | 335 | 78,747 | 42,363 | - | - | 126,066 |
| Due to customers | 577,037 | 21,630 | 52,360 | 8,372 | 544 | - | 659,943 |
| Amounts payable under repurchase agreements | 32,321 | - | - | - | - | - | 32,321 |
| Deferred income and accrued expense | 1,286 | - | - | - | - | - | 1,286 |
| Current tax liability | - | 544 | - | - | - | - | 544 |
| Deferred tax liability | - | - | - | - | 1,809 | - | 1,809 |
| Other liabilities | 849 | 1,890 | 641 | - | - | - | 3,380 |
| Total shareholders' equity | - | - | - | - | 96,158 | - | 96,158 |
| **Total liabilities and shareholders' equity** | **616,114** | **24,399** | **131,748** | **50,735** | **98,511** | **-** | **921,507** |
| **Net liquidity** | **(189,736)** | **18,949** | **(41,777)** | **88,872** | **83,173** | **40,519** | **-** |

## 37 INTEREST RATE RISK ANALYSIS

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument therefore indicates to what extent it is exposed to interest rate risk. The Group seeks to control this risk through the activities of the Bank's Treasury, Treasury policy and Asset and Liability committee.

The Bank's residual contractual maturities of financial liabilities has not been presented as the difference to the Group analysis is insignificant. Maturity profile of assets, liabilities and shareholders' equity of the Group as at December 31, 2007 was as follows:

| LVL'000 | Up to 1 month | 1 - 3 months | 3 – 12 months | 1 - 5 years | More than 5 years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with central banks | 62,478 | - | - | - | - | 3,832 | 66,310 |
| Balances due from other banks | 391,419 | 3,536 | 5,325 | - | - | 5,184 | 405,464 |
| Financial assets held for trading | 75,125 | - | - | - | - | 2,921 | 78,046 |
| Financial assets available-for-sale | - | - | - | - | - | 1,477 | 1,477 |
| Loans to non-banking customers | 133,321 | 14,258 | 71,089 | 159,145 | 195,417 | 26,206 | 599,436 |
| Held-to-maturity investments | - | 2,463 | 2,417 | 10,269 | 8,321 | 464 | 23,934 |
| Accrued income and deferred expenses | - | - | - | - | - | 1,754 | 1,754 |
| Property, plant and equipment | - | - | - | - | | 32,533 | 32,533 |
| Intangible assets | - | - | - | - | - | 2,978 | 2,978 |
| Investments in subsidiaries | - | - | - | - | - | 52 | 52 |
| Other assets | - | - | - | - | - | 4,257 | 4,257 |
| **Total assets** | **662,343** | **20,257** | **78,831** | **169,414** | **203,738** | **81,658** | **1,216,241** |
| **Liabilities** | | | | | | | |
| Balances due to other banks | 17,254 | 3,897 | - | 127,542 | - | 10,786 | 159,479 |
| Financial liabilities at amortised cost | 545,321 | 33,331 | 36,091 | 7,634 | 7,568 | 246,846 | 876,791 |
| Amounts payable under repurchase agreements | 51,037 | - | - | - | - | - | 51,037 |
| Held gor trading financial liabilities - derivatives | - | - | - | - | - | 360 | 360 |
| Deferred income and accrued expense | - | - | - | - | - | 2,180 | 2,180 |
| Tax liabilities | - | - | - | - | - | 1,607 | 1,607 |
| Other liabilities | - | - | - | - | - | 3,078 | 3,078 |
| Provisions | - | - | - | - | - | 378 | 378 |
| Total shareholders' equity | - | - | - | - | - | 121,331 | 121,331 |
| **Total liabilities and shareholders' equity** | **613,612** | **37,228** | **36,091** | **135,176** | **7,568** | **386,566** | **1,216,241** |
| **Interest sensitivity gap** | **48,731** | **(16,971)** | **42,740** | **34,238** | **196,170** | **(304,908)** | **-** |

