BlueOrange

AS BlueOrange Bank

Group Consolidated and Bank Separate Annual Report for the year ended 31 December 2017

Content

Report of Council and Management Board

AS BlueOrange Bank is a joint–stock company established on 22 June 2001 and entered into the Register of Enterprises of the Republic of Latvia under uniform registration No. 40003551060. The bank's address is Smilšu iela 6, Rīga, LV–1050, Republic of Latvia. On 8 June 2001, the bank received a license for conducting the activities of a credit institution, which was re-registered on 28 June 2011 and on 14 September 2017 – license No. 06.01.05.002/483 at the license register of the FCMC. The bank operates in accordance with the applicable legislation of the Republic of Latvia and the European Union.

AS BlueOrange Bank develops new lines of business in 2017

Last year, the bank underwent significant changes, becoming an international financial platform that offers services to a much broader clientele. The bank adjusted its business model and expanded the market where it offers services. Timed to the introduction of new products and services, in January the bank began to operate under a new brand, BlueOrange, and in autumn it registered with the new trade name AS BlueOrange Bank (previous name – Baltikums Bank).

According to audited data, the year 2017 was closed with profit of EUR 4.8 million. The bank's income from operating activities during the reporting period constituted EUR 36.9 million. Its equity increased by 2 % year on year, reaching EUR 60 million. Total assets (including assets under management) increased by EUR 18.1 million, reached EUR 692 million by the end of 2017. During the reporting period the Bank's operating income decreased by 15% compared to the previous year. The decrease is mainly the result of lower commission fee income from servicing of customer payment operations and payment card servicing in the e-commerce business. In 2016, profit of EUR 1.96 million was recognised on exchange of VISA shares.

The bank's core financial performance indicators are strong: its liquidity ratio at the end of 2017 equalled 76.61%, its capital adequacy 18.68%, with return on equity (ROE) of 8.09% and return on assets (ROA) of 0.75%.

The volume of BlueOrange Bank lending grew significantly during the year: the total loan portfolio and credit obligations reached EUR 214.4 million at the end of 2017, posting a 26% improvement. Loans worth EUR 84.3 million were issued during the year, with nearly half (EUR 38.3 M) invested in the national economy of Latvia, facilitating the growth of local businesses.

Impairment allowances for assets and doubtful loans amounted to EUR 2.4 million, which is 69% less than last year. The amount of allowances recognised in 2016 was untypically high and appears to be overstated due to an excessively prudent policy. A significant part of the allowances recognised in 2016, EUR 2.6 million, was recovered in 2017 after the respective loans were repaid. The significant changes in net allowances had a positive impact on the Bank's profit.

Last year, the bank invested substantial resources and assets in expanding the range of products and services available to entrepreneurs and retail clients in Latvia. The number of BlueOrange Bank clients increased by 61%.

Client portfolio management was very successful, where weighted average yield after fees totalled 18.39% for the 12 months of 2017. The amount of assets under management in client portfolios increased by 38 % year-on-year.

For the convenience of clients, a new Client Support Centre was opened in Old Riga, supplementing the bank's extensive online communication with clients with in-person service.

Late in 2017, BlueOrange Bank started working with a major fintech company in Germany, attracting significant numbers of retail clients from Germany and Austria. Within the last few months of 2017, this brought a total of EUR 38.5 million in deposits to the bank.

Over 1 million euros were invested in the bank's technological development projects last year. BlueOrange Bank was among the first few banks in Latvia to release its API in 2017 – an interface with the bank's systems that attract high-tech businesses as partners. Likewise, the BlueOrange Internet Bank was optimised with expanded functionality, and a large volume of the bank's internal processes are now automated.

Report of Council and Management Board

BlueOrange Bank paid a lot of attention to mitigating risks and enhancing security standards: internal controls are being improved, and work is ongoing to accommodate the growing client base and new regulations. This process is time-consuming and resource-intensive, and, as the external AML reviews in 2017 show, there are still many tasks to complete, as described in the financial statements 4(8) note.

In 2017, the bank launched, and is currently implementing a number of ongoing internal control system enhancement initiatives and activities that will develop its business and ensure effectiveness in detecting suspicious transactions. The bank has expanded relevant staff and maintains continuous training and professional development activities. Crucial compliance initiatives were launched in 2017 and are slated for completion in 2018: in cooperation with US partners, two automated monitoring systems will be implemented for client transaction monitoring and detection of suspicious transaction indicators. The bank's new business model has manifested in fewer clients from high-risk geographical regions, with substantially higher numbers of domestic and Western European clients. This process will continue in 2018 in order to meet the expected changes in AML legislation, as described in the financial statements 47 Note.

Further in 2018, the bank will develop state of the art technological platforms, introduce new high-tech services and modernise existing solutions. In the 1st quarter of 2018, BlueOrange Bank installed the first five ATMs in Latvia that accept contactless cards.

Last year, BlueOrange Bank proved that it can offer innovative, convenient solutions t o its clients while adhering to high standards of banking security and service quality.

Events in the first few months of 2018 on the Latvian financial market affirmed the timing and reasoning of the decision to change the business model that bank management had adopted two years ago. This year, considering increased reputational risk throughout the banking sector of Latvia, the bank will continue to focus particular attention on every aspect of security, maintaining its status as a stable, sustainable banking institution for servicing individuals and business clients.

On behalf of bank management,

Aleksandrs Peškovs	**Dmitrijs Latiševs**
Chairman of the Council	Chairman of the Board

20 April 2018

Council and Board of the Bank

Council as of 31 December 2017

Vārds, uzvārds	Amats	Iecelšanas datums
Aleksandrs Peškovs	Chairman of the Council	22 June 2001
Sergejs Peškovs	Member of the Council	22 June 2001
	Deputy Chairman of the Council	25 July 2002
Andrejs Kočetkovs	Member of the Council	22 June 2001

Management Board as of 31 December 2017

Vārds, uzvārds	Amats	Iecelšanas datums
Dmitrijs Latiševs	Member of the Board	1 July 2002
	Deputy Chairman of the Board	25 April 2003
	Chairman of the Board	27 April 2011
Inga Preimane	Member of the Board	11 January 2016
Jānis Dubrovskis	Member of the Board	24 July 2017

On 24 July 2017, Jānis Dubrovskis was appointed a Member of the Board.
On 29 December 2017, Ēriks Zaics was released from his duties of a Member of the Board.

On behalf of bank management,

Aleksandrs Peškovs
Chairman of the Council

Dmitrijs Latiševs
Chairman of the Board

20 April 2018

Statement of the Management's responsibility

The Management of AS BlueOrange Bank (hereinafter – the "Bank") is responsible for the preparation of the consolidated financial statements of the Bank and its subsidiaries (hereinafter – the "Group") as well as for the preparation of the financial statements of the Bank.

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

The Group consolidated and Bank separate financial statements on pages 15 to 96 are prepared in accordance with the source documents and present fairly the financial position of the Group as at 31 December 2017 and the consolidated results of its operations and cash flows for the year then ended, as well as the financial position of the Bank as at 31 December 2017 and the results of its operations and cash flows for the year ended 31 December 2017.

