

LATVIJAS BANKA

FINANCIAL STATEMENTS OF LATVIJAS BANKA
FOR THE YEAR ENDED 31 DECEMBER 2013

INDEPENDENT AUDITORS' REPORT TO THE COUNCIL
OF LATVIJAS BANKA

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ABBREVIATIONS

BIS	Bank for International Settlements
EC	European Commission
ECB	European Central Bank
ESCB	European System of Central Banks
EU	European Union
FCMC	Financial and Capital Market Commission
IMF	International Monetary Fund
JSC	Joint Stock Company
OECD	Organisation for Economic Co-operation and Development
OTC	over-the-counter
SDR	Special Drawing Rights
TARGET2-Latvija system	TARGET2 component system of the Trans-European Automated Real-time Gross settlement Express Transfer system in Latvia
US	United States of America

BALANCE SHEET

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

ASSETS	Notes ¹	2013	2012
FOREIGN ASSETS		4 098 441	4 053 478
Gold	6	153 157	218 750
Special Drawing Rights	7	95 692	83 367
Convertible foreign currencies	8	3 815 537	3 692 653
Participating interest in the European Central Bank	9	730	750
Participating interest in the Bank for International Settlements	10	19 992	19 991
Other foreign assets	11	13 333	37 967
DOMESTIC ASSETS		40 935	32 857
Loans to credit institutions	12	10 000	–
Fixed assets	13, 14	30 201	31 963
Other domestic assets	15, 16	734	894
TOTAL ASSETS		4 139 376	4 086 335

¹ The accompanying Notes set out on pages 9 to 41 are an integral part of these financial statements.

(cont.)

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

LIABILITIES, CAPITAL AND RESERVES	Notes	2013	2012
FOREIGN LIABILITIES		24 683	27 680
Convertible foreign currencies	17	8 936	18 775
International Monetary Fund	7	295	305
Other international institution deposits in lats	18	3 278	3 341
Foreign bank deposits in lats		4 055	2 332
Other foreign liabilities	19	8 119	2 927
LATS IN CIRCULATION	20	630 755	1 234 147
DOMESTIC LIABILITIES		3 153 626	2 462 505
Balances due to credit institutions	21	2 901 037	1 688 349
Balances due to the government	22	239 187	761 152
Balances due to other financial institutions	23	9 986	10 814
Other domestic liabilities	24, 25	3 416	2 190
CAPITAL AND RESERVES		330 312	362 003
Nominal capital	26	25 000	25 000
Reserve capital	26	171 683	159 797
Valuation account	26	92 165	143 245
Profit of the reporting year	26	41 464	33 961
TOTAL LIABILITIES, CAPITAL AND RESERVES		4 139 376	4 086 335

The financial statements, which are set out on pages 3 to 41, were authorised by the Board of Latvijas Banka on 13 March 2014.

BOARD OF LATVIJAS BANKA



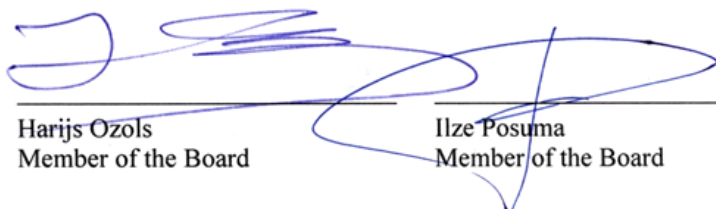
Māris Kālis
Chairman of the Board



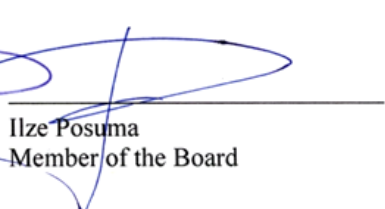
Reinis Jakovļevs
Deputy Chairman
of the Board



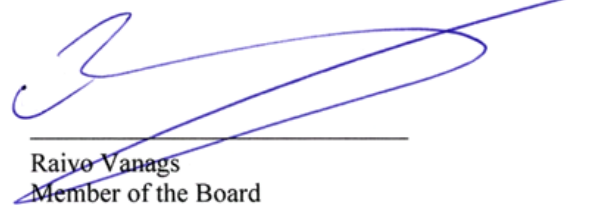
Andris Ņikitins
Member of the Board



Harijs Ozols
Member of the Board



Ilze Pošuma
Member of the Board



Raivo Vanags
Member of the Board

PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes	2013	2012
INTEREST INCOME			
Foreign operations	36	38 331	47 555
Interest on securities		35 433	45 579
Interest on deposits with foreign credit institutions and other foreign financial institutions		123	995
Interest on derivative financial instruments		2 775	981
Domestic operations	36	1	8
Interest on loans to credit institutions		1	8
INTEREST EXPENSE			
Foreign operations	36	-7 967	-5 521
Interest on deposits		-9	-8
Interest on derivative financial instruments		-7 958	-5 513
Domestic operations	36	-1 965	-4 410
Interest on deposits of credit institutions		-735	-2 063
Interest on government deposits		-1 221	-2 273
Interest on deposits of other financial institutions		-9	-74
NET INTEREST INCOME	36	28 400	37 632

(cont.)

(in thousands of lats)

	Notes	2013	2012
REALISED GAINS/LOSSES (-) FROM FINANCIAL OPERATIONS	37	44 530	17 518
Foreign operations		43 009	15 944
Debt securities		13 227	25 892
Derivative financial instruments		29 782	-9 948
Foreign currency exchange transactions		1 521	1 574
WRITE-DOWNS OF REVALUATION RESULT ON FINANCIAL ASSETS AND POSITIONS	26, 38	-4 879	-1 585
Foreign operations		-4 771	-1 482
Debt securities		-4 771	-1 482
Foreign currency position		-108	-103
INCOME FROM PARTICIPATING INTEREST	39	273	278
OTHER OPERATING INCOME	40	2 819	1 482
BANKNOTE AND COIN ACQUISITION COSTS	41	-7 577	-797
OTHER OPERATING EXPENSES		-22 102	-20 567
Remuneration	42	-10 938	-10 243
Social security costs	42	-2 578	-2 430
Depreciation and amortisation charges	13, 16	-2 654	-2 887
Maintenance and operation of information systems		-2 002	-1 993
Other operating expenses	43	-3 930	-3 014
PROFIT OF THE REPORTING YEAR		41 464	33 961

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

(in thousands of lats)

	Notes	2013	2012
REVALUATION	26	-30 539	34 815
Equity instruments		1	995
Foreign currency and gold		-23 912	6 253
Debt securities		-6 628	27 567
REALISATION OF ACCUMULATED REVALUATION RESULT	26	-25 420	-14 702
Foreign currency and gold		-1 712	-145
OTC interest rate swap arrangements		-	-25
Debt securities		-23 708	-14 532
WRITE-DOWNS OF REVALUATION RESULT ON FINANCIAL ASSETS AND POSITIONS	26, 38	4 879	1 585
PROFIT OF THE REPORTING YEAR		41 464	33 961
TOTAL		-9 616	55 659

CASH FLOW STATEMENT

		(in thousands of lats)	
	Notes	2013	2012
CASH FLOW FROM OPERATING ACTIVITIES			
Profit of the reporting year		41 464	33 961
Non-cash transaction adjustments	44 (1)	7 521	4 462
Net movements in balance sheet positions	44 (1)	96 762	398 298
Net cash and cash equivalents inflow from operating activities		145 747	436 721
CASH FLOW FROM INVESTING ACTIVITIES			
Decrease in participating interest in the European Central Bank	9	20	–
Dividends on shares of the Bank for International Settlements	39	273	278
Acquisition of fixed assets	13	–793	–3 925
Disposal of fixed assets	13	13	13
Acquisition of intangible assets	16	–157	–218
Net cash and cash equivalents outflow from investing activities		–644	–3 852
CASH FLOW FROM FINANCING ACTIVITIES			
Profit appropriated to the state budget	26	–22 075	–20 818
Net cash and cash equivalents outflow from financing activities		–22 075	–20 818
NET CASH AND CASH EQUIVALENTS INFLOW		123 028	412 051
Cash and cash equivalents at the beginning of the year	44 (2)	1 008 781	596 730
Cash and cash equivalents at the end of the year	44 (2)	1 131 809	1 008 781

NOTES TO THE FINANCIAL STATEMENTS

1. PRINCIPAL ACTIVITIES

Latvijas Banka is the central bank of Latvia. It was established on 19 September 1922 (re-established in 1990) and operates under the Law on Latvijas Banka and other legislative provisions.

The primary goal of Latvijas Banka is to maintain price stability. Pursuant to the Law on Latvijas Banka, its primary tasks in 2013 were as follows:

- establishment and implementation of monetary policy;
- management of foreign reserves;
- issue of cash, both banknotes and coins;
- promotion of a smooth operation of the payment systems in Latvia and organisation and management of the interbank payment system;
- collecting, compiling and publishing financial statistics and Latvia's balance of payments;
- representation of Latvia in foreign central banks and international financial institutions;
- acting as a financial agent for the Latvian government.

Latvijas Banka also ensures the operation of the Credit Register, issues licences to legal persons registered with the Republic of Latvia's Register of Enterprises, except credit institutions, for the purchase and sale of foreign currency cash as a commercial activity, and controls compliance with the procedure it has established for effecting foreign currency cash purchase and sales transactions.

In the execution of its tasks in accordance with the Law on Latvijas Banka and the Law on Credit Institutions, Latvijas Banka neither seeks nor takes instructions from the government or any other institution. Latvijas Banka is independent in setting and implementing policy under its legal mandate. Latvijas Banka is supervised by the Parliament (Saeima) of the Republic of Latvia.

Latvijas Banka does not engage in any commercial activity, and its operation related to the execution of its tasks is mainly financed from income received from foreign reserves management.

The Head Office of Latvijas Banka is situated in K. Valdemāra iela 2A, Riga. Latvijas Banka manages the storage, processing and circulation of cash through its Riga Branch and the regional branches in Daugavpils and Liepāja. Latvijas Banka's building at K. Valdemāra iela 1B, Riga, is used to ensure the operation of the interbank payment systems, compilation and publishing of statistics, operation of the Credit Register and customer service for cash transactions.

2. PRINCIPAL ACCOUNTING POLICIES

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

2.1. Basis of presentation

These financial statements have been prepared in accordance with the Financial Accounting Policy of Latvijas Banka approved by Latvijas Banka's Council, and the Law on Latvijas Banka.

