Baltikums

AS “Akciju komercbanka “Baltikums”” Non-Audited Consolidated Financial Statement as of 31 December, 2008

Contents

AS Akciju komercbanka BALTIKUMS | Reg. No 40003551060 | Phone: +371 67 031311 | info@baltikums.eu
Maza Pils iela 13, Riga, LV-1050, Latvia | SWIFT code: CBBRLV22 | Fax: +371 67031 300 | www.baltikums.eu

Management Report

In 2008, despite local and international turmoil in the financial markets, performance indicators of AS "Akciju komercbanka "Baltikums"" (hereinafter referred to as the Bank, Banka Baltikums) continued to grow successfully and the Bank consolidated its position in the chosen niche.

Banka Baltikums continued to develop in accordance with its strategy whose major emphasis was to offer dynamic, modern and, what is most important, exclusive service for its customers with strict focus on caution and on the basis of moderation and balance in its continued growth.

Similarly to previous years, the Bank worked along two clearly defined directions: trade and shipping finance, as well as financial markets investment products and wealth management. In 2008, the Bank focused in particular on its current and potential customers, offering them private banking, which is in growing demand nowadays, and working on extension of the range of such products.

The Bank's provisional profit for the last year was LVL 3.66 million, against LVL 2 million profits a year before. At the close of the year, its assets volume amounted to LVL 110.79 million, i.e. by 13.4% more than in late 2007. In 2008, the Bank advanced LVL 34.37 million in loans (a rise of 39.8% against 2007) and attracted LVL 78.61 million in deposits (a rise of 8.7% against 2007). Increasing its equity (up to LVL 15.178 million) and growing its customer deposits allowed the Bank to strengthen its position in its chosen market niche in 2008.

Such results became possible in the fiscal year of 2008, when the world and Latvia were shaken by an unprecedented crisis and instability, due to the Bank's well-thought-out and precise strategy and its professional team. Banka Baltikums is one of the few Latvian banks that operate consistently in the chosen niche that was chosen even when the Bank was founded in 2001. Conservative approach to risk management ensures good profit indicators for the Bank and gives a feeling of safety in these hard times. In 2008, the Bank started more than one project for improvement of effectiveness of the Bank's operations.

As well as in previous year, most of the loans advanced were assigned for projects related to lending to ship-owners and international trade companies. The Bank has never aimed at attraction of large amounts of deposits from individuals and then advancing them as mortgage and consumer loans. Such approach of the Bank is proved by the fact that Banka Baltikums ranks steadily as the last among all banks that are active in Latvia in the areas of both mortgage and consumer lending. In its turn, very high liquidity has always been one of the Bank's priorities, which was justified especially in 2008.

In 2008, the Bank continued to optimise its customer base. Its holding companies operating in Russia, Ukraine and Kazakhstan contributed to attraction of customers substantially. Despite such considerable increase in the number of customers, the Bank monitors closely customer operations by implementing the principles 'Know Your Customer' and 'Know Your Customer's Business'.

In 2008, Banka Baltikums opened its representative offices in Almaty (Kazakhstan) and Kyiv (Ukraine). Further extension of the network of international branches and representative offices is one of the Bank's strategic tasks in the nearest future.

Operation of Banka Baltikums Cyprus Branch that was established in 2008 will ensure further development of the Bank's activities in the European Union and provision of bank services to its customers. The Bank plans to open Baltikums Shipping Business Centre Cyprus. Our customers – ship owners – will be able to receive professional bank service meant especially for this customer

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category and their business. The Bank's experience in sea and shipping business financing makes it possible to prepare competitive and professional offers under the projects for ship purchase or repair and modernisation of the current fleet, as well as full service for the ship purchase process.

Last year, Banka Baltikums extended the network of its correspondent banks for transfers in euros (EUR) and Japanese yens (JPY) in order to save customers' time and funds. We plan to continue this process in 2009 as well.