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

On behalf of bank management,

Aleksandrs Peškovs
Chairman of the Council

Dmitrijs Latiševs
Chairman of the Board

20 April 2018

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Independent Auditors' Report

To the shareholders of JSC "Blue Orange Bank"

Report on the Audit of the Separate and Consolidated Financial Statements

Our Opinion on the Separate and Consolidated Financial Statements

We have audited the accompanying separate financial statements of JSC "Blue Orange Bank" ("the Bank") and the consolidated financial statements of the Bank and its subsidiaries (collectively, "the Group"), set out on pages 15 to 96 of the accompanying separate and consolidated Annual Report, which comprise:

- the separate and consolidated statements of financial position as at 31 December 2017,
- the separate and consolidated statements of comprehensive income for the year then ended,
- the separate and consolidated statements of changes in equity for the year then ended,
- the separate and consolidated statements of cash flows for the year then ended, and
- the notes to the separate and consolidated financial statements, which include a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying separate and consolidated financial statements give a true and fair view of the unconsolidated and consolidated financial position of the Bank and the Group, respectively, as at 31 December 2017, and of their respective unconsolidated and consolidated financial performance and their unconsolidated and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Basis for Opinion

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

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

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

Material Uncertainty Related to Going Concern

We draw attention to Note 47 of the separate and consolidated financial statements, which describes recent developments in the financial sector of the Republic of Latvia. Following these developments, in March 2018, the government of the Republic of Latvia expressed its intent to strengthen the country's legal and regulatory framework for the banking sector. As part of the above, among other things, amendments are expected to be introduced to the country's anti-money laundering and financial sector legislation during the first six months of 2018, aimed at specifically introducing the prohibition to service shell companies (generally entities without real substance as measured by certain criteria set out in law).

In the wake of the facts and circumstances, as also discussed in more detail in Note 47, the Bank has committed to transitioning its business model in order to ensure compliance with the regulators' recommendations and expected future legislative framework. Fundamental changes to the Bank's strategy are planned to be developed and implemented in 2018 and beyond. Certain immediate and medium term steps have been initiated as of the date of this report, including the cessation of business with shell companies, gradual reduction in the number of non-resident customers and refocusing of the Bank's service offering on the Latvian market. As of the date of this report, the above process has been ongoing.

In preparing the accompanying separate and consolidated financial statements, management made a number significant judgements and assumptions related to future events, as also disclosed in Note 47, that form the basis for its provisional financial projections for 2018 and subsequent years, and allowed management to conclude on the appropriateness of the application of the going concern basis in the preparation of these separate and consolidated financial statements. Nevertheless, the Bank's and the Group's continuing operations as a going concern depend on the implementation of the above measures in timely manner, including their prior approval by the regulators. Significant uncertainty is also associated with the outcome of the ongoing anti-money laundering regulatory investigation discussed in Note 4 (8), including any potential resulting fines and sanctions, and the Bank's ability to demonstrate the practical viability of the alternative business model by implementing the required measures.

As stated in Note 47, these events and conditions, along with other matters as set forth in Note 47, indicate that a material uncertainty exists that may cast significant doubt on the Bank's and the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the separate and consolidated financial statements of the current period. These matters were addressed in the context of our audit of the separate and consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In addition to the matter described in the *Material Uncertainty Related to Going Concern* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

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Impairment of loans (consolidated and separate financial statements)	
Key audit matter	*Our response*
The carrying amount of loans in the consolidated financial statements as at 31 December 2017: EUR 161 million; change in impairment allowance recognised in 2017: EUR (1.4) million; total impairment allowance as at 31 December 2017: EUR 4.0 million. The carrying amount of loans in the separate financial statements as at 31 December 2017: EUR 161 million; change in impairment allowance recognised in 2017: EUR (1.4) million; total impairment allowance as at 31 December 2017: EUR 4.0 million. *We refer to the separate and consolidated financial statements: Note 3 (4) and Note 3 (5) (Information on principal accounting policies), Notes 13 and 20 (financial disclosures).* The Bank offers a variety of loan products issued to corporate clients and individuals. Relative significance of the loan receivables to the total assets has increased during 2017 as the Bank has issued a number of individually significant loans to the clients being residents of Latvia. Impairment allowances represent the Management Board's best estimate of the losses incurred within the loan portfolios at the reporting date. We identified this area as a significant risk during our audit because recognition of allowances for loan impairment is associated with significant estimation uncertainty as it requires the Management Board to exercise judgment and develop complex and subjective assumptions about both the timing of recognition and the amounts of such impairment. Individual impairment allowances recognized by the Bank and the Group mostly relate to large, individually monitored, exposures to corporates clients. The assessment is therefore based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. The Bank has a highly concentrated loan portfolio, with individually significant exposures constituting a high proportion of the total portfolio. As a consequence, the Bank's Management Board focuses on individual impairment assessment as in their view it covers substantially all of the loan portfolio's credit risk and as such provides the	Our audit procedures included, among others: • assessing and testing of controls over the approval, recording and monitoring of loans, including, but not limited to, those relating to the identification of loss events and calculation of the impairment allowances; • for a sample of loans with higher risk characteristics, such as individually significant exposures to related borrower groups, watchlist, restructured or borrowers in foreign jurisdictions and exposures with delayed repayment, critically assessing, by reference to the underlying loan files, and through inquiries of responsible loan officers, the existence of any impairment triggers; • where impairment triggers had been identified, making inquiries of the responsible loan officers to corroborate their forecasts of future cash flows used in the assessment of loan impairment, evaluating key assumptions applied, such as discount rates, collateral values (assisted by our own valuation specialists), forecasted business performance as well as, where applicable, collateral selling costs and sales periods. Based on the above procedures, developing our estimate of the loan recoverable values and comparing it to the Bank's estimate, seeking explanations for any significant differences; • assessing the accuracy and completeness of the financial instruments disclosures, specifically in respect of loans and receivables' category, including in respect of the related impairment, against the requirements of the relevant financial reporting standards.

appropriate basis for determination of impairment allowances.	

Impairment of investments in subsidiaries (separate financial statements)

Key audit matter	*Our response*
The carrying amount of investments in subsidiaries in the separate financial statements as at 31 December 2017: EUR 31.1 million; impairment loss recognised in 2017: EUR 0.7 million; total impairment loss allowance as at 31 December 2017: EUR 3.9 million. *We refer to the financial statements: Note 3 (1 (i)) (Information on principal accounting policies), Note 13 and Note 22 (financial disclosures).* The Bank has 11 subsidiaries in Latvia and Lithuania that provide the financial and real estate development services to customers in those countries. Investments in these subsidiaries are measured at cost less any accumulated impairment losses. At the end of each reporting period, management assesses whether there is any indication that the investments in subsidiaries may be impaired, such as, among other things, significant current losses, negative equity or below-budget performance. Based on the above, the Bank identified one subsidiary, SIA BlueOrange International, as showing indicators of impairment. For the investments with identified impairment indicators, the Bank estimates their recoverable amounts by identifying their higher of value-in-use or fair value less cost to sell, using an internal discounted cash flow model or a comparable transactions model, as appropriate, assisted, on a case by case basis, by contracted external appraisers. The determination of the recoverable amounts of investments in subsidiaries is a complex process that requires management to make subjective judgements, including those in respect of the fair values of assets hold by the subsidiaries. The above estimation uncertainty was particularly high in respect of BlueOrange International SIA, the Bank's subsidiary with recent history of operating	Our procedures included, among others: • evaluating the reasonableness of the Management Board's judgments as to the existence of impairment indicators, and consequently, the requirement to perform related impairment tests. This included, but was not limited to, making inquiries of the Management Board members about the subsidiaries' performance, and assessing their historical results as well as strategies going forward; • for the investments with identified impairment indicators, assisted by our own valuation specialists, assessing the Bank's assumptions and estimates applied to determine their recoverable amounts. Our assessment included, among other things: o evaluating the appropriateness of the impairment models used for the assets in question against the requirements of relevant financial reporting standards; o assessing competence, experience and objectivity of the external appraisers engaged by the Bank to determine fair values of the key assets held by the subsidiaries (repossessed real estate and movable assets); o challenging the reasonableness of the key assumptions applied in the valuations of the key assets held by the subsidiaries, such as the discount rate applied, selection of comparable transactions and selling prices, and also evaluating historical reliability of the Bank's forecasts of the subsidiary performance by comparing actual performance against previous forecasts and considering recent developments and future plans.