The Financial Accounting Policy of Latvijas Banka requires that events and financial transactions of Latvijas Banka relating to the implementation of monetary policy and management of foreign reserves as well as participating interest in the ECB are reported in accordance with the legal framework for accounting and financial reporting in the ESCB.

2.2. Basis of measurement

These financial statements have been prepared in accordance with the historical cost basis of accounting except for gold, debt securities, participating interest (except the participating interest in the ECB), currency future contracts and interest rate derivatives, which are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 2.15. The comparison of the book value and fair value of these instruments is provided in Note 27.

2.3. Fair value of financial assets and financial liabilities

Fair value is the estimated amount at which financial assets could be exchanged, or financial liabilities settled in a transaction on an arm's length basis between knowledgeable and willing parties.

Fair value of financial instruments is determined by Latvijas Banka using quoted prices in active markets, other financial market information sources or discounted cash flows. The discounted cash flows are modelled using quoted market prices of financial instruments and money market interest rates. The breakdown of assets and liabilities measured at fair value, taking into account the hierarchy of fair value determination, is provided in Note 5.

Fair value of the financial assets and financial liabilities of Latvijas Banka does not differ materially from the reported book value of the respective assets and liabilities.

2.4. Foreign currency and gold translation

Transactions denominated in foreign currencies are recorded in lats at the exchange rates quoted by Latvijas Banka for the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the exchange rates set by Latvijas Banka at the end of the reporting period. Non-monetary assets and liabilities, measured at cost or amortised cost, are translated into lats at the exchange rate for the respective foreign currency set by Latvijas Banka on the day of the transaction. Taking into account the lats peg to the euro, Latvijas Banka set the exchange rates for other currencies on the basis of the exchange rate of euro against the US dollar and the exchange rates of the US dollar against other currencies as quoted in the electronic information system *Reuters*.

Transactions in foreign currencies are included in the calculation of net foreign currency position of the respective currency. The transactions in foreign currencies reducing the respective currency position result in realised gains or losses. Any gain or loss arising from revaluation of transactions in foreign currencies and currency positions are credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 2.25. The principles referred to herein and in Note 2.25 for valuation and recording of transactions denominated in foreign currencies are applied also to gold reserves and transactions in gold.

The exchange rates of major foreign currencies and gold price in lats set by Latvijas Banka and used in the preparation of the balance sheet for the year ended 31 December 2013 and the year ended 31 December 2012 are as follows:

	(at the end of the year)		
	2013	2012	Changes (%)
Euro (EUR)	0.702804	0.702804	0
US dollar (USD)	0.515	0.531	-3.0
Japanese yen (JPY)	0.00493	0.00619	-20.4
Gold (XAU)	615.817	879.554	-30.0
Special Drawing Rights (XDR)	0.792	0.818	-3.2

2.5. Recognition and derecognition of financial assets and liabilities

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

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

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

2.6. Offsetting financial assets and financial liabilities

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

2.7. Use of estimates and assumptions

Estimates and assumptions have been made in the preparation of the financial statements that affect the amounts of certain assets, liabilities and contingent liabilities reported in the financial statements. Future events may affect the above mentioned estimates and assumptions. The effect of a change in such estimates and assumptions is reported in the financial statements of the reporting period and each particular future period to which it refers.

The major estimates and assumptions in the preparation of the financial statements have been made with respect to the following: impairment of assets (see Note 2.19), the method for establishing the fair value of the BIS shares (see Note 10), the useful life of fixed assets and intangible assets (see Notes 2.17 and 2.18), and the repurchasing probability of collector coins (see Note 2.22).

2.8. Gold

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

Any gain or loss arising from transactions in gold and revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles described in Note 2.25.

2.9. Debt securities

Debt securities are stated at fair value in the balance sheet.

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income. Gain or loss arising from transactions in debt securities and their revaluation are credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 2.25.

2.10. Reverse repurchase agreements

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not included in Latvijas Banka's balance sheet. The related funding provided to the counterparty is included in Latvijas Banka's at nominal value as claims on domestic credit institutions or foreign credit institutions and other foreign financial institutions, as appropriate.

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

2.11. Repurchase agreements

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

The difference between the sale and repurchase price of securities is recognised as interest expense in the profit and loss statement over the term of the agreement.

2.12. Securities lending

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

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

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

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

2.14. Participating interest

Participating interest includes long-term investments of Latvijas Banka in equity instruments. Latvijas Banka has no control or significant influence in any institution, therefore participating interest is not accounted for as an investment in a subsidiary or an associate. Equity instruments are reported at fair value in the balance sheet, except participating interest in the ECB, which is reported at cost in the balance sheet in accordance with the legal framework for accounting and financial reporting in the ESCB.

The change in fair value of participating interest is reported in the balance sheet caption "Valuation account".

2.15. Derivative financial instruments

Latvijas Banka enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements, and interest rate and currency future contracts, which are reported in off-balance sheet accounts at their contract or notional amount. Forward exchange rate contracts and currency swap arrangements are included in the net position of the respective currency on the transaction day at the spot rate of the transaction and are recorded in the balance sheet in lats at the exchange rate of the respective currency set by Latvijas Banka at the end of the reporting period. Other derivative financial instruments are reported in the balance sheet at fair value.

Interest on derivative financial instruments, including the spot and forward interest rate spread of forward exchange rate contracts and currency swap arrangements, is recognised in the profit and loss statement as interest income or interest expense. Any gain or loss arising from a change in fair value of interest rate and currency future contracts is included in the profit and loss statement taking into account settlement. Any gain or loss arising from a change in fair value of other derivative financial instruments is credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 2.25.

2.16. Accrued interest income and expense

Accrued interest income on securities is included in the carrying amount of the respective interest bearing securities. Accrued interest income and expense on other financial instruments are reported under relevant balance sheet captions of other assets or other liabilities.

2.17. Fixed assets

Fixed assets are tangible long-term investments with the useful life over one year. Capitalisation limit of fixed assets is 100 lats, except the costs related to real estate improvements and replacement of fixed asset parts for which the Board of Latvijas Banka has set a higher capitalisation limit depending on their significance. These assets are used in the provision of services as well as in the maintenance of other fixed assets and to ensure operation of Latvijas Banka.

Fixed assets are recorded at cost less accumulated depreciation and impairment, if any.

Depreciation is recognised using the straight-line method over the estimated useful life of the asset. Assets under construction or development, land and works of art are not depreciated. Buildings and structures are accounted by separate components, with individual useful life set for each such component.

In 2013 and 2012, the useful lives set for fixed assets were as follows:

	(years)	
	2013	2012
Buildings and their components, improvements to the territory	5–100	5–100
Transport vehicles	10–15	10–15
Office equipment and tools	5–25	5–25
Cash processing, verifying, and storage equipment	5–15	5–15
Computer and telecommunication equipment	2–7	2–7
Other fixed assets	5–15	5–15

In accordance with generally accepted principles for hedge accounting, the cost of individual fixed assets includes an effective result arising from financial instruments designated as hedges of exchange risk associated with development of the respective fixed assets.

2.18. Intangible assets

Intangible assets are long-term investments without physical substance with a useful life of over one year. Capitalisation limit of intangible assets is 100 lats. Intangible assets include software application rights and other rights.

Intangible assets are reported in the balance sheet at cost less accumulated amortisation and impairment, if any.

Acquisition costs of intangible assets are amortised over the useful life of the respective assets using the straight-line method; however, this period may not exceed 10 years.

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

2.19. Impairment of assets

An asset is impaired when its carrying amount exceeds its recoverable amount. Upon detecting any indications of impairment of an asset, the recoverable amount of the respective asset is estimated. If the recoverable amount is less than the carrying amount of the respective asset, adequate allowances for the respective asset are made. Such allowances are recognised in the profit and loss statement with a respective reduction in the asset's carrying amount.

No impairment of assets was detected in 2013 and 2012.

2.20. Lats in circulation

Lats banknotes and coins in circulation issued by Latvijas Banka, except for gold circulation coins and collector coins, are included in the balance sheet caption "Lats in circulation" at nominal value reflecting Latvijas Banka's liabilities to holders of the respective banknotes and coins.

2.21. Gold circulation coins

When gold circulation coins (fineness .999) are issued, they are excluded from the balance sheet caption "Other domestic assets". The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", as their value is directly supported by their content of gold.

2.22. Collector coins

Collector coins sold are not included in the balance sheet liabilities, as the repurchasing probability of those coins is low or the value of precious metals of which the coins are made exceeds repurchase value. Proceeds from sales of collector coins are recognised in the profit and loss statement when incurred.

2.23. Provisions

Provisions are recognised in the financial statements when Latvijas Banka has incurred a present legal or constructive obligation arising from a past event or transaction and a reliable estimate can be made of the obligation and it can be expected to result in a cash outflow from Latvijas Banka.

2.24. Cash and cash equivalents

Cash and cash equivalents stated in the cash flow statement include convertible foreign currency in cash, demand deposits and deposits with an original maturity up to 5 business days made with foreign credit institutions and other foreign financial institutions.

2.25. Recognition of gains or losses on financial instruments

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

- (a) realised gains and losses shall be recognised in the profit and loss statement;
- (b) unrealised gains shall be recognised in the balance sheet caption "Valuation account";
- (c) unrealised losses recognised in the balance sheet caption "Valuation account" at the end of the reporting year shall be transferred to the profit and loss statement if they exceed previous revaluation gain on the respective financial instrument, foreign currency or gold position;
- (d) unrealised losses recognised in the profit and loss statement at the end of the reporting year shall not be reversed and offset by unrealised gains of the respective financial instrument, foreign currency or gold position in the subsequent years;
- (e) there shall be no netting of unrealised losses in a financial instrument, foreign currency or gold position against unrealised gains in other financial instrument, foreign currency or gold position.

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

2.26. Interest income and expense

Interest income and expense are recognised in the profit and loss statement on an accrual basis.

Interest income includes interest on securities, securities lending, deposits, loans granted, forward exchange rate contracts, and currency and interest rate swap arrangements. Interest on securities also includes premium and discount, which is amortised over the remaining life of the respective securities using the straight-line method.

Interest expense includes interest on deposits received from the Latvian government, domestic credit institutions and other financial institutions, as well as interest on forward exchange rate contracts and currency and interest rate swap arrangements.

2.27. Realised gains or losses from financial operations

Realised gains or losses from financial operations are recognised in the profit and loss statement at the time of disposal of financial instrument or at the time of settlement.

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

2.28. Income from participating interest

The change in fair value of participating interest is reported in the balance sheet caption "Valuation account".