The process of optimisation of Baltikums Holding structure continued too, where Banka Baltikums was assigned a central place. Under such process, Banka Baltikums sold 93.46% shares in AAS Baltikums to AS Latvijas Krājbanka in 2008. This step is related to the Bank's strict adherence to its earlier strategy and lack on focus on retail banking now or in the future.

In 2008, ASIPS Baltikums Asset Management reorganised its operations and sold its pension plan business. Currently, it provides asset and wealth management services, offering full service to its customers, which enables it to retain and increase its business turnover and private capital. In 2009, ASIPS Baltikums Asset Management plans to establish a number of investment funds of different types and structure in order to satisfy investment appetite and to meet the requirements at the risk and profit level that is acceptable to customers.

In 2008, our customers appreciated the Bank's strategic and balanced approach, as both increase of our deposit volumes and substantial growth of the scope of the Bank's services used indicate. We are grateful to our customers for co-operation and confidence in these complicated times, and hope to continue our joint and successful business in the future.

Aldis Reims
AS "Akciju komercbanka "Baltikums""
Chairman of the Board

February 27, 2009

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Consolidated Income Statement

Position	31.12.2008, LVL`000	31.12.2007, LVL`000	31.12.2008, EUR`000	31.12.2007, EUR`000
Interest income	5 997	4 970	8 533	7 072
Interest expense	-1 549	-1 680	-2 204	-2 390
Securities income	0	0	0	0
Fees and commission income	4 789	2 735	6 814	3 892
Fees and commission expense	-892	-595	-1 269	-849
Net profit/loss from financial assets and liabilities valued at fair value	-3 453	-720	-4 913	-1 024
Net trading income from foreign exchange	3 578	446	5 091	635
Trading income from financial instruments and foreign exchange	0	189	0	269
Other operating income	1 117	181	1 589	258
Administrative expenses	-3 891	-2 732	-5 536	-3 887
Depreciation and amortization	-252	-95	-359	-135
Other operating expenses	-632	-95	-899	-135
Provisions for impairment losses	-790	-108	-1 125	-154
Income from decrease of provisions	6	9	9	13
Income before corporate income tax	4 028	2 505	5 731	3 565
Income tax	-1 251	-488	-1 780	-695
Profit for the period	**2 777**	**2 017**	**3 951**	**2 870**
Attributable to:				
Equity holders of the Bank	*3 041*	*2 009*	*4 327*	*2 859*
Minority interest	*-264*	*8*	*-376*	*11*
Net income	**2 777**	**2 017**	**3 951**	**2 870**

The fixed exchange rate of the Bank of Latvia is 1 EUR=0.702804 LVL

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Consolidated Balance Sheet

Position	31.12.2008, LVL`000	31.12.2007, LVL`000	31.12.2008, EUR`000	31.12.2007, EUR`000
Cash and deposits with the Bank of Latvia	5 550	11 816	7 897	16 813
Due from credit institutions on demand	36 653	40 415	52 153	57 505
Trading assets	**7 857**	**13 497**	**11 180**	**19 205**
Financial assets at fair value through profit or loss	0	15	0	21
Available-for-sale financial assets	10	2 126	14	3 025
Loans and receivables	34 556	25 076	49 169	35 680
Held to maturity financial investments	15 461	1 329	21 999	1 891
Investments in associated entities and in subsidiaries	2 822	3 071	4 015	4 370
Intangible assets	257	212	366	302
Property, plant and equipment	1 738	359	2 473	511
Investment property	3 619	545	5 149	774
Other assets	4 254	274	6 053	390
Prepayments and accrued income	86	30	122	43
Total assets	**112 863**	**98 765**	**160 590**	**140 530**
Balances due to credit institutions on demand	7	1 501	10	2 136
Trading liabilities	135	188	192	267
Financial liabilities carried at amortized cost	**90 850**	**82 735**	**129 268**	**117 721**
Balances due to credit institutions on term	*1 270*	*0*	*1 807*	*0*
Customers deposits	*79 096*	*72 142*	*112 543*	*102 649*
Notes payable	*10 484*	*10 593*	*14 917*	*15 072*
Insurance contracts	0	664	0	945
Tax liabilities	682	254	971	360
Other liabilities	275	338	391	482
Total liabilities	**91 949**	**85 680**	**130 832**	**121 911**
Shareholders' equity				
Share capital	15 178	10 525	21 596	14 976
Reserve capital and other reserves	17	17	24	24
Retained earnings	661	352	941	501
Profit of the year	2 777	2 017	3 951	2 870
Attributable to:				
Equity holders of the Bank	*3 041*	*2 009*	*4 327*	*2 859*
Minority interest	*-264*	*8*	*-376*	*11*
Minority interest	2 281	174	3 246	248
Total liabilities and shareholders' equity	**112 863**	**98 765**	**160 590**	**140 530**
Contingent liabilities	0	0	0	0
Financial commitments	3 662	2 587	5 211	3 681
Assets / Liabilities under management	**3 675**	**1 494**	**5 229**	**2 126**