losses, which one of the business purposes is to manage the Group's repossessed real estate and movable asset, with the investment's recoverability dependent on the uncertain realisation of these assets, as discussed further in the Key Audit Matter "Impairment of investment property".	• considering the accuracy and completeness of the Bank's disclosures relating to the key assumptions and significant judgments applied in estimating the recoverable amounts of its investments in subsidiaries, against the requirements of the relevant financial reporting standards.
Impairment of investment property (consolidated financial statements)	
Key audit matter	***Our response***
The carrying amount of investment property in the consolidated financial statements as at 31 December 2017: EUR 2.7 million; change in impairment allowance in 2017: EUR (0.4) million; total impairment loss allowance as at 31 December 2017: EUR 2.7 million. *We refer to the financial statements: Note 3 (8) (Information on principal accounting policies) and Notes 13 and 23 (financial disclosures).* Significant judgement is required from the Management Board in identifying and measuring impairment of the Group's investment properties, such as the real estate in Bulgaria and Lithuania, which are held for capital appreciation. Subsequent to initial recognition, the Group carries its investment property at cost less accumulated depreciation and any accumulated impairment losses. At the end of each reporting period, the Management Board assesses whether any indications exist that the investment property may be impaired, such as, among other things, depressed real estate market at a given location or deteriorated demand for these properties. Once such impairment indicators are identified, recoverable value of investment property is determined generally by reference to the asset's fair value that is determined internally and/or using external appraisers applying market (comparable transaction) method. Due to the complexity of the judgments and estimates required as part of the assessment, and the fact that impairment losses were recognized in the past in relation to the investment property, with	Our procedures included, among others: • updating our understanding of the Group's approach to the identification of properties with impairment triggers and the resulting assessment of the recoverable amounts of such investment properties; • for selected investment properties with higher risk characteristics, such as those with high carrying amounts, in locations with no recent history of market transactions, and/or lack of demand observed in the recent past, examining valuation reports prepared by external appraisal experts engaged by the Group, as well as the Group's internal estimates of fair values, where relevant, to assess the amounts recoverable from the investment properties. The procedure included, among other things: o assessing competence, experience and objectivity of the external experts engaged by the Group to determine fair value of the investment property in Lithuania, and also of the Bank's internal experts charged with the determination of fair value of the investment property in Bulgaria; o assisted by our own valuation specialists, challenging the key assumptions made in the above-mentioned valuations, such as the selection of comparable properties used in the valuation and the transaction prices of those comparable properties, by means of inquiries of the Management Board, and by reference to our understanding of the real estate market and benchmarking against observable

consequential effects on the impairment recognized in the Bank's separate financial statements in respect of its investment in the subsidiaries holding the assets, we considered this area to be our key audit matter.	market transactions with comparable properties, where available; • assessing accuracy and completeness of the investment property-related disclosures in the financial statements, including those in respect of impairment, against the requirements of the relevant financial reporting standards.

Reporting on Other Information

The Bank's and the Group's management is responsible for the other information. The other information comprises:

- the Management Report, as set out on pages 2 to 3 of the accompanying Annual Report ("Annual Report"),
- the Composition of the Supervisory Council and Management Board, as set out on page 4 of the Annual Report, and
- the Statement of Management Responsibility, as set out on page 5 of the Annual Report.

Our opinion on the separate and consolidated financial statements does not cover the other information, and we do not express any form of assurance conclusion thereon, except as explicitly stated in the *Other Reporting Responsibilities in Accordance with the Legislation of the Republic of Latvia* section of our report.

In connection with our audit of the separate and consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate and consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed and in light of the knowledge and understanding of the Bank, the Group and their environment obtained, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Other Reporting Responsibilities in Accordance with the Legislation of the Republic of Latvia

In addition, in accordance with the 'Law on Audit Services' of the Republic of Latvia with respect to the Management Report, our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Financial and Capital Market Commission of the Republic of Latvia's Regulation No. 46 'Regulations on the Preparation of Annual Reports and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies' ("Regulation No. 46").

Based solely on the work required to be undertaken in the course of our audit of the separate and consolidated financial statements, in our opinion:

- the information given in the Management Report for the financial year for which the separate and consolidated financial statements are prepared is consistent with the separate and consolidated financial statements; and
- the Management Report has been prepared in accordance with the requirements of Regulation No. 46.

Responsibilities of Management and Those Charged with Governance for the Separate and Consolidated Financial Statements

Management is responsible for the preparation of the separate and consolidated financial statements that give a true and fair view in accordance with IFRSs as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate and consolidated financial statements, management is responsible for assessing the Bank's and the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank and/or the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's and the Group's financial reporting process.

Auditors' Responsibility for the Audit of the Separate and Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the separate and consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the separate and consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank and/or the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the separate and consolidated financial statements, including the disclosures, and whether the separate and consolidated financial statements represent the underlying transactions and events in a manner that achieves a fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and objectivity, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the separate and consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

Other Reporting Responsibilities and Confirmations Required by the Legislation of the Republic of Latvia and the European Union when Providing Audit Services to Public Interest Entities

We were appointed by the annual shareholders' meeting on 17 July 2017 to audit the separate and consolidated financial statements of JSC "Blue Orange Bank" for the year ended 31 December 2017. Our total uninterrupted period of engagement is 16 years, covering the years ended 31 December 2002 to 31 December 2017.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank and the Group;
- as referred to in the paragraph 37.6 of the 'Law On the Annual Reports and Consolidated Annual Reports' of the Republic of Latvia, we have not provided to the Bank and the Group the prohibited non-audit services (NASs) referred to of EU Regulation (EU) No 537/2014. We also remained independent of the audited entity (the Bank) and the Group in conducting the audit.

For the period to which our statutory audit relates, in addition to the audit, we have not provided any services to the Bank and the Group and its controlled entities which are not disclosed in the Management Report or in the separate and consolidated financial statements of the Bank and the Group.