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

2.29. Banknote and coin acquisition costs

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

2.30. Other expense and income

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

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

3.1. Financial position

In 2013, the assets of Latvijas Banka grew by 53.0 million lats, mainly on account of an increase in foreign assets in the amount of 45.0 million lats.

Assets in convertible foreign currencies posted 122.9 million lats growth, mostly as a result of net increases of 246.0 million lats in credit institution deposits in foreign currencies and revaluation of convertible foreign currency assets, while a 205.8 million lats reduction in the Latvian government's foreign currency deposits with Latvijas Banka had a decreasing effect. In 2013, Latvijas Banka did not engage in foreign exchange buying and selling transactions with credit institutions or the Treasury.

In 2013, excess liquidity in lats held by credit institutions persisted; nevertheless, Latvijas Banka had granted loans in the amount of 10.0 million lats to credit institutions at the end of 2013. Credit institution deposits in lats grew by 966.7 million lats in 2013, mostly as a result of cash deposits in preparation by credit institutions for the euro changeover, as well as the government placing part of its deposits with credit institutions. Government deposits in lats with Latvijas Banka contracted by 316.2 million lats.

With the euro changeover approaching, currency in circulation shrank in the second half of 2013, hence the Latvijas Banka's balance sheet caption "Lats in circulation" decreased by 603.4 million lats.

Capital and reserves of Latvijas Banka decreased by 31.7 million lats on account of net changes in valuation of financial instruments (-51.1 million lats) and profits remitted to the state budget in the amount of 22.1 million lats, whereas profits earned in 2013 (41.5 million lats) had an increasing effect.

3.2. Financial performance

In 2013, Latvijas Banka's profit amounted to 41.5 million lats (34.0 million lats in 2012).

In 2013, net interest income decreased by 9.2 million lats in comparison with 2012. Interest income on securities shrank by 10.1 million lats, with the adverse impact of the low interest rates in 2013 persisting. However, such adverse impact from the low interest rates was partly offset by an increase in Latvijas Banka's foreign reserves and investment decisions, which ensured a return on foreign reserves.

In 2013, the short-term interest rates on the euro were lower than those on other foreign currencies of Latvijas Banka investments, reducing interest income from and increasing interest expense on financial derivatives used for hedging currency and gold price risk (hereinafter, currency risk).

Given the excess lats liquidity of credit institutions, Latvijas Banka issued loans to credit institutions in small amounts in 2013 and the respective interest income was 1 thousand lats (8 thousand lats in 2012).

With average credit institution deposits in lats with Latvijas Banka increasing, but average interest rates on these deposits decreasing in comparison with 2012, the interest expense on credit institution deposits contracted by 1.3 million lats. Lower interest rates on government deposits in foreign currencies and a smaller amount of funds in foreign currencies received from the Latvian government as deposits accounted for a 0.7 million lats fall in interest expense on the above deposits. Interest expense on the government deposits in lats fell by 0.4 million lats due to lower average interest rates on these deposits than in 2012.

Realised gains from financial operations increased by 27.0 million lats in comparison with 2012, and write-downs of the negative revaluation result on financial assets and positions were 3.3 million lats larger than in 2012. The increase in the realised gains from financial operations was promoted by the result of currency future contracts concluded for the purpose of hedging the currency risk. The positive revaluation result of the hedged balance sheet items is reported in the balance sheet caption "Valuation account". The increase in the realised gains from financial operations moderated on account of lower gains from the disposal of debt securities due to a decrease in the positive securities revaluation result, accumulated on the valuation account in previous reporting years.

The uncertainty of Latvijas Banka's further financial performance is mostly related to interest rate developments in the euro area and US financial markets since Latvijas Banka is exposed to the interest rate risk. In view of the very low levels of interest rates, a further interest rate fall is potentially negligible in comparison with a potential rise; thus, an increase in interest rates in foreign financial markets in the future may negatively affect the income on foreign fixed income securities.

4. INVESTMENT POLICY

Foreign reserves are managed in compliance with the basic principles set out in the Procedure adopted by the Council of Latvijas Banka, including preserving the value of foreign reserves, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting the monetary policy implemented by Latvijas Banka.

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

Foreign reserves are managed by classifying them into different investment portfolios by investment strategy and source of funding. Portfolios of borrowed funds include foreign reserves which correspond to Latvijas Banka's liabilities in foreign currencies to other institutions, mainly government deposits. Foreign reserves that are not included in the portfolios of borrowed funds (net reserves) are included in the portfolios of gold reserves, portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark. A part of foreign reserves included in the portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark are managed by external foreign reserves managers.

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

The breakdown of foreign reserves by type of investment portfolio at the end of 2013 and 2012 was as follows:

	Portfolio value (in thousands of lats)		Percentage (%)	
	2013	2012	2013	2012
Portfolios managed against multi-currency fixed income securities benchmark	2 665 121	2 703 967	85.6	79.9
Portfolios managed against asset-backed securities benchmark	179 470	181 438	5.8	5.3
Gold reserves portfolio	156 883	225 862	5.0	6.7
Portfolios of borrowed funds	111 577	274 931	3.6	8.1
Total	3 113 051	3 386 198	100.0	100.0

In 2013 Latvijas Banka increased diversification of foreign reserves by adding the government securities of Denmark and the UK to its multi-currency fixed income securities benchmark. Consequently, now the benchmark is tied to the weighted 1–3 year government securities index of the euro area countries, the US, Denmark, Japan, Canada, the UK and Singapore (in 2012, the benchmark was limited to the euro area countries, the US, Japan, Canada and Singapore).

The benchmark of portfolios managed against asset-backed securities benchmark is tied to the US mortgage-backed securities index.

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

According to the exchange rate policy of Latvijas Banka in 2013, the currency of the foreign reserves benchmark is the euro, except for portfolios of borrowed funds, thus limiting the currency risk. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the currency of respective liabilities.

The description of the main methods used in financial risk management is provided in Note 28.1.

BALANCE SHEET NOTES

5. ASSETS AND LIABILITIES AT FAIR VALUE

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

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

At the end of 2013 and 2012, Latvijas Banka's assets and liabilities carried at fair value were generally valued on the basis of quoted market price.

At the end of 2013 and 2012, participating interest in the BIS was assessed using non-observable data. The assessment was conducted using the 70% net asset value model (see also Note 10).

At the end of 2013 and 2012, the breakdown of assets and liabilities carried at fair value according to the fair value hierarchy was as follows:

	(in thousands of lats)			
	Quoted market price	Observable data	Non- observable data	Total
As at 31 December 2013				
FOREIGN ASSETS				
Gold	153 157	–	–	153 157
Convertible foreign currencies				
Debt securities	2 402 296	281 432	–	2 683 728
Participating interest in the Bank for International Settlements	–	–	19 992	19 992
Other foreign assets				
Forward transactions in securities	206	–	–	206
Total foreign assets at fair value	2 555 659	281 432	19 992	2 857 083
FOREIGN LIABILITIES				
Other foreign liabilities				
Forward transactions in securities	355	–	–	355
Total foreign liabilities at fair value	355	–	–	355
As at 31 December 2012				
FOREIGN ASSETS				
Gold	218 750	–	–	218 750
Convertible foreign currencies				
Debt securities	2 418 964	264 908	–	2 683 872
Participating interest in the Bank for International Settlements	–	–	19 991	19 991
Other foreign assets				
Forward transactions in securities	158	–	–	158
Total foreign assets at fair value	2 637 872	264 908	19 991	2 922 771
FOREIGN LIABILITIES				
Other foreign liabilities				
Forward transactions in securities	121	–	–	121
Total foreign liabilities at fair value	121	–	–	121

The average market prices on the last trading day of the reporting year are obtained from the electronic information systems *Bloomberg* and *Interactive Data*. Where the above price for a financial instrument is absent in the electronic information systems, the price provided by a market participant (broker) or the price determined by applying the discounted cash flow approach is used for evaluating the financial instrument.

6. GOLD

	Troy ounces	In thousands of lats
As at 31 December 2011	248 706	210 066
During 2012		
Increase in gold market value	x	8 684
As at 31 December 2012	248 706	218 750
During 2013		
Decrease in gold market value	x	-65 593
As at 31 December 2013	248 706	153 157

Latvijas Banka hedges the risk related to gold price fluctuations by entering into forward exchange rate contracts, currency swap arrangements, and currency future contracts (see also Note 2.8, 2.15 and 29). Revaluation of gold reserves, forward exchange rate contracts, and currency swap arrangements is recognised in the balance sheet caption "Valuation account", whereas revaluation of currency future contracts, taking into account that they are settled, is recognised in the profit and loss statement caption "Realised gains/losses from financial operations".

7. SPECIAL DRAWING RIGHTS, INTERNATIONAL MONETARY FUND

Pursuant to the Law "On the Republic of Latvia Joining the International Monetary Fund" Latvijas Banka serves as a depository for the IMF and services the IMF accounts in the member state currency without compensation. The IMF holdings in lats comprise promissory notes issued by the Latvian government, Account No. 1 used for financial transactions with the IMF, and Account No. 2 used for the IMF administrative expenditure and receipts.

Latvia's claims on the IMF include SDR and Latvia's quota in the IMF. SDR is an international reserve asset created by the IMF and used in transactions between the IMF and its members. The quota in the IMF reflects the subscription in the IMF of respective members. Latvia's quota in the IMF is secured by the Latvian government promissory note issued to the IMF and is recorded as an asset denominated in SDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in lats and IMF allocations. At the end of 2013, the claims on the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 95 692 thousand lats (83 367 thousand lats at the end of 2012), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 295 thousand lats (305 thousand lats at the end of 2012) held on its Accounts No. 1 and No. 2.

At the end of 2013 and 2012, Latvia's net claims on/liabilities to the IMF were as follows:

	(in thousands of lats)		(in thousands of SDR)	
	2013	2012	2013	2012
Latvia's quota in the IMF	112 543	116 238	142 100	142 100
IMF holdings in lats	-112 513	-116 207	-142 062	-142 062
Promissory notes of the Latvian government	-112 218	-115 902	-141 690	-141 690
Account No. 1	-281	-291	-355	-355
Account No. 2	-14	-14	-17	-17
Reserve position in IMF	44	45	55	55
SDR	95 692	83 367	120 824	101 916
General allocation	-74 446	-76 890	-93 998	-93 998
Special allocation	-21 245	-21 942	-26 824	-26 824
Latvia's net claims on/liabilities(-) to the IMF	45	-15 420	57	-18 851

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

Claims on and liabilities to the IMF are translated into lats at the SDR exchange rate set by Latvijas Banka at the end of the year.