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Consolidated Statement of Changes in Shareholders Equity

	Share capital, LVL'000	Reserve capital and other reserves, LVL'000	Retained earnings, LVL'000	Profit for the year, LVL`000	Minority interest, LVL'000	Total, LVL'000
Balance as at 31 December 2006	**7 450**	**17**	**1 484**	**8 951**	**174**	**9 125**
Profit for the year	0	0	2 009	2 009	8	2 017
Issue of shares	3 075	-	-	3 075	-	3 075
Dividends paid	0	0	-1 132	-1 132	0	-1 132
Balance as at 31 December 2007	**10 525**	**17**	**2 361**	**12 903**	**182**	**13 085**
Profit for the year	0	0	3 041	3 041	-264	2 777
Issue of shares	4 653	0	0	4 653	0	4 653
Deals of subsidiaries	0	0	0	0	2 363	2 363
Dividends paid	-	0	-1 964	-1 964	-	-1 964
Balance as at 30 June 2008	**15 178**	**17**	**3 438**	**18 633**	**2 281**	**20 914**

	Share capital, EUR`000	Reserve capital and other reserves, EUR`000	Retained earnings, EUR`000	Profit for the year, EUR`000	Minority interest, EUR'000	Total, EUR`000
Balance as at 31 December 2006	**10 600**	**24**	**2 112**	**12 736**	**248**	**12 984**
Profit for the year	0	0	2 859	2 859	11	2 870
Issue of shares	4 375	0	0	4 375	0	4 375
Dividends paid	-	-	-1 611	-1 611	-	-1 611
Balance as at 31 December 2007	**14 975**	**24**	**3 360**	**18 359**	**259**	**18 618**
Profit for the year	0	0	4 327	4 327	-376	3 951
Issue of shares	6 621	0	0	6 621	0	6 621
Deals of subsidiaries	0	0	0	0	3 363	3 363
Dividends paid	-	-	-2 795	-2 795	-	-2 795
Balance as at 30 June 2008	**21 596**	**24**	**4 892**	**26 512**	**3 246**	**29 758**

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Consolidated Cash Flows Statement