## 37 INTEREST RATE RISK ANALYSIS (CONTINUED)

The comparative figures in this disclosure as of December 31, 2006 have not been adjusted to conform to changes in presentation in the current year. The Bank's residual contractual maturities of financial liabilities has not been presented as the difference to the Group analysis is insignificant. Maturity profile of assets, liabilities and shareholders' equity of the Group as at December 31, 2006 was as follows:

| LVL'000 | Up to 1 month | 1 - 3 months | 3 – 12 months | 1 - 5 years | More than 5 years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and deposits with the Bank of Latvia | 58,347 | - | - | - | - | 3,606 | 61,953 |
| Balances due from credit institutions | 303,597 | 26,226 | 10,315 | 2,688 | - | 17,827 | 360,653 |
| Financial assets held for trading | 32,802 | - | - | - | - | 4,099 | 36,901 |
| Financial assets available for sale | - | - | - | - | - | 1,851 | 1,851 |
| Loans and advances to non-banking customers | 37,061 | 15,202 | 56,171 | 117,094 | 147,417 | 1,750 | 374,695 |
| Held to maturity investments | - | 1,898 | 23,484 | 19,756 | 11,854 | 514 | 57,506 |
| Accrued income and deferred expenses | - | - | - | - | - | 804 | 804 |
| Property, plant and equipment | - | - | - | - | - | 187,233 | 18,233 |
| Intangible assets | - | - | - | - | - | 3,361 | 3,361 |
| Investments in subsidiaries and associates | - | - | - | - | - | 310 | 310 |
| Other assets | - | - | - | - | - | 5,240 | 5,240 |
| **Total assets** | **431,807** | **43,326** | **89,970** | **139,538** | **159,271** | **57,595** | **921,507** |
| **Liabilities** | | | | | | | |
| Balances due to credit institutions | 1,999 | 335 | 78,760 | 42,362 | - | 2,610 | 126,066 |
| Financial liabilities at amortised cost | 39,323 | 21,630 | 52,690 | 8,372 | 544 | 537,384 | 659,943 |
| Amounts payable under repurchase agreements | 32,321 | - | - | - | - | - | 32,321 |
| Deferred income and accrued expense | - | - | - | - | - | 1,286 | 1,286 |
| Tax liabilities | - | - | - | - | - | 2,353 | 2,353 |
| Other liabilities | - | - | - | - | - | 3,380 | 3,380 |
| Total shareholders' equity | - | - | - | - | - | 96,158 | 96,158 |
| **Total liabilities and shareholders' equity** | **73,643** | **21,965** | **131,450** | **50,734** | **544** | **643,171** | **921,507** |
| **Interest sensitivity gap** | **358,164** | **21,361** | **(41,480)** | **88,804** | **158,727** | **(585,576)** | **-** |

## 38 AVERAGE EFFECTIVE INTEREST RATES

The table below displays the Group's interest bearing assets and liabilities as at December 31, 2007 and their corresponding average effective interest rates as at that date. These interest rates are an approximation of the yields to maturity of these assets and liabilities. The Bank's residual contractual maturities of financial liabilities has not been presented as the difference to the Group analysis is insignificant.

| | Value LVL'000 | 2007 Average Effective Interest Rate | Value LVL'000 | 2006 Average Effective Interest Rate |
|---|---|---|---|---|
| **Assets** | | | | |
| Balances due from credit institutions | 455,108 | 4.27 | 400,078 | 4.01 |
| Investments | 23,470 | 4.35 | 56,992 | 5.01 |
| Financial instruments held for trading | 75,125 | 4.58 | 32,802 | 3.04 |
| Loans to customers | 573,230 | 8.01 | 371,765 | 7.47 |
| **Total interest bearing assets** | **1,126,933** | **6.21** | **861,637** | **5.51** |
| **Liabilities** | | | | |
| Deposits and balances from banks | 148,693 | 4.92 | 120,887 | 3.65 |
| Current accounts and deposits from customers | 680,982 | 3.39 | 154,078 | 3.51 |
| **Total interest bearing liabilities** | **829,675** | **3.67** | **274,965** | **3.55** |

## 39 SENSITIVITY ANALYSES

*Market interest rate risk*

The following demonstrates the sensitivity to reasonably possible changes in interest rates on the Bank's income statement. The analysis assumes that all other variables, in particular foreign currency rates, remain constant.