8. CONVERTIBLE FOREIGN CURRENCIES

Latvijas Banka's foreign assets in convertible foreign currencies are invested primarily in highly liquid debt securities and short-term deposits.

The carrying amount of interest bearing debt securities includes accrued interest income (13 132 thousand lats at the end of 2013 and 18 724 thousand lats at the end of 2012).

At the end of 2013 and 2012, the balance sheet asset caption "Convertible foreign currencies" was comprised of the following assets:

	(in thousands of lats)	
	2013	2012
Debt securities of foreign governments, financial institutions and non-financial corporations	2 683 728	2 683 872
Demand deposits with foreign central banks, credit institutions and international institutions	1 107 133	991 831
Time deposits with foreign credit institutions and other foreign financial institutions	12 051	3 611
Foreign currency in cash	12 625	13 339
Total	3 815 537	3 692 653

For pledged foreign assets in convertible foreign currencies see Note 46.

9. PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, Latvijas Banka became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and of the ECB, the share of Latvijas Banka in the ECB's capital was calculated on the basis of the EU states' population and gross domestic product data and is adjusted every five years or at shorter intervals depending on changes in the number of the EU Member States.

At the end of 2012, Latvijas Banka's percentage share in the ECB's capital was 0.2837% equivalent to 30 528 thousand euro (21 455 thousand lats). On 1 July 2013, with Croatia joining the EU, the number of EU Member States changed. As a result, the ECB capital shares held by the national central banks were adjusted in compliance with the Statute of the ESCB and the ECB. Consequently, the share of Latvijas Banka in the ECB's capital decreased to 0.2742%, which corresponded to 29 682 thousand euro (20 861 thousand lats). As Latvia

was not a member of the euro area at the end of 2013, pursuant to the transitional provisions of the Statute of the ESCB and of the ECB and Decision of the ECB's General Council, Latvijas Banka had paid up a 3.75% minimum contribution of its total subscribed capital in the ECB amounting to 1 113 thousand euro or 730 thousand lats (1 145 thousand euro or 750 thousand lats at the end of 2012; see also Notes 48 and 49).

ECB's capital shares are not traded in the public securities market, and the share of Latvijas Banka in the ECB's capital can be increased or decreased only in the cases referred to in this Note (see also Note 2.14).

10. PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2013 and 2012, Latvijas Banka owned 1 070 shares in the BIS, which correspond to 0.19% of the total subscribed and paid-up BIS capital.

The nominal value of Latvijas Banka's shareholding in the BIS is 5 350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1 338 thousand SDR or 25% (see also Note 48). At the end of 2013 and 2012, the BIS shareholding is reported in Latvijas Banka's balance sheet at fair value. The shares in the BIS are not traded in the public securities market. In the opinion of Latvijas Banka's management, the most appropriate method for establishing the fair value of the BIS shares is the use of 70% of the BIS net asset value based on the latest audited financial statements of the BIS. The BIS applied this valuation method for calculating the issue price of its shares; the International Court at the Hague has also recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. At the end of 2013, the fair value of BIS shares was 19 992 thousand lats (19 991 thousand lats at the end of 2012) (see also Note 2.14).

11. OTHER FOREIGN ASSETS

	(in thousands of lats)	
	2013	2012
OTC financial derivative and spot exchange rate contracts with non-residents	12 830	37 001
Prepaid expense	420	740
Other	83	226
Total	13 333	37 967

12. LOANS TO CREDIT INSTITUTIONS

At the end of 2013, Latvijas Banka had granted loans through main refinancing operations in the amount of 10 000 thousand lats (at the end of 2012, Latvijas Banka had granted no loans to credit institutions).

13. FIXED ASSETS

(in thousands of lats)

	Buildings, improvement of territory, and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
As at 31 December 2011						
Cost	38 566	6 698	4 570	1 211	5 356	56 401
Accumulated depreciation	-12 735	-5 226	-2 687	-821	-4 257	-25 726
Net book value	25 831	1 472	1 883	390	1 099	30 675
During 2012						
Additions	2 872	552	25	-	476	3 925
Change in classification	-8	-	-	-	-27	-35
Disposals and write-offs	-1	-455	-12	-38	-38	-544
Net change in cost	2 863	97	13	-38	411	3 346
Depreciation charge	-1 715	-320	-240	-43	-281	-2 599
Accumulated depreciation on disposals and write-offs	1	452	12	38	38	541
Net change in accumulated depreciation	-1 714	132	-228	-5	-243	-2 058
As at 31 December 2012						
Cost	41 429	6 795	4 583	1 173	5 767	59 747
Accumulated depreciation	-14 449	-5 094	-2 915	-826	-4 500	-27 784
Net book value	26 980	1 701	1 668	347	1 267	31 963
During 2013						
Additions	87	268	361	15	62	793
Change in classification	-	-	-	-21	-1	-22
Disposals and write-offs	-	-117	-10	-	-167	-294
Net change in cost	87	151	351	-6	-106	477
Depreciation charge	-1 598	-354	-240	-41	-299	-2 532
Change in classification	-	-	-	21	-21	-
Accumulated depreciation on disposals and write-offs	-	116	10	-	167	293
Net change in accumulated depreciation	-1 598	-238	-230	-20	-153	-2 239
As at 31 December 2013						
Cost	41 516	6 946	4 934	1 167	5 661	60 224
Accumulated depreciation	-16 047	-5 332	-3 145	-846	-4 653	-30 023
Net book value	25 469	1 614	1 789	321	1 008	30 201

At the end of 2013, the total cadastral value of land under the ownership and possession of Latvijas Banka was 1 906 thousand lats (1 771 thousand lats at the end of 2012; the change is related to a revision in the cadastral value of land). Land is reported in the balance sheet of Latvijas Banka at cost (1 669 thousand lats at the end of 2013 and 2012).

At the end of 2013, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 211 thousand lats (165 thousand lats at the end of 2012).

14. LEASING

Latvijas Banka's assets subject to leases are premises and equipment. In the balance sheet they are reported as fixed assets. Asset lease agreements where Latvijas Banka acts as a lessor are operating leases. Lease payments, except those that are directly transferred to the state budget, are recognised in the profit and loss statement proportionally over the term of the respective agreement. The depreciation of the assets given on lease is calculated on the basis of the depreciation policy described in Note 2.17 and reported in the profit and loss statement as depreciation charges.

Carrying amount of assets given on lease at the end of 2013 and 2012 was as follows:

	(in thousands of lats)
<hr/>	
As at 31 December 2012	
Cost	1 163
Accumulated depreciation	-580
<hr/>	
Net book value	583
<hr/>	
As at 31 December 2013	
Cost	1 167
Accumulated depreciation	-614
<hr/>	
Net book value	553
<hr/>	

15. OTHER DOMESTIC ASSETS

	(in thousands of lats)	
	2013	2012
<hr/>		
Intangible assets	462	405
Prepaid expense	156	161
Spot exchange rate contracts with residents	-	73
Other	116	255
<hr/>		
Total	734	894
<hr/>		

16. INTANGIBLE ASSETS

(in thousands of lats)

As at 31 December 2011	
Cost	3 970
Accumulated amortisation	-3 530
Net book value	440
During 2012	
Additions	218
Change in classification	35
Net change in cost	253
Amortisation charge	-288
Net change in accumulated amortisation	-288
As at 31 December 2012	
Cost	4 223
Accumulated amortisation	-3 818
Net book value	405
During 2013	
Additions	157
Change in classification	22
Derecognised assets	-18
Net change in cost	161
Amortisation charge	-122
Accumulated amortisation on derecognised assets	18
Net change in accumulated amortisation	-104
As at 31 December 2013	
Cost	4 384
Accumulated amortisation	-3 922
Net book value	462

17. CONVERTIBLE FOREIGN CURRENCIES

At the end of 2013, convertible foreign currency liabilities mostly consisted of the cash collateral received by Latvijas Banka for securing transactions in derivative financial instruments, as well as funds on the EC account for settlements in euro. The EC account is used by the EC for the distribution of EU budgetary funds (see also Note 18).

(in thousands of lats)

	2013	2012
Cash collateral received	5 853	15 279
EC demand deposits	2 390	1 488
Other liabilities	693	2 008
Total	8 936	18 775

18. OTHER INTERNATIONAL INSTITUTION DEPOSITS IN LATS

Other international institution deposits in lats mostly consist of funds on the EC account for settlements in lats, which is used for effecting Latvian government payments to the EU budget (see also Note 17).

	(in thousands of lats)	
	2013	2012
EC demand deposits	2 783	2 965
Other deposits	495	376
Total	3 278	3 341

19. OTHER FOREIGN LIABILITIES

	(in thousands of lats)	
	2013	2012
OTC financial derivative contracts and spot exchange rate contracts with non-residents	6 799	1 977
Payments due	–	607
Accrued expense	1 290	309
Other	30	34
Total	8 119	2 927

20. LATS IN CIRCULATION

Banknotes and circulation coins with the total nominal value of 563 557 thousand lats and 67 198 thousand lats respectively were in circulation at the end of 2013 (1 160 654 thousand lats and 73 493 thousand lats respectively at the end of 2012). The decrease in currency in circulation during 2013 is mostly related to the planned euro changeover as of 1 January 2014.

At the end of 2013, the total nominal value of the issued gold circulation coins (fineness .999), with the denomination of 100 lats, and collector coins was 1 989 thousand lats and 1 836 thousand lats respectively (1 989 thousand lats and 1 613 thousand lats at the end of 2012 respectively). The respective coins in circulation are not included in the balance sheet caption "Lats in circulation" (see also Notes 2.21 and 2.22).

21. BALANCES DUE TO CREDIT INSTITUTIONS

Balances due to credit institutions include balances on the settlement accounts of domestic credit institutions opened with Latvijas Banka, as well as overnight and 7-day deposits in lats (deposit facility) received from them. The respective credit institutions place their funds with Latvijas Banka in order to comply with its minimum reserve requirement, as well as to effect interbank and customer payments, and settlements related to the monetary policy operations of Latvijas Banka. At the end of 2013, the overnight deposit facility rate and 7-day deposit facility rate as set by Latvijas Banka were 0.05% and 0.075% respectively (at the end of 2012, the overnight deposit facility rate and 7-day deposit facility rate were 0.05% and 0.075% respectively).