Position	31.12.2008, LVL`000	31.12.2007, LVL`000	31.12.2008, EUR`000	31.12.2007, EUR`000
Cash flow from operating activities				
Profit before income tax	4 028	2 505	5 731	3 564
Depreciation and amortization	148	95	211	135
Impairment of financial assets, net	784	99	1 116	141
Unrealized loss from foreign exchange	326	272	464	387
Profit from the sale of PPE	0	-53	0	-75
Investment property and other revaluation	-109	-170	-155	-242
Profit from the sale of subsidiaries	-632	0	-899	0
Increase in cash and cash equivalents from operating activities before changes in assets and liabilities	**4 545**	**2 748**	**6 468**	**3 910**
Changes in loans and receivables	-9 816	-8 319	-13 967	-11 837
Changes in financial assets classified as available–for-sale	2 116	-212	3 011	-302
Changes in financial assets classified as trading assets	-8 725	-3 227	-12 415	-4 592
Changes in financial assets classified at fair value through profit or loss	25	0	36	0
Changes in financial assets classified as held-to-maturity financial assets	-2 352	-78	-3 347	-111
Changes in prepayments and accrued income	-17	109	-24	155
Changes in other assets	-3 947	94	-5 616	134
Changes in other customer deposits	6 954	34 239	9 895	48 718
Changes in financial liabilities held for trading	-53	188	-75	267
Changes in other and tax liabilities	-1 839	-164	-2 617	-233
Changes in deferred income and accrued expense	4	-24	6	-34
Net cash from operating activities before income tax	**-13 105**	**25 354**	**-18 645**	**36 075**
Income taxes paid	-488	-220	-693	-312
Increase in cash and cash equivalents from operating activities	**-13 593**	**25 134**	**-19 338**	**35 763**
Cash flow from investing activities				
Acquisition of fixed and intangible assets	-1 757	-351	-2 500	-499
Proceeds from disposals of fixed and intangible assets	185	4	263	6
Cash flow from other investing activities	-862	191	-1 228	272
Acquisition of investments in subsidiaries, net of cash acquired	-4 253	-3 077	-6 051	-4 378
Net value of subsidiaries sale	8 675	232	12 343	330
Cash and cash equivalents used in investing activities	**1 988**	**-3 001**	**2 827**	**-4 269**
Cash flow from financing activities				
Issue of shares	4 653	3 075	6 621	4 375
Proceeds from issue of debt securities	0	7 114	0	10 122
Redemption of notes	0	0	0	0
Dividends paid	-1 964	-1 132	-2 795	-1 611
Cash and cash equivalents provided by financing activities	**2 689**	**9 057**	**3 826**	**12 886**
Net increase in cash and cash equivalents	**-8 916**	**31 190**	**-12 685**	**44 380**

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Cash and cash equivalents at the beginning of the year	51 938	21 020	73 902	29 909
Loss from foreign exchange revaluation	-326	-272	-464	-387
Cash and cash equivalents at the end of the year	***42 696***	***51 938***	***60 753***	***73 902***

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Notes

1. GENERAL INFORMATION

The Bank was established on 22nd June 2001, when it was incorporated in the Republic of Latvia as a joint stock company. The address of the Bank is Maza Pils iela 13, Riga, LV-1050. The Bank is a commercial bank specialising in the servicing of export and import operations, trade finance and investment management. The Bank operates in accordance with Latvian legislation and the licence issued by the Bank of Latvia.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Statement of compliance

The Bank's financial statements have been prepared in compliance with the EU-endorsed International Financial Standards (IFS) and the Permanent Interpretation Committee's interpretations as well as the Financial and Capital Market Commission's regulations that were in effect at the time of the preparation of the financial statements.

(2) Basis for preparation of the financial statements

The Bank maintains its accounting records in accordance with the legislation of the Republic of Latvia. The Bank's financial year corresponds to the calendar year.

The financial statements are based on the accounting records prepared in accordance with the cost accounting principle or fair value, as appropriate. The financial statements are prepared on a fair value basis for derivative financial instruments, financial assets and liabilities held for trading and available-for-sale assets except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised cost or historical cost.

The accounting policies used in the preparation of the financial statements are consistent with those used in the financial statements for the period ending 31 December 2007.

(3) Foreign currency translation

The currency of the Republic of Latvia – lat (LVL) – is used in the financial statements. All assets and liabilities and off-balance sheet claims and liabilities in foreign currencies are revaluated in lats using the end of period exchange rates determined by the Bank of Latvia. Gains and losses arising from revaluation are included in the profit and loss statement for the period, except for differences, which arise from the revaluation of available-for-sale elements of the shareholders' equity.