KPMG Baltics SIA
License No 55

Armine Movsisjana

Armine Movsisjana
Chairperson of the Board
Sworn Auditor
Certificate No 178
Riga, Latvia
20 April 2018

GROUP CONSOLIDATED AND BANK SEPARATE INCOME STATEMENTS

	Note	2017		2016	
		Group EUR'000	Bank EUR'000	Group EUR'000	Bank EUR'000
Interest income		10 850	10 850	11 103	11 103
Interest expenses		(3 835)	(3 835)	(3 159)	(3 159)
Net interest income	6	**7 015**	**7 015**	**7 944**	**7 944**
Fee and commission income		17 018	17 021	23 282	23 286
Fee and commission expense		(4 985)	(4 985)	(7 905)	(7 905)
Net fee and commission income	7	**12 033**	**12 036**	**15 377**	**15 381**
Net profit from trading and revaluation of financial instruments	8	473	473	2 542	2 542
Net foreign exchange income	9	7 885	7 886	7 381	7 380
Other operating income	10	772	712	335	282
Total operating income		**28 178**	**28 122**	**33 579**	**33 529**
Administrative expenses	11	(18 835)	(17 629)	(17 151)	(16 075)
Other operating expenses	12	(1 776)	(2 051)	(1 696)	(2 053)
Net impairment losses	13	(1 885)	(2 386)	(7 983)	(7 727)
Total operating expenses		**(22 496)**	**(22 066)**	**(26 830)**	**(25 855)**
Profit before taxation		**5 682**	**6 056**	**6 749**	**7 674**
Corporate income tax	14	(1 231)	(1 225)	128	137
Net profit for the year		**4 451**	**4 831**	**6 877**	**7 811**
Attributable to:					
Equity holders of the Bank		*4 442*	*4 831*	*6 851*	*7 811*
Non-controlling interest		*9*	–	*26*	–

The accompanying notes on pages 22 to 94 form an integral part of these financial statements.

The Council and the Board of the Bank approved the issue of these financial statements as presented from page 15 to 94 on 20 April 2018 The financial statements are signed on behalf of the Council and the Board of the Bank by:

Aleksandrs Peškovs
Chairman of the Council

Dmitrijs Latiševs
Chairman of the Board

20 April 2018

GROUP CONSOLIDATED AND BANK SEPARATE STATEMENTS OF OTHER COMPREHENSIVE INCOME

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Net profit for the year	**4 451**	**4 831**	**6 877**	**7 811**
Other comprehensive income				
Items that are or may be reclassified to profit or loss				
Foreign exchange revaluation reserve	(1)	–	(18)	–
Revaluation reserve – AFS financial assets	123	123	86	86
Total other comprehensive income	**122**	**123**	**68**	**86**
Total comprehensive income	**4 573**	**4 954**	**6 945**	**7 897**
Attributable to:				
Equity holders of the Bank	*4 564*	*4 954*	*6 919*	*7 897*
Non-controlling interest	*9*	*–*	*26*	*–*

The accompanying notes on pages 22 to 94 form an integral part of these financial statements.

The Council and the Board of the Bank approve the issue of these financial statements as presented from page 15 to 94 on 20 April 2018. The financial statements are signed on behalf of the Council and the Board of the Bank by:

Aleksandrs Peškovs
Chairman of the Council

Dmitrijs Latiševs
Chairman of the Board

20 April 2018

GROUP CONSOLIDATED AND BANK SEPARATE STATEMENTS OF FINANCIAL POSITION

Aktīvi	Note	2017		2016	
		Group	Bank	Group	Bank
		EUR'000	EUR'000	EUR'000	EUR'000
Cash and demand deposits with central bank	15	233 803	233 803	153 865	153 865
Loans and receivables from banks	16	118 030	118 002	181 180	181 141
Demand deposits with credit institutions		*112 523*	*112 495*	*118 886*	*118 847*
Term deposits with credit institutions		*521*	*521*	*57 247*	*57 247*
Loans issued to credit institutions		*4 986*	*4 986*	*5 047*	*5 047*
Financial assets designated as at fair value through profit or loss	18	397	397	–	–
Held-for-trading financial assets		8 372	8 372	3 045	3 045
Fixed income securities	17	*8 253*	*8 253*	*2 955*	*2 955*
Derivatives	32	*119*	*119*	*90*	*90*
Available-for-sale financial assets	19	54 461	54 461	68 998	68 998
Fixed income securities		*53 660*	*53 660*	*68 009*	*68 009*
Non fixed income securities		*801*	*801*	*989*	*989*
Loans and receivables	20	161 000	161 000	114 920	114 920
Held-to-maturity financial assets	21	31 535	31 535	82 786	82 786
Investments in associates	22	827	–	827	–
Investments in subsidiary undertakings	22	–	31 138	–	19 085
Investment property	23	2 788	1 355	3 684	2 527
Property and equipment	24	30 291	5 463	23 204	4 928
Intangible assets	25	1 322	1 321	1 216	1 214
Prepayments and accrued income		287	287	221	221
Other assets	26	13 681	13 544	17 956	17 705
Corporate income tax receivable		317	317	262	262
Deferred tax assets		–	–	795	795
Total assets		**657 111**	**660 995**	**652 959**	**651 492**

The accompanying notes on pages 22 to 96 form an integral part of these financial statements.

The Council and the Board of the Bank approve the issue of these financial statements as presented from page 15 to 96 on 20 April 2018. The financial statements are signed on behalf of the Council and the Board of the Bank by:

Aleksandrs Peškovs
Chairman of the Council

Dmitrijs Latiševs
Chairman of the Board

20 April 2018

GROUP CONSOLIDATED AND BANK SEPARATE STATEMENTS OF FINANCIAL POSITION

Liabilities and Equity	Note	2017		2016	
		Group	Bank	Group	Bank
		EUR'000	EUR'000	EUR'000	EUR'000
Due to credit institutions on demand	27	1 428	1 428	3 504	3 504
Derivatives	32	232	232	136	136
Financial liabilities carried at amortized cost		594 189	596 424	582 779	585 240
Deposits and balances due to financial institutions	28	96	96	–	–
Deposits	29	*564 506*	*566 741*	*557 730*	*560 191*
Deposits (subordinated)	29	*4 561*	*4 561*	*5 112*	*5 112*
Debt securities (subordinated)	30	*25 026*	*25 026*	*19 937*	*19 937*
Deferred income and accrued expenses		1 125	1 126	987	987
Corporate income tax payable		*5*	–	*6*	–
Other liabilities	31	2 227	1 759	2 746	2 553
Total liabilities		**599 206**	**600 969**	**590 158**	**592 420**
Shareholders' equity					
Share capital	33	39 493	39 493	39 493	39 493
Statutory reserves	33	24	24	24	24
Revaluation reserve – AFS financial assets		143	143	20	20
Other reserves	22, 33	(3 431)	(2 400)	(2 417)	(2 400)
Retained earnings		21 676	22 766	21 243	21 935
Total equity attributable to equity holders of the Bank		**57 905**	**60 026**	**58 363**	**59 072**
Non-controlling interest	22	–	–	4 438	–
Total equity		**57 905**	**60 026**	**62 801**	**59 072**
Total equity and liabilities		**657 111**	**660 995**	**652 959**	**651 492**
Contingent liabilities and commitments	35	66 189	66 201	55 447	55 459