	(in thousands of lats)	
	2013	2012
Current account balances in lats	2 007 883	857 728
Current account balances in euro	813 154	567 191
Overnight deposit facility in lats	33 000	11 930
7-day deposit facility in lats	47 000	251 500
Total	2 901 037	1 688 349

At the end of 2013, the balances on the credit institution settlement accounts in lats also comprise the financial collateral in the amount of 206 076 thousand lats, transferred by credit institutions to Latvijas Banka in accordance with the requirements stipulated by Latvijas Banka's Council in the procedure for frontloading and sub-frontloading of euro banknotes and coins.

22. BALANCES DUE TO THE GOVERNMENT

Balances due to the government consist of the Treasury demand deposits received by Latvijas Banka acting as the financial agent of the Latvian government.

	(in thousands of lats)	
	2013	2012
Demand deposits in lats	125 006	441 218
Demand deposits in foreign currencies	114 181	319 934
Total	239 187	761 152

23. BALANCES DUE TO OTHER FINANCIAL INSTITUTIONS

Balances due to other financial institutions mostly include the funds of the FCMC and the Deposit Guarantee Fund and Fund for the Protection of the Insured, both managed by the FCMC, in the amount of 8 038 thousand lats (9 080 thousand lats at the end of 2012).

24. OTHER DOMESTIC LIABILITIES

	(in thousands of lats)	
	2013	2012
Accrued expense and similar liabilities	2 577	1 669
Tax liabilities	148	96
Other	691	425
Total	3 416	2 190

25. TAX

	(in thousands of lats)						
	Personal income tax	Compulsory social security contributions (by employer)	Compulsory social security contributions (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2011	0	0	0	0	69	0	69
During 2012							
Calculated	2 074	2 430	1 097	89	505	1	6 196
Decrease in deferred liabilities	0	-27	0	0	0	0	-27
Paid	-2 074	-2 403	-1 097	-89	-478	-1	-6 142
Liabilities as at 31 December 2012	0	0	0	0	96	0	96
During 2013							
Calculated	2 066	2 578	1 137	100	525	4	6 410
Decrease in deferred liabilities	0	-88	0	0	0	0	-88
Paid	-2 066	-2 489	-1 137	-100	-411	-2	-6 205
Recalculation of liabilities					-65		-65
Liabilities as at 31 December 2013	0	1	0	0	145	2	148

In addition to the tax payments indicated herein, Latvijas Banka transfers to the state budget 65% of the profit for the reporting year (22 075 thousand lats in 2013; 20 818 thousand lats in 2012; see also Notes 26 and 45). The transfer includes the payment for the usage of state capital. Latvijas Banka is not subject to corporate income tax.

26. CAPITAL AND RESERVES

(in thousands of lats)

	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2011	25 000	148 587	121 547	32 028	327 162
During 2012					
Revaluation, realisation, and write-downs	x	x	21 698	x	21 698
Profit appropriated to the state budget	x	x	x	-20 818	-20 818
Profit transferred to the reserve capital	x	11 210	x	-11 210	0
Profit of the reporting year	x	x	x	33 961	33 961
As at 31 December 2012	25 000	159 797	143 245	33 961	362 003
During 2013					
Revaluation, realisation, and write-downs	x	x	-51 080	x	-51 080
Profit appropriated to the state budget	x	x	x	-22 075	-22 075
Profit transferred to the reserve capital	x	11 886	x	-11 886	0
Profit of the reporting year	x	x	x	41 464	41 464
As at 31 December 2013	25 000	171 683	92 165	41 464	330 312

The capital of Latvijas Banka is comprised of the nominal capital, reserve capital and the balance sheet item "Valuation account", as well as the undistributed profit of the reporting year. Latvijas Banka does not take decisions affecting the formation of the nominal capital, reserve capital, and the profit distribution as they are provided for by the Law on Latvijas Banka. The balance sheet item "Valuation account" comprises the positive result on revaluation of the financial instruments and gold. The accounting policy, harmonised with the principal accounting policies established by the legal framework for accounting and financial reporting in the ESCB and described in Note 2, stipulates that the realised gains are recognised in the profit and loss statement only after the disposal of a financial instrument or settlement while unrealised gains are recorded under the balance sheet item "Valuation account", thus facilitating the preservation of the capital, protecting it from the impact of financial instrument price, interest rate and exchange rate fluctuations.

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

The nominal capital of Latvijas Banka is comprised of the state-allotted resources and Latvijas Banka's profit allocations. The authorised and paid-up nominal capital of Latvijas Banka has reached the amount prescribed by the Law on Latvijas Banka.

The Law on Latvijas Banka establishes that a part of Latvijas Banka's profit of the reporting year, calculated by applying the same percentage as the tax rate set for resident corporate entities of Latvia by the Law "On Corporate Income Tax", together with a payment in the amount of 50% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget. At the end of 2013 and 2012, the corporate income tax rate applicable to residents of Latvia was 15%. Therefore, 65% of Latvijas Banka's profit of the reporting year shall be transferred to the state budget within 15 days following the approval of the Annual Report of 2013 by the Council of Latvijas Banka. In 2014, 26 952 thousand lats (38 349 thousand euro) from the profit earned in 2013 shall be transferred to the state budget.

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

In 2013 and 2012, changes in the balance sheet caption "Valuation account" were as follows:

	(in thousands of lats)								
	2013	Write-downs	Revaluation	Realisation	2012	Write-downs	Revaluation	Realisation	2011
Initial valuation account	24 018	x	x	–	24 018	x	x	–	24 018
Result on revaluation of foreign currencies and gold	30 277	108	–23 912	–1 712	55 793	103	6 253	–145	49 582
Result on revaluation of debt securities	19 641	4 771	–6 628	–23 708	45 206	1 482	27 567	–14 532	30 689
Revaluation reserve for equity instruments	18 229	–	1	–	18 228	–	995	–	17 233
Result on revaluation of OTC interest rate swap arrangements	–	–	–	–	–	–	–	–25	25
Total	92 165	4 879	–30 539	–25 420	143 245	1 585	34 815	–14 702	121 547

The initial valuation account was established by transferring thereto the result of financial instruments and gold revaluation prior to the change in the accounting policy on 1 January 2007, whereas the revaluation reserve for equity instruments has been established to account for the result on revaluation of the BIS shares.

27. DERIVATIVE FINANCIAL INSTRUMENTS AND SPOT EXCHANGE RATE CONTRACTS

Latvijas Banka enters into forward and spot exchange rate contracts, currency and interest rate swap arrangements and interest rate and currency future contracts in order to manage interest rate and currency risks associated with Latvijas Banka's foreign reserves. As part of its monetary policy, Latvijas Banka also engaged in spot exchange rate contracts in 2013 and 2012.

	(in thousands of lats)					
	Contract or notional amount		Book value			
			Assets		Liabilities	
	2013	2012	2013	2012	2013	2012
OTC financial derivative and spot exchange rate contracts with non-residents						
Forward exchange rate contracts and currency swap arrangements	2 490 620	2 462 085	10 059	36 805	6 443	1 660
Spot exchange rate contracts	187 442	66 645	2 565	38	–	196
Forward transactions in securities	171 958	249 195	206	158	356	121
Total	x	x	12 830	37 001	6 799	1 977
Spot exchange rate contracts with residents						
Spot exchange rate contracts	–	22 229	–	73	–	–
Total	x	x	–	73	–	–
Traded financial derivative contracts with non-residents						
Interest rate future contracts	696 781	957 105	x	x	x	x
Currency future contracts	129 214	154 718	x	x	x	x

The book value of the OTC financial derivative contracts and spot exchange rate contracts is reported in the respective balance sheet captions of other assets or other liabilities (see also Notes 11, 15 and 19). Since settlement has been made for the change in the fair value of future contracts, it is reported as demand deposits in the balance sheet asset caption "Convertible foreign currencies".

At the end of 2013 and 2012, the book value and the fair value of OTC contracts concluded by Latvijas Banka and not reported at their fair value, were not materially different. The reconciliation of the book value and net fair value of these instruments at the end of 2013 and 2012 was as follows:

(in thousands of lats)

	Net fair value		Net book value		Difference	
	2013	2012	2013	2012	2013	2012
OTC financial derivative and spot exchange rate contracts with non-residents						
Forward exchange rate contracts and currency swap arrangements	3 650	34 899	3 616	35 145	34	-246
Spot exchange rate contracts	2 566	-158	2 565	-158	1	-
Total	6 216	34 741	6 181	34 987	35	-246
Spot exchange rate contracts with residents						
Spot exchange rate contracts	-	73	-	73	-	-
Total	-	73	-	73	-	-

MAJOR RISKS AND PRINCIPLES FOR THEIR MANAGEMENT

28. RISK MANAGEMENT

Financial and operational risks are the main risks associated with the activities of Latvijas Banka. Management of Latvijas Banka's risks is organized and implemented according to the Risk Management Policy of Latvijas Banka approved by the Council of Latvijas Banka. Therefore, the Board of Latvijas Banka has established a risk management framework under the basic principles set forth by the Council of Latvijas Banka, which is improved in line with the developments in financial markets and operations of Latvijas Banka as well as changes in external environment. Management of Latvijas Banka's financial and operational risks is reviewed by the Internal Audit Department and is monitored by the Security Supervision Commission, Audit Committee, and Budget Commission of Latvijas Banka, each of which is comprised of Members of the Council of Latvijas Banka.

28.1. Financial risks

Market risk (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks to which Latvijas Banka is exposed in its daily activities.

Latvijas Banka manages financial risks related to foreign reserves in accordance with the Procedure approved by the Council of Latvijas Banka. The basic principles of investment policy are provided in Note 4. Foreign reserves are managed by classifying them into different investment portfolios. Parameters for a benchmark reflecting the acceptable level of financial risks and return targets are set out for each financial instrument portfolio type. On a business day basis, the Risk Management Division of the Market Operations Department monitors the compliance of foreign reserves with the established requirements.

In 2013, parameters of the multi-currency fixed income securities portfolio benchmark have been changed in order to increase the diversification of the benchmark and reduce credit risk.

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

28.1.1. Market Risk

Market risk is exposure to losses due to adverse changes in financial markets (for example, movements in interest rates or exchange rates).

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

Latvijas Banka's exposure to currency risk is determined by the structure of its foreign reserves, which cannot be formed in compliance with the liability parameters of Latvijas Banka. Latvijas Banka manages the currency risk by determining open currency position limits and using tracking error. Tracking error is calculated as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark. The aggregate market and credit risk of portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark (see Note 4) is managed by determining the tracking error limit. Tracking error observed in 2013 and 2012 is disclosed in Note 31.