The foreign currency exchange rates for the principal currencies that were used as of the end of the period were as follows:

	As of 31 December 2008	As of 31 December 2007
EUR	0.7028	0.7028
GPB	0.7280	0.9630
LTL	0.2030	0.2040
RUB	0.0171	0.0197

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UAH	0.0656	0.0958
USD	0.4950	0.4840

Transactions in foreign currencies are revaluated in lats according to the date of the transaction using exchange rates set by the Bank of Latvia.

(4) Going concern

The consolidated and Bank's financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

(5) Basis of consolidation

Consolidated financial statements as of 31 December 2007 include financial statements of the Bank and financial statements of the following companies:

Company	State of origin	Company's profile	Share of capital, %
IPAS Baltikums Asset Management	Latvia	Financial services	100.00
SIA Baltikums Lizings	Latvia	Financial services	100.00
SIA Baltikums Direct	Latvia	Lawyer services	100.00
AAS Baltikums Dziviba	Latvia	Insurance services	93.46

In February 2008 Bank had bought 93.46% of AAS "Baltikums Dzīvība" from IPAS "Baltikums Asset Management" with purpose to sell and in September 2008 has sold it for TLVL 2 542, gaining profit of TLVL 188.

In April 2008 Bank had acquired 100% of SIA "Konsalting Invest", but in December 49 % of SIA "Konsalting Invest" has been sold for TLVL 2 601, gaining profit of LVL 218.

On 19 September 2008 had been sold 100% of IPAS "Baltikums Asset Management" and Bank had bought 100% of AS IPS "Finasta", which after acquisition had been renamed as AS IPS "Baltikums Asset Management". Profit from this deal is TLVL 278.

Consolidated financial statements as of 31 December 2008 include financial statements of the Bank and financial statements of the following companies:

Company	State of origin	Company's profile	Share of capital, %
IPAS Baltikums Asset Management	Latvia	Financial services	100.00
SIA Baltikums Lizings	Latvia	Financial services	100.00
SIA Baltikums Direct	Latvia	Lawyer services	100.00
SIA Konsalting Invest	Latvija	Financial services	51.00

Consolidated balance sheet is composed of balance sheets of all subsidiaries, which are controlled by the Group and in where Group has more than half voting rights. Control exists when the company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal.

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During consolidation all significant transactions between Group's companies are cancelled.
While consolidating subsidiaries assets and liabilities are revaluated using exchange rates of The Bank of Latvia on balance day. Incomes and losses are recalculated in Latvian lats using average for the year exchange rate on balance date.

(6) Financial instruments

a) Classification:

Financial assets and liabilities at fair value through profit and loss are those that have been designated by the Bank at inception as at fair value through profit and loss and those classified as held for trading. Trading instruments are those that the Bank principally holds for the purpose of generating a profit from short-term fluctuations in the price of the instruments.
Originated loans and receivables are loans and receivables that the Bank has created by providing funds to customers other than those created with the intent to be sold immediately or in the short-term. Originated loans and receivables include loans and advances to banks and customers other than purchased loans.
Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity. These include certain debt instruments.
Available-for-sale assets are financial assets that are not held for trading purposes, originated loans and receivables, or held to maturity.

b) Recognition

Financial instruments are recognized in the balance sheet on a settlement date basis. Originated loans and receivables are recognised on the day they are transferred to or originated by the Bank.

c) Measurement

Financial instruments are measured initially at fair value plus transaction costs if the financial instruments are not at fair value through profit and loss account.
Subsequent to initial recognition, all financial assets and liabilities at fair value through profit and loss and all available-for-sale assets are measured at fair value, except for any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured. These are stated at cost, including transaction costs, less impairment losses. The fair value is assessed based on quoted market prices.
All non-trading financial assets and liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost using the effective interest rate method. All such financial instruments are subject to revaluation for impairment.

d) Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models or discounted cash flow techniques.
Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

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The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank/(Group) would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

e) Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of all financial assets and liabilities at fair value through profit and loss are recognised in the income statement. Gains and losses arising from a change in the fair value of available-for-sale securities are recognised directly in equity. The Bank does not apply hedge accounting.

f) Derecognition

A financial asset is derecognised when the Bank loses control over contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished.
Available-for-sale assets, financial assets and liabilities at fair value through profit and loss, held-to-maturity instruments and originated loans and receivables are derecognised on the day they are transferred by the Bank.

(7) Interest income and expenses

Interest income and expense are recognised in the income statement as they accrue, taking into account the effective yield of the asset/liability or an applicable floating rate. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.
Recognition of interest income is discontinued when there is uncertainty regarding the repayment of interest or principal.

(8) Fee and commission income

Fee and commission income is recognised when earned or incurred.

(9) Investments

Subsidiaries
Subsidiaries are entities in which the Group, directly or indirectly, has power to control or exercise control over financial and operating policies.
Investments in subsidiaries are carried at cost in the Bank's financial statements. The Bank recognizes income from the investment only to the extent that the Bank receives distributions from accumulated profits of the subsidiary arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.

Investments in associates
Associates are those enterprises in which the Bank has significant influence, but not control, over the financial and operational policies. The consolidated financial statements include the Bank's share of the total recognized gains and losses of associates on an equity accounted basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases. When the Bank's share of losses exceeds cost, the carrying amount is reduced to nil and

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recognition of further losses is discontinued except to the extent that the Bank has incurred obligations in respect of the associate.

(10) Loans

Loans and advances are classified as originated loans and receivables and carried at amortised cost, where cost is defined as the fair value of cash consideration given to originate those loans. Loans are recognized in the balance sheet at the amount of the outstanding value, less impairment for doubtful debts.

The Bank mainly grants commercial and industrial loans to customers.

(11) Impairment

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

Calculation of recoverable amount

The recoverable amount of the Bank's loans and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. The recoverable amount of the Bank's available-for-sale investments is their fair value.

Reversals of impairment

An impairment loss in respect of loans and receivables is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

(12) Interest bearing borrowings

Interest-bearing borrowings are recognised initially at fair value, net of any transaction costs incurred. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings.
When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

(13) Depreciation and amortisation of fixed and intangible assets

Fixed assets and intangible assets are recorded at cost, less accumulated depreciation. Depreciation is calculated on a straight-line basis. Based on the useful lives of fixed assets, the following rates are applied:

Intangible assets	20%
Furniture and equipment	20%
Computers	25%
Other	20%

Gains and losses on disposals of fixed assets are recognised in the profit and loss statement in the period of disposal.
Useful lives, residual values and depreciation methods are reviewed annually.

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(14) Cash and cash equivalents

Cash and cash equivalents are composed of cash and amounts due from the Bank of Latvia and other credit institutions on demand, and deposits in other credit institutions with a maturity less than 3 months less balances due to other credit institutions with a maturity less than 3 months.

(15) Off-balance-sheet items

Off-balance-sheet items include guarantees, letters of credit and unused credit lines provided to customers as well as unused limits of credit cards.

(16) Corporate income tax

Corporate income tax at the rate of 15% is calculated by the Bank in accordance with the Latvian tax regulations.

Deferred tax is recognized using the balance sheet liability method, taking into account temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax calculated is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates applied or substantially applied at the balance sheet date.

The deferred tax asset is acknowledged only in those cases when the expected taxable profit is likely to be reduced through the usage of temporary differences.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced by the amount that is not probable that the related tax benefit will be realized.

(17) Provisions

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(18) Assets under management

Assets managed by the Bank on behalf of customers are not treated as assets of the Bank. The Bank assumes no risk on the assets.