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20 April 2018

GROUP CONSOLIDATED STATEMENTS OF CHANGES IN THE SHAREHOLDERS' EQUITY

	NO-TE	Share capital	Statutory reserves	Revalua-tion reserve – AFS financial assets	Other reserves	Retained earnings	Total equity attribut-able to equity holders of the parent	Non-con-trolling interest	Total equity
		EUR`000	EUR`000	EUR`000	EUR'000	EUR`000	EUR`000	EUR`000	EUR`000
Balance as at 1 January 2016		**39 493**	**24**	**(66)**	(2 399)	**18 142**	**55 194**	**4 412**	**59 606**
Comprehensive income for the reporting period:									
Revaluation reserve – AFS financial assets		–	–	86	–	–	**86**	–	**86**
Foreign exchange revaluation reserve		–	–	–	(18)	–	**(18)**	–	**(18)**
Net profit for the period		–	–	–	–	6 851	**6 851**	26	**6 877**
Total comprehensive income for the reporting period		–	–	**86**	**(18)**	**6 851**	**6 919**	**26**	**6 945**
Transactions with shareholders recorded directly in equity:									
Dividends paid	33	–	–	–	–	(3 750)	**(3 750)**	–	**(3 750)**
Balance as at 31 December 2016		**39 493**	**24**	**20**	(2 417)	**21 243**	**58 363**	**4 438**	**62 801**
Comprehensive income for the reporting period:									
Revaluation reserve – AFS financial assets		–	–	123	–	–	**123**	–	**123**
Foreign exchange revaluation reserve		–	–	–	(1)	–	**(1)**	–	**(1)**
Net profit for the reporting period		–	–	–	–	4 442	**4 442**	9	**4 451**
Total comprehensive income for the reporting period		–	–	**123**	**(1)**	**4 442**	**4 564**	**9**	**4 573**
Transactions with shareholders recorded directly in equity:									
Adjustment of profit/(loss) of previous years		–	–	–	–	(9)	**(9)**	–	**(9)**
Acquisition of NCI without a change in control	22	–	–	–	(1 013)	–	**(1 013)**	(4 447)	**(5 460)**
Dividends paid	33	–	–	–	–	(4 000)	**(4 000)**	–	**(4 000)**
Balance as at 31 December 2017		**39 493**	**24**	**143**	**(3 431)**	**21 676**	**57 905**	–	**57 905**

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20 April 2018

BANK SEPARATE STATEMENTS OF CHANGES IN THE SHAREHOLDERS' EQUITY

	Note	Share capital	Statutory reserves	Other reserves	Revaluation reserve – AFS financial assets	Retained Earnings	Total capital and reserves
		EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Balance as at 1 January 2016		39 493	24	(2 400)	(66)	17 874	54 925
Comprehensive income for the reporting period:							
Revaluation reserve – AFS financial assets		–	–	–	86	–	**86**
Net profit for the period		–	–	–	–	7 811	**7 811**
Total comprehensive income for the reporting period		–	–	–	**86**	**7 811**	**7 897**
Transactions with shareholders recorded directly in equity:							
Dividends paid		–	–	–	–	(3 750)	**(3 750)**
Balance at 31 December 2016		39 493	24	(2 400)	20	21 935	59 072
Comprehensive income for the reporting period:							
Revaluation reserve – AFS financial assets		–	–	–	123	–	**123**
Net profit for the reporting period		–	–	–	–	4 831	**4 831**
Total comprehensive income for the reporting period		–	–	–	**123**	**4 831**	**4 954**
Transactions with shareholders recorded directly in equity:							
Dividends paid	33	–	–	–	–	(4 000)	**(4 000)**
Balance as at 31 December 2017		39 493	24	(2 400)	143	22 766	60 026

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20 April 2018

GROUP CONSOLIDATED AND BANK SEPARATE STATEMENTS OF CASH FLOWS

	NOTE	2017		2016	
		Group	Bank	Group	Bank
		EUR'000	EUR'000	EUR'000	EUR'000
Cash flow from operating activities					
Profit before taxation		**5 682**	**6 056**	**6 749**	**7 674**
Adjustment of profit of previous years		(9)	–	–	–
Depreciation of intangible assets, property and equipment and investment property		807	665	480	327
Impairment of assets		1 885	2 386	7 983	7 727
Interest expense from bonds		1 379	1 379	1 170	1 170
Result from disposal of property investment and investment property		(72)	(73)	–	–
Increase in cash and cash equivalents before changes in assets and liabilities, as a result of ordinary operations		**9 672**	**10 413**	**16 382**	**16 898**
(Increase) in loans and receivables		(44 659)	(44 659)	(44 314)	(44 314)
(Increase)/decrease in term deposits with banks		(5 405)	(5 405)	5 158	5 158
(Increase)/decrease in available-for-sale financial assets		14 348	14 348	(11 469)	(11 469)
Increase/(decrease) in held-for-trading financial assets		(5 327)	(5 327)	10 766	10 766
Increase in financial assets at fair value through profit or loss		(397)	(397)	–	–
(Increase)/decrease in held-to-maturity financial assets		51 251	51 251	1 241	1 241
(Increase)/decrease in prepayments and accrued income		(66)	(66)	(56)	(56)
(Increase)/Decrease in other assets		2 594	1 556	(9 968)	(9 870)
Increase/(decrease) in deposits and due to banks		6 321	6 095	(107 170)	(106 432)
Increase/(decrease) in held-for-trading financial liabilities		96	96	76	76
Increase/(decrease) in other liabilities and current tax liabilities		(1 012)	(1 280)	(1 122)	(1 250)
Increase/(decrease) in deferred income and accrued expenses		138	139	611	611
Net cash from/(used in) operating activities before tax and interest		**27 554**	**26 764**	**(139 865)**	**(138 641)**
Interest paid for bonds		(1 290)	(1 290)	(1 058)	(1 058)
Corporate income tax paid		(739)	(739)	(916)	(916)
Net cash from/(used in) operating activities		**25 525**	**24 735**	**(141 839)**	**(140 615)**
Cash flows from investment activities					
Purchase of fixed and intangible assets		(8 006)	(1 312)	(6 040)	(2 993)
Disposal of investment property		400	400	–	–
Capital increase in investment in subsidiaries	22	–	(5 404)	–	(4 260)
Acquisition of subsidiaries, net of cash acquired	22	–	(489)	–	–
Net cash from/(used in) investing activities		**(7 606)**	**(6 805)**	**(6 040)**	**(7 253)**
Cash flows from financing activities					
Bonds issued	30	5 000	5 000	2 000	2 000
Acquisition of Non-controlling interests		(5 460)	(5 460)	–	–
Dividends paid	33	(4 000)	(4 000)	(3 750)	(3 750)
Net cash from/(used in) financing activities		**(4 460)**	**(4 460)**	**(1 750)**	**(1 750)**
Net changes in cash and cash equivalents		**13 459**	**13 470**	**(149 629)**	**(149 618)**
Cash and cash equivalents at the beginning of the reporting year		**331 541**	**331 502**	**481 170**	**481 120**
Cash and cash equivalents at the end of the reporting period	**34**	**345 000**	**344 972**	**331 541**	**331 502**

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20 April 2018

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1. GENERAL INFORMATION

AS BlueOrange Bank (previous name – Baltikums Bank) ("the Bank") is a Joint Stock Company registered with the Enterprise Register of the Republic of Latvia on 22 June 2001. The address of the Bank is Smilšu iela 6, Riga, LV 1050, Latvia. The Bank holds a banking license issued in Latvia and it acts in accordance with the legislation of Latvia and the European Union.

The primary lines of business for the Bank are servicing corporate customers and high net worth individuals, and managing investments and finances.

The sole shareholder of the Bank is Joint Stock Company BBG that holds 100% voting shares of the Bank. JSC BBG is a financial management company registered in Latvia and owned by four Latvian companies and two private individuals. The consolidated financial statements of the parent company AS BBG can be obtained from the Enterprise Register of Latvia.