For investment portfolios, except for portfolios of borrowed funds, the benchmark currency is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the parameters of respective liabilities. Deviations from the benchmark currency structure give rise to the open currency position. In order to achieve the compliance of open foreign currency positions with the limits, Latvijas Banka hedges the currency risk by using forward exchange rate contracts, currency swap arrangements, and currency future contracts.

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

Latvijas Banka's exposure to market risk (as at the end of 2013 and 2012) is disclosed in Notes 29–31.

28.1.2. Credit Risk

Credit risk is exposure to losses resulting from counterparty default. Latvijas Banka's exposure to credit risk results mainly from investments in foreign financial instruments and short-term lending to domestic credit institutions.

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

Short-term loans granted to domestic credit institutions in 2013 and 2012 were secured by collateral of Latvian government securities and such private sector debt securities, in accordance with the requirements established by the Council of Latvijas Banka. The Market Operations Department reviews the compliance of credit ratings assigned to issuers of these securities with the requirements of the Council of Latvijas Banka and monitors the adequacy of collateral on a regular basis.

Latvijas Banka's exposure to credit risk (as at the end of 2013 and 2012) is disclosed in Notes 33 to 35.

28.1.3. Liquidity Risk

Liquidity risk is associated with a failure to meet liabilities timely. Latvijas Banka's exposure to liquidity risk arises mainly from the need to ensure foreign currency for conducting foreign exchange transactions with credit institutions and repaying deposits of the Latvian government and other institutions. Latvijas Banka manages liquidity risk by investing foreign reserves in liquid debt securities issued by international institutions, foreign governments and the corporate sector, short-term deposits with foreign financial institutions and other financial instruments. Investments are made so as to ensure timely settlement of Latvijas Banka's liabilities. The structure of cash and its equivalents of Latvijas Banka is provided in Note 44. The liquidity profile of Latvijas Banka's assets and liabilities as at the end of 2013 and 2012 is disclosed in Note 32.

Latvijas Banka manages liquidity risk also by setting limits on the maximum investment in financial instruments of the same class and in financial instruments of the same issuer.

28.2. Operational risks

Operational risk is exposure to financial and non-financial losses resulting from inadequate or failed internal processes, individual's actions, operation of information or technical systems, or from external events.

Latvijas Banka's operational risk management is implemented by the Board of Latvijas Banka according to the basic principles determined by the Council of Latvijas Banka. The Board of Latvijas Banka has established the Committee for Managing Latvijas Banka's Operational Risks to coordinate, on a day-to-day basis, the activities under the operational risk management process and to provide support to the Board of Latvijas Banka on operational risk management issues. The Committee is presided by a Member of the Board of Latvijas Banka and is composed of the Operational Risk Manager, Business Continuity Manager, Information Security Manager, Information Systems Security Manager, and the Head of Security Department.

To promote successful euro changeover in Latvia, in 2013 the main focus was on the management of risks associated with the integration of Latvijas Banka into the Eurosystem. In 2013, the recording of risk events was improved, linking Latvijas Banka Operational Risk Register with the register of incidents and other events.

The security management of the information and information systems of Latvijas Banka is organised and implemented in accordance with the "Information and Information Systems Security Policy of Latvijas Banka" approved by Latvijas Banka's Council. In order to ensure confidentiality, access to and integrity of information, information at Latvijas Banka is classified on the basis of its level of confidentiality and is protected against its unauthorised disclosure or use. The information systems of Latvijas Banka are classified into levels depending on their impact on the implementation of processes and the confidentiality and integrity requirements regarding the processed information. The owners of Latvijas Banka's information systems in cooperation with the Information Systems Department have established the rules for the usage and access rights of the information system, as well as ensure the implementation of the risk analysis of the respective information system, coordinated by the information systems security manager of Latvijas Banka who also oversees the introduction of measures aimed at minimising the identified risks. The Information Systems Department ensures that the functionality and performance of Latvijas Banka's information system infrastructure complies with the requirements set for the individual information systems, as well as the infrastructure's safe and continuous operation. Latvijas Banka conducts, on a regular basis, the analysis of information systems security risks and improves security measures and tools.

The management of Latvijas Banka's business continuity is organised and conducted in accordance with the Business Continuity Policy of Latvijas Banka, approved by the Council, abiding by the internationally recognised standards and taking into account the ECB recommendations regarding business continuity management.

The physical security of the officials and employees of Latvijas Banka and an environment protected against physical hazards is organised and ensured on the premises of Latvijas Banka and during transportation of cash and other valuables in accordance with the Physical Security Policy of Latvijas Banka, adopted by the Council of Latvijas Banka, and other legislative acts of Latvijas Banka regulating the physical security management procedure for Latvijas Banka. Fire and evacuation training is organised for the staff of Latvijas Banka, and training for the employees of the Security Department to maintain and improved their qualification is organised on a regular basis.

In order to limit the implications of operational risks, Latvijas Banka is insured against a possible impact of certain types of operational risks.

In 2013, Latvijas Banka was not subject to threats that could substantially affect or hamper its operation.

29. CURRENCY PROFILE¹

(in thousands of lats)

	LVL	EUR	USD	JPY	Gold	Other	Total
As at 31 December 2013							
Assets							
Foreign assets	13 084	1 963 444	1 155 153	265 456	153 157	548 147	4 098 441
Domestic assets	40 910	28	–	–	–	–3	40 935
TOTAL ASSETS	53 994	1 963 472	1 155 153	265 456	153 157	548 144	4 139 376
Liabilities							
Foreign liabilities	13 914	9 505	1 000	23	–	241	24 683
Lats in circulation	630 755	–	–	–	–	–	630 755
Domestic liabilities	2 225 702	866 880	42 086	7 347	–	11 611	3 153 626
TOTAL LIABILITIES	2 870 371	876 385	43 086	7 370	–	11 852	3 809 064
Net position on balance sheet	–2 816 377	1 087 087	1 112 067	258 086	153 157	536 292	330 312
Net position on financial instruments' off-balance sheet accounts	–	1 926 382	–1 102 690	–131 926	–153 154	–532 581	6 031
Net position on balance sheet and off-balance sheet accounts	–2 816 377	3 013 469	9 377	126 160	3	3 711	336 343
Profile of the net position on balance sheet and off-balance sheet accounts (%)	x	95.6	0.3	4.0	0	0.1	100.0
Benchmark currency structure (%)	x	100.0	0	0	0	0	100.0
As at 31 December 2012							
TOTAL ASSETS	70 564	1 935 506	1 315 386	263 702	218 750	282 427	4 086 335
TOTAL LIABILITIES	2 816 655	815 414	67 475	8 241	–	16 547	3 724 332
Net position on balance sheet	–2 746 091	1 120 092	1 247 911	255 461	218 750	265 880	362 003
Net position on financial instruments' off-balance sheet accounts	–	2 004 323	–1 234 596	–254 185	–219 009	–261 436	35 097
Net position on balance sheet and off-balance sheet accounts	–2 746 091	3 124 415	13 315	1 276	–259	4 444	397 100
Profile of the net position on balance sheet and off-balance sheet accounts (%)	x	99.5	0.4	0	0	0.1	100.0
Benchmark currency structure (%)	x	100.0	0	0	0	0	100.0

¹ The assets and liabilities, denominated in SDR and exposed to the SDR currency risk, including liabilities to the IMF, are reported as per the SDR basket of currencies.

30. REPRICING MATURITY

The table below reflects Latvijas Banka's assets, liabilities and off-balance sheet accounts sensitive to a change in interest rates. Items reported in this table are stated at carrying amounts, except for interest rate and currency future contracts and forward transactions in securities that are stated at notional amounts and included in off-balance sheet accounts. A nearest contractual interest repricing or residual maturity date to 31 December of the reporting year is used for categorising items reported in this table.

	(in thousands of lats)					
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years	Total
As at 31 December 2013						
Foreign assets						
Special Drawing Rights	95 692	–	–	–	–	95 692
Convertible foreign currencies	1 783 109	48 751	132 661	1 108 089	800 789	3 873 399
Total interest-sensitive assets	1 878 801	48 751	132 661	1 108 089	800 789	3 969 091
Foreign liabilities						
Convertible foreign currencies	5 855	–	–	–	–	5 855
Domestic liabilities						
Balances due to credit institutions	2 087 883	–	–	–	–	2 087 883
Balances due to the government	137 854	–	–	–	–	137 854
Balances due to other financial institutions	2 451	–	–	–	–	2 451
Other domestic liabilities	–	–	–	–	–	–
Total interest-sensitive liabilities	2 234 043	–	–	–	–	2 234 043
Net position on balance sheet	–355 242	48 751	132 661	1 108 089	800 789	1 735 048
Assets on financial instrument off-balance sheet accounts	3 109 510	–	–	451 639	121 136	3 682 285
Liabilities on financial instrument off-balance sheet accounts	3 380 289	–	–	48 925	247 040	3 676 254
Net position on balance sheet and off-balance sheet accounts	–626 021	48 751	132 661	1 510 803	674 885	1 741 079
As at 31 December 2012						
Total interest-sensitive assets	1 632 126	80 324	108 887	1 268 329	662 429	3 752 095
Total interest-sensitive liabilities	1 769 140	–	–	–	–	1 769 140
Net position on balance sheet	–137 014	80 324	108 887	1 268 329	662 429	1 982 955
Assets on financial instrument off-balance sheet accounts	3 080 862	–	–	692 492	173 291	3 946 645
Liabilities on financial instrument off-balance sheet accounts	3 571 031	398	–	4 909	335 210	3 911 548
Net position on balance sheet and off-balance sheet accounts	–627 183	79 926	108 887	1 955 912	500 510	2 018 052

31. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in portfolios managed against multi-currency fixed income securities benchmark and asset-backed securities benchmark is characterised by the tracking error, which is measured as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark (see also Note 28.1). At the end of 2013 and 2012, the actual (*ex-post*) tracking errors of the portfolios managed against multi-currency fixed income securities benchmark were 23 basis points and 27 basis points respectively, whereas the tracking errors of the portfolios managed against asset-backed securities benchmark were 94 basis points and 69 basis points respectively.