A significant amount of managed assets are involved in repurchase (repo) transactions with other commercial banks. The Bank discloses on the balance sheet amounts due to credit institutions for cash received in repo transactions and the amounts due from the providers of liabilities under management as loans granted.

(19) Repo transactions

Repo transactions are recognized as financing transactions.

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When the Bank is the seller of securities, securities are continued to be recognized on the balance sheet. Proceeds from the sale are recognized as a liability to the purchaser of the securities.

When the Bank is the purchaser of securities, the purchased securities are not recognized on the balance sheet. The amount paid for securities is recognized as a loan provided to the seller. The Bank is involved in two types of such transactions – classic repo and buy/sell back transactions.

The result of repo and buy/sellback transactions is recognized in the profit and loss statement as interest income or expense according to the accrual principle.

(20) Net profit from insurance

Net profit from insurance (is included in another operating income) includes earned insurance premiums, changes in life insurance reserves less reinsurer's part in such changes in life insurance reserves, and insurance claims paid less reinsurer's part in such insurance claims paid.

Net earned premiums are obtained from subscribed premiums less amounts transferred to reinsurers and changes in unearned premium reserves. Subscribed premiums under life insurance contracts with regular payments are equal to the total premium for the current insurance year regardless of their payment dates. Subscribed premiums are decreased by the premiums cancelled and terminated over the accounting year. Insurance receivables, which result from the difference between subscribed and received premiums, are included in loans. Subscribed premiums under life insurance contracts with non-regular payments are recognized as of the moment of their receipt and are equal to the received premiums.

Insurance claims paid are calculated as claims paid less gross reinsurer's share.

The concern maintains investment assets on a continuous basis in order to cover its insurance liabilities under insurance contracts. Such investment assets include investment securities at their fair value with revaluation result included in the profit and loss account, and investment properties. Income from such investment assets is disclosed in the relevant items of the consolidated profit and loss account. Insurance sales commissions paid out to sales agents and brokers are included in expenses for the period when the same are incurred. They are included in the fees and commissions expenses. Administrative expenses, including payments to the Financial and Capital Market Commission and the Insured Protection Fund, as well as depreciation are disclosed in the relevant items of the consolidated profit and loss account.

(21) Insurance liabilities

Insurance liabilities that result from life and accident insurance contracts are composed of life insurance reserves, reserves for unearned premiums and unpredictable risks, and reserves for deferred insurance claims.

Life insurance reserves reflect existing liabilities against insurants under life insurance contracts. Life insurance reserves are determined for each life insurance contract according to calculations made by actuaries. Prospective method is applied to contracts with regular payment schedule (the reserve equals the difference between the present value of the insurer's liabilities and the present value of future premium income). Retrospective method is applied to contracts with non-regular payment schedule (reserves equal the amount of paid-in accrued premiums less deductions set out in contracts and plus accrued guaranteed interest pursuant to the contract). Life insurance reserves also include reserves for deferred life insurance claims.

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Reserves for unearned premiums and unpredictable risks reflect deferred income from non-life insurance contracts according to the share of gross subscribed premiums that refers to the period from the balance sheet date to the end date of insurance contracts, in order to cover all claims and expenses related to existing insurance contracts.

Reserves for deferred claims reflect the amount of claims that have been filled but have not been paid out, as well as the amount of claims that have been assessed and have occurred but have not been filled. Claims reserves are also formed for direct expenses for claims settlement that will be required for settlement of insurance events that have occurred over the accounting and earlier years.

(22) Basis for comparison

When necessary the previous financial year's indicators have been reclassified to be comparable with those for the reporting year.

3. RISK MANAGEMENT

The Bank pays significant attention to risk identification and management. The most significant risks to which the Bank is exposed to are credit risk, interest rate risk, liquidity risk, foreign exchange risk, operational and reputation risk.
Risk management principles are set forth in the Bank's risk management policies, which are approved by the Council. Financial Analysis and Risk Management Department, the Asset and Liability committee, Credit committee and Anti Money Laundering committee are responsible for ensuring the implementation of the risk management policies.