The Bank has a number of subsidiaries in Latvia, special purpose entities in foreign countries and investments in associated companies. The above entities form the Group which comprises the following:

Name of the company	Country of incorporation, address	Line of business	Holding 31.12.2017, %	Holding 31.12.2016, %
SIA BlueOrange International	M. Pils iela 13, Riga, Latvia,	Financial Services	100	100
SIA CityCap Service	Kr. Valdemara iela 149, Riga, Latvia	Real estate development	100	100
SIA Zapdvina Development	Kr. Valdemara iela 149, Riga, Latvia	Real estate development	100	100
Kamaly Development EOOD	Etiera k-s ½B – 18, Sveti Vlas, Burgas obl., Nesebier 8256, Bulgaria		100	100
Real estate development	100	100	100	100
UAB Kamaly Development	Klaipedos m. sav. Klaipedos m., Karklu g. 12, Lithuania	Management of collaterals overtaken by the bank	100	100
AS Pils Pakalpojumi	Smilšu iela, Riga, Latvia	Real estate development	100	61
Foxtran Management Ltd	Suite 102, Blake Building, Corner Eyre & Huston Str., Belize	Management of collaterals overtaken by the bank	100	100
Enarlia International Inc	Suite 102, Blake Building, Corner Eyre & Huston Str., Belize	Management of collaterals overtaken by the bank	100	100
SIA Jēkaba 2	Jēkaba iela, Riga, Latvia	Real estate development	100	100
Baltikums E-Centre Limited	55 Park Lane - Suite 14, London W1 1NR, UK		100	–
Advisory services	100	100	100	–
Mateli Estate SIA	Kr. Valdemara 149-405, Riga, Latvia	Real estate development	100	-
Darzciems Entity SIA	Kr. Valdemara 149-405, Riga, Latvia	Real estate development	100	-
Mazirbe Estate SIA	Kr. Valdemara 149-405, Riga, Latvia	Real estate development	100	-
Lielie Zaķi SIA	Kr. Valdemara 149-405, Riga, Latvia	Real estate development	100	-
Pulkarne Entity SIA	Kr. Valdemara 149-405, Riga, Latvia	Real estate development	100	-

Investments in associated companies (the Bank and the Group):

Company	Country of incorporation, address	Line of business	Holding (%) 31.12.2017	Holding (%) 31.12.2016
AS Termo biznesa Centrs	Kr. Valdemāra iela 149, Riga, Latvia	Real estate development	26.15	26.15

2. BASIS OF PREPARATION

(1) Statement of Compliance

The financial statements of the Bank and the Group ("financial statements") have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, and regulations of the Financial and Capital Market Commission of the Republic of Latvia ('FCMC') in force as at 31 December 2017.

The Group consolidated and Bank separate financial statements were authorized for issue by the Board on 20 April 2018. Shareholders have the power to reject the financial statements prepared and issued by management and the right to request that new financial statements be issued.

(2) Functional and presentation currency

These consolidated and separate financial statements are presented in thousands of euros ('000 EUR), unless stated otherwise. Subsidiaries of the Group and the Bank operate in the functional currency of euro and bulgarian lev.

(3) Basis of measurement

- The Group's consolidated financial statements and the Bank's separate financial statements are prepared on the historical cost basis except for the following:
- - financial instruments at fair value through profit or loss are stated at fair value;
- - derivative instruments are stated at fair value;
- - available-for-sale assets are stated at fair value;
- - repossessed collateral are recognised at take-over value which set to be a notional cost, and subsequently, recoverable amount is determined which was fair value less cost to sell.

3. SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies have been applied in the preparation of these Group Consolidated and Bank Separate Financial Statements. The accounting principles have been consistently applied except for the changes in accounting policies described in Note 3.21.

(1) Basis for consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

Investments in subsidiaries are carried in the Bank's separate financial statements at cost less impairment, if any.

(ii) Non-controlling interest

Non-controlling interest is measured as a proportion of fair value of net assets of the acquired subsidiary at the acquisition date. Changes in the Group's interest in a subsidiary other than resulting in the loss of control are recognised through equity (transactions with shareholders).

(iii) Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related NCI and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured by the Group at fair value when control is lost.

(iv) Special purpose entities

The Group has established a number of special purpose entities (SPE's) for trading and investment purposes. The SPE's are established under terms that impose strict limits on the decision-making powers of the SPE's management over the operations of the SPE. SPE's are consolidated by the Group because the Group owns 100% capital and has control over these SPE.

(v) Acquisition of entities under common control

Acquisitions of controlling interests in entities that were under the control of the same controlling shareholder as the Group are accounted for on the date the common control was established. The acquired assets and liabilities are recognised at their carrying amount as recognised in the separate financial statements of the acquiree at the acquisition date. Any net transaction result is included as a separate reserve under equity.

(vi) Interest in equity-accounted investees

The Group's interests in equity accounted investees comprise interests in associates.

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies.

Investments in associates are accounted for in the Group consolidated financial statements using the equity method. They are initially recognised at cost, including transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and OCI in equity-accounted investees, until the date on which significant influence or joint control ceases.

Investments in associates are carried in the Bank's separate financial statements at cost less impairment, if any.

(vii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity-accounted investees are eliminated to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(viii) Common Group accounting policy

In the preparation of the consolidated financial statements, the financial statements of those Group entities that use different accounting policies are adjusted to conform with the Group's accounting policy.

(2) Foreign currency

Transactions in foreign currencies are translated into the respective functional currencies of Group companies at the exchange rate at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in the income statement except for the differences arising on the retranslation of available-for-sale equity instruments or a financial liability designated as the hedging instrument in a hedge of the net investment in a foreign operation or in a qualifying cash flow hedge, which are recognized in other comprehensive income.

The exchange rates for the most significant currencies as set by the European Central Bank at reporting date are as follows:

	31 December 2017	31 December 2016
USD	1.1993	1.0541

Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into EUR at exchange rates set by the European Central Bank at the reporting date. The income and expenses of foreign operations are translated into the functional currency at the exchange rates of transaction dates.

Foreign currency differences are recognized in other comprehensive income and accumulated in the translation reserve, except to the extent that the translation difference is allocated to non-controlling interest.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income and accumulated in the translation reserve.

(3) Financial instruments

a) Classification

Financial instruments are classified into the following categories:

Financial instruments at fair value through profit or loss are held-for-trading financial instruments and financial assets and liabilities that the Group and the Bank initially defines as assets and liabilities designated at fair value through profit or loss.

A financial instrument is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

Derivatives are also categorized as held for trading unless they are designated as a hedging instrument for hedge accounting purposes.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group and the Bank has the positive intention and ability to hold to maturity, and which are not designated at fair value through profit or loss, available for sale, or loans and receivables. Held-to-maturity financial instruments include certain debt securities.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Group or the Bank intends to sell immediately or in the short-term, (b) those that the Group or the Bank upon initial recognition designates as at the fair value through profit or loss or as available for sale; or (c) those for which the holder may not recover substantially all of its initial investments, other than because of credit deterioration. Loans and receivables include amounts due from credit institutions on term, loans and receivables from customers and other financial assets which comply with these classification criteria. Loans and receivables are accounted for at amortized cost using the effective interest method. Certain expenses, such as legal fees or sales commissions for employees acting as agents or other expenses that are incurred in securing a loan are treated as part of the cost of the transaction.

Available-for-sale financial assets are financial assets classified at inception as available for sale or assets other than classified as financial assets at fair value through profit and loss or held to maturity or loans and receivables. Available for sale instruments include short term investments and certain debt and equity securities. Generally, this category is assigned by the Bank and the Group to financial assets that are held for an indeterminate period of time and may be sold based on liquidity or interest rate needs, or as a result of changes in exchange rates and share prices.

Financial liabilities carried at amortised cost represent financial liabilities of the Group and the Bank other than financial instruments designated at fair value through profit or loss. This category includes due to credit institutions on term, customer deposits, issued bonds and other financial liabilities.