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

	Book value (at the end of the year; in thousands of lats)	Expected tracking error (number of business days)			
		10–39	40–69	70–99	100–110
During 2013					
Portfolios managed against multi-currency fixed income securities benchmark	2 665 121	158	92	–	–
Portfolios managed against asset-backed securities benchmark	179 470	–	145	93	12
During 2012					
Portfolios managed against multi-currency fixed income securities benchmark	2 703 967	2	242	8	–
Portfolios managed against asset-backed securities benchmark	181 438	–	13	212	27

32. LIQUIDITY PROFILE

	(in thousands of lats)					
	2013			2012		
	Up to 3 months	No fixed maturity	Total	Up to 3 months	No fixed maturity	Total
Assets						
Foreign assets	4 077 217	21 224	4 098 441	4 031 772	21 706	4 053 478
Domestic assets	10 108	30 827	40 935	241	32 616	32 857
TOTAL ASSETS	4 087 325	52 051	4 139 376	4 032 013	54 322	4 086 335
Liabilities						
Foreign liabilities	24 652	31	24 683	27 646	34	27 680
Lats in circulation	–	630 755	630 755	–	1 234 147	1 234 147
Domestic liabilities	3 153 626	–	3 153 626	2 462 505	–	2 462 505
TOTAL LIABILITIES	3 178 278	630 786	3 809 064	2 490 151	1 234 181	3 724 332
Net position on balance sheet	909 047	–578 735	x	1 541 862	–1 179 859	x

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

33. SECTORAL PROFILE OF ASSETS

	Amount (in thousands of lats)		Percentage (%)	
	2013	2012	2013	2012
Foreign central governments and other governmental institutions	1 227 428	1 284 308	29.7	31.4
Foreign local governments	26 593	31 626	0.6	0.8
Foreign central banks and credit institutions	1 628 702	1 690 083	39.3	41.4
Other foreign financial institutions	941 954	879 987	22.8	21.5
Foreign non-financial corporations	12 270	31 372	0.3	0.8
International institutions	248 076	135 141	6.0	3.3
Domestic credit institutions	10 001	–	0.2	–
Unclassified assets	44 352	33 818	1.1	0.8
Total	4 139 376	4 086 335	100.0	100.0

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

	Amount (in thousands of lats)		Percentage (%)	
	2013	2012	2013	2012
Euro area countries	1 125 515	1 464 393	27.5	36.1
Other EU countries	685 620	621 690	16.7	15.3
US	375 806	494 259	9.2	12.2
Canada	272 948	275 222	6.7	6.8
Japan	279 301	261 529	6.8	6.5
Other countries and international institutions	1 359 251	936 385	33.1	23.1
Total	4 098 441	4 053 478	100.0	100.0

Assets under "Other countries and international institutions" also comprise claims on the ECB corresponding to the balances on the settlement accounts of the direct participants in TARGET2-Latvija, standing at 819 230 thousand lats at the end of 2013 (616 232 thousand lats at the end of 2012).

35. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Credit rating	Amount (in thousands of lats)		Percentage (%)	
		2013	2012	2013	2012
FOREIGN ASSETS					
Gold	AAA	153 157	218 750	3.7	5.4
Special Drawing Rights	AAA	95 692	83 367	2.3	2.0
Foreign debt securities	AAA	1 372 866	1 255 817	33.3	30.8
	AA+	397 713	631 139	9.6	15.4
	AA	284 017	50 227	6.9	1.2
	AA-	365 633	454 599	8.8	11.1
	A+	138 235	182 817	3.3	4.5
	A	103 730	71 599	2.5	1.8
	A-	7 057	7 403	0.2	0.2
	BBB+	4 186	6 058	0.1	0.1
	BBB	5 367	956	0.1	0
	BBB-	4 924	355	0.1	0
	BB+	–	22 902	–	0.6
Deposits with foreign financial institutions	AAA	1 000 260	818 704	24.3	20.1
	AA+	25 627	110 355	0.6	2.7
	AA	51 574	27 092	1.2	0.7
	A+	29 242	35 579	0.7	0.9
	A	5 046	3 638	0.1	0.1
	A-	7 115	74	0.2	0
	BBB+	320	–	0	–
Foreign currency in cash	AAA	12 614	13 332	0.3	0.3
	AA+	11	7	0	0
Participating interest in the European Central Bank	AAA	730	750	0	0
Participating interest in the Bank for International Settlements	AAA	19 992	19 991	0.5	0.5
Derivative financial instruments	AAA	343	1 917	0	0
	AA-	1 557	4 844	0	0.1
	A+	1 503	3 189	0	0.1
	A	5 358	16 847	0.1	0.4
	A-	2 271	7 670	0.1	0.2
	BBB+	689	1 982	0	0
	BBB	1 109	552	0	0
	Other foreign assets	Different	503	966	0
DOMESTIC ASSETS	Different	40 935	32 857	1.0	0.8
TOTAL		4 139 376	4 086 335	100.0	100.0

The amount in the rating group "BB+" consisted of securities issued by an agency partially owned by an OECD country government; these securities were disposed of in February 2013.

At the end of 2013 and 2012, Latvijas Banka's foreign assets, broken down by major categories of credit ratings assigned to the counterparty, were as follows:

	Credit rating category	Amount (in thousands of lats)		Percentage (%)	
		2013	2012	2013	2012
Foreign assets	AAA	2 655 654	2 412 628	64.8	59.6
	AA	1 126 132	1 278 263	27.5	31.5
	A	299 557	328 816	7.3	8.1
	BBB	16 595	9 903	0.4	0.2
	BB	–	22 902	–	0.6
	Different	503	966	0	0
Total		4 098 441	4 053 478	100.0	100.0

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above tables show the breakdown of Latvijas Banka's assets as at the end of the reporting period. The rating "AAA" is the highest possible long-term creditworthiness rating, which indicates an extremely strong capacity of the counterparty to meet its financial commitments. The rating "AA" confirms the counterparty's very strong capacity and the rating "A" – the counterparty's strong capacity to meet its financial commitments in the long term. "BBB" is a medium grade considered to be the lowest level of investment-grade rating, while "BB" is a rating below investment grade implying that the counterparty's long-term creditworthiness is risky. Ratings below "AAA" are modified by marks "+" or "-" to show the relative standing within the major categories of credit ratings of an international credit rating agency.

PROFIT AND LOSS NOTES

36. NET INTEREST INCOME

Net interest income of Latvijas Banka was mainly derived from foreign securities. In 2013, net interest income decreased by 9 232 million lats in comparison with 2012.

In 2013, interest income from foreign operations shrank by 9 224 thousand lats in comparison with 2012, and interest expense increased by 2 446 thousand lats year-on-year. Lower interest rates in 2013 resulted in a 10 146 thousand lats fall in interest income from securities.

Higher short-term interest rates on the British pound sterling and Canadian dollar in comparison with those on the euro in 2013 in their turn mostly accounted for a 1 794 thousand lats increase in the interest income from financial derivatives and a 2 445 thousand lats increase in the interest expense on them.

Interest income from domestic operations was a mere 1 thousand lats (8 thousand lats in 2012) as the demand for loans granted by Latvijas Banka was low due to the excess lats liquidity of credit institutions.

Interest expense on domestic operations was largely comprised of interest on deposits of domestic credit institutions and the Latvian government. Interest expense on domestic credit institution deposits contracted by 1 328 thousand lats, as average interest rates paid on these deposits decreased in comparison with 2012, including the remuneration for holding the minimum reserves. In 2013, the average amount of Latvian government foreign currency funds deposited with Latvijas Banka decreased, as well as the average interest rates paid on the government funds in lats fell; as a result, interest expense on government deposits shrank by 1 052 thousand lats.

37. REALISED GAINS/LOSSES FROM FINANCIAL OPERATIONS

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

Gains from the disposal of debt securities decreased by 12 665 thousand lats in comparison with 2012, related to a decrease in the positive debt securities revaluation result, which was accumulated on the valuation account in previous reporting years.

The realised gains from financial operations were positively affected by the positive result on derivative financial instruments posting an increase of 39 730 thousand lats in comparison with 2012, mostly on account of the result of interest rate future contracts as well as the result of currency future contracts concluded for the purpose of hedging currency risks. The positive result of the currency future contracts concluded for the purpose of hedging currency risk exposure is offset in equal value by the negative revaluation result of the hedged

balance sheet items reported in the balance sheet caption "Valuation account" as well as the realised gains on foreign exchange transactions recognised in the profit and loss statement.

38. WRITE-DOWNS OF REVALUATION RESULT ON FINANCIAL ASSETS AND POSITIONS

The revaluation result of several debt securities and foreign currency positions at the end of 2013 and 2012 was negative, and it has been recognised in the profit and loss statement while the positive result on the revaluation of debt securities and foreign currency positions has been reported in the balance sheet caption "Valuation account" (see also Note 26).

39. INCOME FROM PARTICIPATING INTEREST

Income from participating interest comprises the dividends received from the participating interest in the BIS (see also Note 10).

40. OTHER OPERATING INCOME

	(in thousands of lats)	
	2013	2012
Income from sale of collector coins	1 163	773
Income from disposal of demonetized coins	911	–
Income from payment and securities settlement services	360	368
Other	385	341
Total	2 819	1 482

41. BANKNOTE AND COIN ACQUISITION COSTS

	(in thousands of lats)	
	2013	2012
Acquisition of circulation coins	–6 576	–82
Acquisition of collector coins	–736	–715
Supply of banknotes	–265	–
Total	–7 577	–797

The increase in the acquisition costs of circulation coins is associated with the acquisition of euro circulation coins.

42. REMUNERATION AND SOCIAL SECURITY COSTS

	(in thousands of lats)	
	2013	2012
Remuneration		
Remuneration of Members of the Council and the Board	–885	–880
Remuneration of other personnel	–10 053	–9 363
Total remuneration	–10 938	–10 243
Social security costs	–2 578	–2 430
Total remuneration and social security costs	–13 516	–12 673

Remuneration of those Members of the Board of Latvijas Banka who are also Heads of Departments of Latvijas Banka includes remuneration for performance of these duties.

The number of employees in 2013 and 2012 was as follows:

	2013	2012
Number of employees at the end of the year		
Members of the Council and the Board	14	14
Other personnel	559	547
Total at the end of the year	573	561
Average number of employees per period	567	561

43. OTHER OPERATING EXPENSES

(in thousands of lats)

	2013	2012
Municipal services	-712	-671
Information and public relations	-640	-366
Maintenance of buildings, territory and equipment	-620	-348
Event services	-369	-107
Business travel	-330	-269
Risk insurance	-235	-263
Telecommunications services and system maintenance	-194	-197
Personnel training	-181	-181
Acquisition of low value office supplies	-163	-175
Transport provision	-126	-114
Tax on real estate	-98	-89
Audit, advisory and legal services	-27	-38
Other	-235	-196
Total	-3 930	-3 014

The audit, advisory and legal services expenses also comprise the remuneration in the amount of 24 thousand lats paid to SIA "Ernst & Young Baltic" for the audit of 2013 financial statements of Latvijas Banka (24 thousand lats in 2012).