(1) Credit risk

Credit risk is the risk of potential losses resulting from non-fulfilment of contractual obligations by the Bank's debtor or counterparty.
Credit risk is managed in accordance with the Credit risk management policy approved by the Council. This policy details the basic principles of credit risk management, identification, assessment, restriction and control.

The management of risks related to ordinary loans involves assessment of the potential borrower's credit standing that is performed by the Financial Analysis and Risk Management Department. Decisions on granting loans are made by the Credit Committee based on the above analysis and evaluation of collateral. Subsequent to loan granting, the Financial Analysis and Risk Management Department performs a regular analysis of the borrower's financial position, which enables the Bank to take prompt action in the case of deterioration of the borrower's financial position.

Credit risk that is related to inter-bank operations (or operations with financial institutions), including the credit risk related to inter-bank settlements, is controlled by the Asset and Liability Committee that sets limits for transactions with each counter party.

The Bank monitors the concentration of significant balance sheet and off balance items' credit risk by geographical regions (i.e., countries, groups of countries, specific regions within the countries etc), client groups (i.e., central governments, local authorities, state enterprises, private enterprises, private individuals, etc) and industries.

(2) Foreign exchange risk

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Foreign exchange risk is the risk of potential losses as a result of the revaluation of balance sheet and off-balance sheet items denominated in foreign currencies.
The Bank continuously monitors the open positions of foreign currencies and regularly assesses the structure of assets and liabilities by currency. In order to improve the currency structure of its balance sheet, the Bank issued bonds in EUR currency, taking into account the increasing share of EUR denominated assets.
The Asset and Liability Committee sets limits for the open position in each currency providing an acceptable overall level of foreign currency risk.

(3) Interest rate risk

Interest rate risk is the risk of potential losses the Bank may incur as a result of interest rate fluctuations.
For the purpose of controlling the interest rate risk, the Asset and Liability Committee performs regular analysis of assets and liabilities by maturity and type of interest.

(4) Liquidity risk

Liquidity risk is the risk of potential losses as a result of sales of assets or acquisition of resources at unfavourable prices in order for the Bank to fulfil its liabilities to creditors.
Liquidity risk management is based on the analysis of the structure of assets and liabilities performed by the Bank's Financial Analysis and Risk Management Department. That includes the analysis of dynamics in customer funds by customer group and assessment of the possibilities of external borrowing. Based on this information, the Asset and Liability Committee monitors the Bank's ability to fulfil all its commitments. Operating short-term liquidity management, i.e. attraction and placement of resources, in the Bank is performed by the Resources Department of the Bank based on the short-term liquidity forecast.

(5) Country risk

Country risk is the risk of potential losses arising from transactions with residents of foreign countries (or their securities) due to changes in the economic, political, and legal environment of the respective countries.
Before entering into transactions with residents of foreign countries, the Bank performs an assessment of the influence of economic, social, political and legal circumstances on the residents' ability to fulfil their obligations.

(6) Operational risks

The Bank's organizational structure, precise job specifications, clear division of responsibilities as well as control procedures allow the Bank to monitor operational risks. The Bank has also developed an action plan for various crisis situations.
The Bank has set up an independent "Internal audit service" (IAS) with its main functions to ensure that the Bank's activities comply with existing legislation, approved plans, policies and other internal Bank documents and to monitor the compliance of the Bank's department activities with internal control procedures.

(7) Reputation risk

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The Bank recognizes the importance of preventing of money laundering and preventing of terrorism financing. Reputation risk management department was set up in the Bank to implement an internal control system, which monitors the timely control of clients and their business partners. IAS regularly monitors execution of money laundering and terrorism financing prevention policy and procedures.

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