Financial liabilities carried at amortized cost are initially measured at fair value less directly attributable transaction costs and are subsequently remeasured to amortized cost using the effective interest rate.

Subordinated deposits have a fixed term of at least five years from the date of placement and they are repayable before maturity only in the event of termination of the Bank's operations or the Bank's bankruptcy and such deposits rank before shareholders' claims. Subordinated debts are repayable before maturity only in the event of termination of the Bank's operations, or the Bank's bankruptcy.

b) Recognition

The Group and the Bank initially recognize loans and advances, deposits, debt securities issued and subordinated liabilities on the date at which they are originated. Regular way purchases and sales of financial assets are recognized on the settlement date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities (including assets and liabilities designated at fair value through profit or loss) are initially recognized on the trade date at which the Group and the Bank becomes a party to the contractual provisions of the instrument.

c) Measurement

A financial asset or financial liability is initially measured at fair value plus (for a financial asset or liability other than measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition of the financial asset or liability, in the case of a financial asset or liability other than measured at fair value through profit or loss.

Subsequent to initial recognition, all financial assets and liabilities measured at fair value through profit or loss and all available for sale financial assets are measured at fair value except those available for sale instruments which have no quoted market price in an active market or for which no reliable fair value measurement is possible. Such instruments are carried at cost less transaction costs and impairment.

All financial liabilities other than those measured at fair value through profit or loss, loans and receivables and held to maturity assets are measured at amortized cost using the effective interest rate method. All such instruments are subject to revaluation when impaired.

Profit or loss arising from changes in the fair value of financial instruments measured at fair value through profit or loss are recognized in the income statement. Profit or loss arising from changes in the fair value of available-for-sale financial instruments is recognized in equity through other comprehensive income (except for impairment losses and foreign exchange gains and losses on monetary assets) until the asset is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss. Interest on an available-for-sale financial asset is recognized in the income statement using the effective interest rate method.For financial assets and liabilities carried at amortised cost, a gain or loss is recognized in the profit or loss when the financial asset or liability is derecognized or impaired, and through the amortization process.

d) Amortized cost measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method, minus any reduction for impairment.

The effective interest rate is a method of calculating the amortized cost of a financial asset or liability, which is based on the recognition of interest income and expenses over a specific period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the management estimates cash flows considering all contractual terms of the financial instrument but does not consider future losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

e) Derecognition

A financial asset is derecognized when the contractual rights to the cash flows from the financial asset expire or when the Group and the Bank transfer substantially all of the risks and rewards of ownership of the financial asset. Any interest in transferred financial assets that is created or retained by the Group and Bank is recognized as a separate asset or liability.

The Group and the Bank derecognize a financial liability when its contractual obligations are discharged or cancelled or expire.

f) Offsetting

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Group and the Bank have a legal right to set off the amounts and intend either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the trading activity.

(4) Identification and measurement of impairment of financial assets

At each reporting date the Group and the Bank assess whether there is objective evidence that the financial assets other than carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the impairment event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group and the Bank on terms that the Group and the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Group and Bank consider evidence of impairment for loans and advances and held-to-maturity investment securities at specific asset level. All loans and receivables from customers and held-to-maturity investment securities are assessed for specific impairment. Accordingly, the Bank does not set aside a collective impairment allowance on loans and receivables due from customers and held-to-maturity investment securities. The Group and the Bank believe that credit risk arising from these financial assets is covered by individual assessment.

Loans are stated at the amount of the principal outstanding, less any impairment allowances. Impairment losses and recoveries are recognized monthly based on regular loan reviews. Allowances during the period are recognized in the income statement.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in the income statement and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognized through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale assets are recognized by transferring the cumulative loss that has been recognized in equity through the statement of other comprehensive income to the income statement. The cumulative loss that is removed from equity and recognized in the income statement is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in the income statement. Changes in impairment allowance attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available for sale bond increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in income statement, the impairment loss is reversed, with the amount of the reversal recognised in income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is not reversed through the income statement and is recognized directly in other comprehensive income.

(5) Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group and the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

The Group and the Bank have an established control framework with respect to the measurement of fair values. This includes a valuation team that has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values, and reports directly to the CFO.

- Specific controls include:
- - Verification of observable pricing;
- - Re-performance of model valuations;
- - A review and approval process for new models against observed market transactions;
- - Analysis and investigation of significant daily valuation movements;
- - Review of significant unobservable inputs, valuation adjustments and significant changes to the fair value measurement of Level 3 instruments compared to previous month.

The methods described below have been used for the determination of fair values.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions with the same instrument or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognized in the profit and loss statement depending on the individual facts and circumstances of the transaction but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

When available, the Group and Bank measure the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as 'active' if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If a market for a financial instrument is not active, the Group and the Bank determine fair value using a valuation technique. Valuation techniques include recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group and the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

Where third-party information, such as broker quotes or pricing services, are used to measure fair value, the Group and the Bank assesses and documents the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS. This includes:

- Verifying that equity broker or pricing service is approved by the Group and Bank for use in pricing the relevant type of financial instrument;

- Understanding how the fair value has been arrived at and the extent to which it represents actual market transactions;

- When prices for similar instruments are used to measure fair value, how these prices have been adjusted to reflect the characteristics of the instrument subject to measurement;

Fair value is classified into different levels of the fair value hierarchy based on the inputs used in the measurement techniques:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorized in different levels of the fair value hierarchy, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Group and the Bank recognize transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred. The Group and the Bank recognizes transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred. For further analysis of the basis for fair value refer to Note 45.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Where the Group and the Bank has positions with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a quoted bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the provisions of the instrument. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Group and the Bank believes a third-party market participant would take them into account in pricing a transaction.

Due from other credit institutions

The fair value of placements on demand, overnight deposits and floating rate placements is considered to be close to their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

Loans

The estimated fair value of loans represents the discounted amount of estimated future cash flows expected to be received. The interest rated used to discount estimated cash flows are based on the prevailing money-market interest rates curve plus an adequate credit spread.

Shares and other non-fixed income securities

The fair value of shares and other non-fixed income securities is determined by reference to their quoted bid price at the reporting date, if available. For a number of non-listed shares where disposal was limited, it was assumed that it was not possible to make a reliable estimate of fair value.

The fair value of S.W.I.F.T shares was determined based on the “transfer amount”, approved for the respective year by the shareholders’ meeting, representing the price for new share allocation and the participants’ quit price.

Derivatives

Valūtas mijmaiņas darījumu patiesā vērtība tiek aplēsta, diskontējot līgumā noteiktās naudas plūsmas, kas tiks saņemtas un samaksātas atbilstošā ārvalstu valūtā ar atlikušo dzēšanas termiņu, un pārvēršot diskontētās naudas plūsmas starpību eiro, piemērojot Eiropas Centrālās Banks noteikto valūtas kursu. Diskontēšanā tiek izmantotas EURIBOR un LIBOR procentu likmes.

Liabilities to other credit institutions and customers

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand, as they are largely due on demand. The estimated fair value of overnight deposits is their carrying amount. The estimated fair value of fixed interest-bearing deposits not quoted in an active market is based on discounted cash flows using interest rates for new deposits with similar remaining maturities.

(6) Derivatives

Derivatives include foreign currency swaps and forwards. As at 31 December 2017 and 2016 all derivatives of the Group and the Bank were classified as financial instruments held for trading.