The sensitivity of income statement is the effect of the assumed changes in the interest rates on the net interest income for one year, following the balance sheet date, based on the floating rate non-trading financial assets and financial liabilities held at December 31, 2007 and December 31, 2006.

*Exchange rate risk*

A 5 percent strengthening of foreign currencies against the lat at December 31, 2007 and December 31, 2006 would have increased (decreased) profit or loss by the amounts shown below. A 5 percent weakening of foreign currencies against the lat at December 31, 2007 and December 31, 2006 would have had the equal but opposite effect in the amounts described above, on the basis that all other variables remain constant.

The scenario used for analysis is based on reasonable volatility of exchange rates equal for all exposures of the Bank in foreign currencies assuming that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for both years.

| | Change | 31 December 2007 Group LVL'000 | 31 December 2006 Group LVL'000 |
|---|---|---|---|
| **Market interest rate** | +1% p.p. | (3,007 ) | (2,600) |
| | -1% p.p. | 3,007 | 2,600 |
| **Exchange rates** | +5% | 611 | 79 |
| | -5% | (611) | (79) |

## 40 GROUP AND BANK'S MAXIMUM CREDIT RISK EXPOSURE

**Group**

| | | Gross maximum credit exposure | | Net maximum credit exposure | |
|---|---|---|---|---|---|
| | Notes | 31 December 2007 | 31 December 2006 | 31 December 2007 | 31 December 2006 |
| Balances with central bank | 13 | 62,478 | 58,347 | - | - |
| Balances due from credit institutions | 14 | 405,464 | 360,653 | 369,450 | 333,976 |
| Loans to non-banking customers | 17 | 599,436 | 374,695 | 19,918 | 23,972 |
| Derivative financial instruments | 15 | 1,358 | 1,076 | 1,358 | 1,076 |
| Investments in securities | 15,16,18 | 102,099 | 95,182 | 102,099 | 95,182 |
| Accrued income and deferred expenses | 19 | 1,754 | 804 | 1,754 | 804 |
| Other assets | 23 | 4,257 | 5,240 | 4,257 | 5,240 |
| **Total balance sheet items** | | **1,176,846** | **895,997** | **498,836** | **460,250** |
| **Total off-balance-sheet items** | | **79,315** | **81,497** | **76,296** | **66,591** |
| **Total credit risk exposure** | | **1,256,161** | **977,494** | **575,132** | **526,841** |

**Bank**

| | | Gross maximum credit exposure | | Net maximum credit exposure | |
|---|---|---|---|---|---|
| | Notes | 31 December 2007 | 31 December 2006 | 31 December 2007 | 31 December 2006 |
| Balances with central bank | 13 | 62,478 | 58,347 | - | - |
| Balances due from credit institutions | 14 | 404,506 | 360,237 | 369,450 | 333,976 |
| Loans to non-banking customers | 17 | 598,699 | 373,633 | 19,918 | 23,972 |
| Derivative financial instruments | 15 | 1,358 | 1,076 | 1,358 | 1,076 |
| Investments in securities | 15,16,18 | 99,978 | 93,661 | 102,099 | 95,182 |
| Accrued income and deferred expenses | 19 | 1,698 | 720 | 1,698 | 720 |
| Other assets | 23 | 4,214 | 4,461 | 4,139 | 4,461 |
| **Total balance sheet items** | | **1,172,931** | **892,135** | **498,662** | **459,387** |
| **Total off-balance-sheet items** | | **79,315** | **82,097** | **76,296** | **66,591** |
| **Total credit risk exposure** | | **1,252,246** | **974,232** | **574,958** | **525,978** |