NOTE TO THE CASH FLOW STATEMENT

44. CASH FLOW STATEMENT

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

	(in thousands of lats)	
	2013	2012
Profit before appropriation	41 464	33 961
Non-cash transaction adjustments		
Depreciation of fixed assets and amortisation of intangible assets	2 654	2 887
Profit on disposal of fixed assets	-12	-10
Write-downs of revaluation result on financial assets and positions	4 879	1 585
Net non-cash transaction adjustments	7 521	4 462
Change in balance sheet items		
Net increase in Special Drawing Rights	-14 975	-6 277
Net increase (-)/decrease in foreign debt securities and other foreign investments	41 210	-148 718
Net increase in loans to credit institutions	-10 000	-
Net increase (-)/decrease in other assets	607	-217
Net increase/decrease (-) in foreign convertible currency liabilities	-9 839	9 215
Net increase/decrease (-) in foreign bank and other international institution deposits in lats	1 660	-13 310
Net increase/decrease (-) in lats in circulation	-603 392	73 964
Net increase in deposits of domestic credit institutions	1 212 688	490 609
Net increase/decrease (-) in Latvian government deposits	-521 965	24 064
Net decrease in deposits of other financial institutions	-828	-31 901
Net increase in other liabilities	1 596	869
Net change in balance sheet items	96 762	398 298
Net cash and cash equivalents inflow arising from operating activities	145 747	436 721

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

	(at the end of the year; in thousands of lats)				
	2013	Change	2012	Change	2011
Convertible foreign currencies in cash	12 625	-714	13 339	-272	13 611
Demand deposits with foreign credit institutions and other foreign financial institutions	1 107 133	115 302	991 831	471 964	519 867
Time deposits with foreign credit institutions and other foreign financial institutions with original maturity up to 5 business days	12 051	8 440	3 611	-59 641	63 252
Total cash and cash equivalents	1 131 809	123 028	1 008 781	412 051	596 730

OTHER NOTES

45. TRANSACTIONS WITH THE LATVIAN GOVERNMENT

Latvijas Banka, whose capital is wholly owned by the Republic of Latvia, carries out transactions with the Treasury, acting as the financial agent of the Latvian government. Performing this function, Latvijas Banka services the Treasury's accounts in lats and foreign currencies, as well as conducts foreign exchange transactions. Latvijas Banka is independent in making its own decisions on entering into the above transactions.

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

At the end of 2013 and 2012, the breakdown of Latvijas Banka's claims on and liabilities to the Latvian government and the respective interest rates were as follows:

	Amount (in thousands of lats)		Interest rate (%)	
	2013	2012	2013	2012
Liabilities/claims (–)				
Demand deposits in lats	125 006	441 218	0.28	0.31
Demand deposits in foreign currencies	114 181	319 934	0.01–0.15	0.00–0.30
Spot exchange rate contracts	–	–73	x	x
Tax liabilities	148	96	x	x
Total net liabilities	239 335	761 175	x	x

In 2013 and 2012, the breakdown of Latvijas Banka's income and expense related to the Latvian government, as well as Latvijas Banka's profit of the previous reporting year appropriated to the state budget was as follows (see also Notes 25, 26, and 36):

	(in thousands of lats)	
	2013	2012
Expense and Latvijas Banka's profit appropriated to the state budget		
Interest on government deposits	1 221	2 273
Taxes	6 410	6 196
Profit appropriated to the state budget	22 075	20 818
Total expense and Latvijas Banka's profit appropriated to the state budget	29 706	29 287

46. PLEDGED ASSETS

Securities and other financial instruments with the market value of 9 855 thousand lats, as at the end of 2013 (15 464 thousand lats at the end of 2012), have been pledged to provide collateral for forward exchange contracts and interest rate and currency future contracts. These financial instruments are included in the balance sheet asset caption "Convertible foreign currencies".

47. SECURITIES LENDING

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

At the end of 2013, the fair value of the securities lent was 130 626 thousand lats (262 087 thousand lats at the end of 2012).

At the end of 2013 and 2012, the fair value of collateral provided in securities lending transactions was as follows:

	(in thousands of lats)	
	2013	2012
Foreign currency cash	109 190	243 203
Debt securities of foreign governments, financial institutions and non-financial corporations	24 560	23 355
Total	133 751	266 558

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

48. CONTINGENT LIABILITIES AND COMMITMENTS

In 2005, the liquidator of the bankrupt JSC *Banka Baltija* filed a claim against Latvijas Banka on behalf of the creditors of JSC *Banka Baltija* in the Riga Regional Court for the recovery of losses. In February 2010, the amount of the claim was increased from 185.6 million lats to 238.3 million lats. The claimant alleged that Latvijas Banka as the institution in charge of banking supervision at that time was responsible for losses arising from the bankruptcy of JSC *Banka Baltija* in 1995. On 21 February 2012, the Chamber of Civil Court of the Supreme Court announced a judgement whereby the court ruled that the claim against Latvijas Banka be completely rejected and court expenses in the amount of 16 thousand lats and legal services in the amount of 150 thousand lats for the benefit of Latvijas Banka be collected from the JSC *Banka Baltija* undergoing liquidation. On 12 April 2012, the claimant appealed the judgement under cassation procedure to the Senate of the Supreme Court. On 16 September 2013, the Senate of the Supreme Court refused to initiate the cassation proceedings; consequently, the judgement of the Chamber of Civil Court of the Supreme Court of 21 February 2012 whereby the claim against Latvijas Banka was completely rejected took effect.

As at 31 December 2013, Latvijas Banka had not paid up 96.25% of its share in the ECB's subscribed capital (see also Notes 9 and 49). At the end of 2013 and 2012, Latvijas Banka's unpaid share in the ECB's subscribed capital was 28 569 thousand euro (20 078 thousand lats) and 29 383 thousand euro (20 651 thousand lats) respectively.

Latvijas Banka's uncalled portion of the BIS shares is 75% of their nominal value. These shares are callable following the decision of the BIS Board. At the end of 2013, the uncalled portion of the BIS share holding was 4 013 thousand SDR (3 178 thousand lats; 4 013 thousand SDR or 3 283 thousand lats at the end of 2012; see also Note 10).

At the end of 2013, Latvijas Banka had issued collector coins in the nominal value of 1 836 thousand lats (1 613 thousand lats at the end of 2012) and gold circulation coins with a nominal value of 1 989 thousand lats (1 989 thousand lats at the end of 2012). These coins may be represented to Latvijas Banka in exchange for lats at a nominal value. In the opinion of management of Latvijas Banka, the probability that Latvijas Banka will be required to repurchase these coins from their holders is considered low and no provisions have been made.

49. EVENTS AFTER THE REPORTING PERIOD

On 1 January 2014, Latvia joined the euro area and Latvijas Banka became a member of the Eurosystem.

On 1 January 2014, the ECB capital shares held by the EU national central banks were adjusted in compliance with the Statute of the ESCB and the ECB; as a result, the share of Latvijas Banka in the ECB's capital increased to 0.2821%, which corresponds to 30 537 thousand euro (21 462 thousand lats). The Statute of the ESCB and the ECB stipulates that an EU national central bank joining the Eurosystem shall pay up its share in the ECB's capital in full, as well as in the ECB's reserve capital, provisions equivalent to reserves and the revaluation account. On 2 January 2014, Latvijas Banka paid up the remaining share in the ECB's capital in the amount of 29 424 thousand euro (20 679 thousand lats). On 21 February 2014, after the approval of the ECB's 2013 annual accounts, Latvijas Banka also paid up its shares in the ECB's provisions equivalent to reserves and in the revaluation account in the amount of 42 752 thousand euro (30 046 thousand lats).

Pursuant to the Statute of the ESCB and the ECB, the EU national central bank joining the Eurosystem shall transfer a definite amount of its foreign reserves to the ECB in proportion to its share in the ECB's subscribed capital. In January 2014 Latvijas Banka transferred to the ECB its foreign reserves in the amount of 205 273 thousand euro (122 639 thousand lats) which is equal to Latvijas Banka's proportionate share of the market value of the foreign reserves transferred by other national central banks of the Eurosystem. Gold accounted for 15% or 30 774 thousand euro (21 628 thousand lats), and Japanese yen for 85% or 174 499 thousand euro (144 267 thousand lats). For the foreign reserves transferred to the ECB Latvijas Banka received a claim credited by the ECB in the amount of 163 480 thousand euro (114 894 thousand lats), i.e. in

proportion to the value of the respective claims of other national central banks of the Eurosystem. The difference between the market value of the transferred foreign reserves and the value of the above claim in the amount of 41 793 thousand euro (29 372 thousand lats) is reported as participating interest in the ECB.

With Latvia having joined the euro area and according to Paragraph 2 of the transitional provisions of the Law on Latvijas Banka, on 3 January 2014 Latvijas Banka transferred part of its reserve capital into its nominal capital, raising it to 100 000 thousand euro (70 280 thousand lats).

INDEPENDENT AUDITORS' REPORT

To the Council of Latvijas Banka

We have audited the accompanying financial statements of Latvijas Banka ("the Bank") set out on pages 3 to 41, which comprise the balance sheet as at 31 December 2013, and the related statements of profit and loss, total recognised gains and losses and cash flows for the year then ended, and a summary of principal accounting policies and other explanatory notes.

Board's Responsibility for the Financial Statements

The Board of the Bank is responsible for the preparation and fair presentation of these financial statements in accordance with the "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the Law on Latvijas Banka, and for such internal control as the Board of the Bank determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

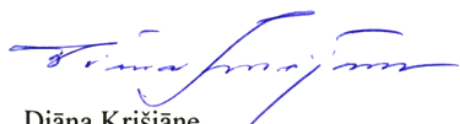
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of the Bank, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements of the Bank give a true and fair view of the financial position of the Bank as at 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with the "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the Law on Latvijas Banka.

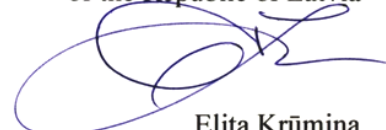
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Diāna Krišjāne
Chairperson of the Board

Riga, Latvia
13 March 2014

The State Audit Office
of the Republic of Latvia



Elita Krūmiņa
Auditor General

Riga, Latvia
13 March 2014