Derivatives are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in the income statement.

Although the Group and the Bank trades in derivative instruments for risk hedging purposes, the Group and the Bank does not apply hedge accounting.

(7) Repo transactions

Repo transactions are recognized as financing transactions. When the Bank or the Group is the seller of securities, securities continue to be recognized on the statement of financial position. Proceeds from the sale are recognized as a liability to the purchaser of the securities. When the Bank or the Group is the purchaser of securities, the purchased securities are not recognized in the statement of financial position. The amount paid for securities is recognized as a loan provided to the seller. The Group is involved in two types of such transactions – classic repo and buy/sellback transactions. The result of repo and buy/sellback transactions is recognized in the income statement on an accrual basis as interest income or expense.

Securities purchased under agreements to resell ("reverse repo") are recorded as amounts receivable under reverse repo transactions. The differences between the purchase and resale prices are treated as interest income and accrued over the term of the reverse repo agreement using the effective interest method.

(8) Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes.

If the use of the property has been changed, investment properties are reclassified to property and equipment.

Investment property is initially measured at cost. Subsequently investment property is carried at its cost less any accumulated depreciation and any accumulated impairment losses. The useful life of investment property has been estimated at 20 years with the annual depreciation rate of 5%.

(9) Repossessed assets

In the normal course of business the Group and the Bank occasionally take title to property and other assets that originally were pledged as security for a loan. When the Group and Bank acquires (i.e. gains a full title to) an asset in this way, the asset's classification follows the nature of its intended use by the Group and Bank. When the Group or the Bank is uncertain of its intentions with respect to land and buildings that it has repossessed, those properties are classified as investment property. Other types of collateral are classified as other assets or property, plant and equipment.

(10) Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Current repair and maintenance costs are charged to the income statement as incurred. Capital repairs of property and equipment are added to property and equipment at cost, and its useful life is extended. Upon increasing the carrying amount of an item of property and equipment by expenses incurred to replace a material component, the replaced component is derecognised according to the derecognition requirements.

Items of property and equipment are derecognised when disposed or when no economic benefits are expected from the use or disposal of these items in the future. Gains or losses from derecognition of items of property and equipment are determined as the difference between the proceeds from disposal and the net carrying amount of the asset at the date of disposal, and are recognised in the income statement.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation is calculated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

Depreciation methods, useful lives and residual amounts are reviewed at each reporting date.

Land and buildings

The cost of land and buildings disclosed in the financial statements is their assumed fair value measured at the date of acquisition. Subsequent measurement is carried out on a cost basis similar to other items of property and equipment. Land is not depreciated.

Construction in progress and capital repairs of real estate properties include costs directly attributable to construction in progress, including a corresponding proportion of direct overheads incurred during the establishment of the item of property and equipment. Depreciation of such assets is calculated from the date when the assets are put into operation.

For real estate properties that are in use at the acquisition date, depreciation is not discontinued after reconstruction begins. Depreciation is calculated assuming the useful life of the building is 20 years and the annual depreciation rate is 5%.

Corporate assets

Buildings that include the headquarters of the Group and the Bank are classified as corporate assets. Corporate assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated assuming the useful life of the building is 20 years and the annual depreciation rate is 5%.

Leasehold improvements

Depreciation of leasehold improvements is calculated over the remaining period of lease. Depreciation is calculated from the date when leasehold improvements are completed and ready for use.

Useful lives of vehicle and other property and equipment

The estimated useful lives are as follows:

Furniture and equipment	20%
Computers	25%
Others	20%
Vehicle	10%

(11) Intangible assets

Intangible assets, except goodwill, are identifiable non-monetary assets without physical substance (licenses, software that is separately identifiable from electronic devices and others) held for rendering of services or other purposes if it is expected that an economic benefit attributable to these assets will flow to the Group and the Bank.

Intangible assets are recorded at cost less accumulated amortization and amortized to the profit or loss in equal amounts over the useful life of the intangible asset. The annual amortization rate for software is 20%.

(12) Recognition of income and expenses

All significant categories of income and expenses, including interest income and expenses, are recognized on an accrual basis.

Interest income and expenses are recognized in the income statement based on the effective interest rate of the asset/liability. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Group and Bank estimate future cash flows considering all contractual terms of the financial instruments, but not future credit losses. Interest income and expenses include discount or premium amortization or other difference between the carrying amount of an interest bearing instrument and its value on the maturity date calculated based on the effective interest rate method.

Fees and commissions (excluding commissions for long-term loans issued) are accounted for when earned and/or incurred. Income and expenses that refer to the reporting period are reflected in the income statement regardless of the date of receipt or payment. Loan origination fees together with the related direct costs, are deferred and amortised to interest income over the estimated life of the financial instrument using the effective interest rate method.

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

(13) Credit liabilities

In the normal course of business, the Group and the Bank enter into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Financial guarantees are contracts that require the Group and the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument or loan agreement.

A financial guarantee liability is recognized initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognized less cumulative amortization or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognized when losses are considered probable and can be measured reliably.

Financial guarantee liabilities and provisions for other credit related commitments are included within other liabilities.

(14) Taxes

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the income statement except to the extent that it relates to the items recognized in other comprehensive income or directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

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

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

Changes to the Corporate Income Tax legislation effective since 1 January 2018

As of 1 January 2018, the new Law on Corporate Income Tax of the Republic of Latvia comes into effect, setting out a conceptually new regime for paying taxes. As of the date, the tax rate will be 20% instead of the current 15%, the taxation period will be one month instead of a year and the taxable base will include:

- - distributed profit (dividends calculated, payments equivalent to dividends, conditional dividends) and
- - conditionally or theoretically distributed profit (non-operating expenses, doubtful debts, excessive interest

payments, loans to related parties, decrease of income or excessive expenses which are incurred by entering into transactions at prices other than those on the market that should be calculated using the methodology determined by the Cabinet of Ministers, benefits bestowed by the non-resident upon its staff or board (council members) regardless of whether the receiving party is a resident or a non-resident, if they relate to the operation of a permanent establishment in Latvia, liquidation quota).

The use of tax losses carried forward from previous periods is limited: it will be possible to utilise these losses to decrease the amount of tax calculated on dividends in the reporting period by not more than 50%. It will be possible to carry forward unused tax losses and utilise them in the previously described manner only until 2022.

Deferred tax

According to the new Law on Enterprise Income Tax of the Republic of Latvia adopted on 28 July 2017, and effective from 1 January 2018, a 20% rate is only applied to distributed profits while a 0% rate is expected to be applied to undistributed profits. Therefore, deferred tax assets and liabilities are recognisable at nil amount. This principle has been applied in the Group's and Bank's financial statements for the year ended 31 December 2017.

The carrying amounts of deferred tax assets and liabilities were reversed and changes were charged to profit or loss in the reporting period, except when deferred tax had previously been recognised in relation to revaluation reserves.

(15) Dividends

The Group and the Bank receive dividends from the equity instruments that are recorded to income when the right to receive payment is established. Proposed dividends are recognized in the financial statements only when approved by the shareholders.

(16) Cash and cash equivalents

Cash and cash equivalents are cash on hand and amounts due from the Bank of Latvia and other credit institutions with initial maturities of up to 3 months, except liabilities towards the Bank of Latvia and other credit institutions with initial maturities of up to 3 months.

(17) Leases

Operating lease (the Group and the Bank as a lessee)

Payments made under operating leases are recognized in profit or loss statement on a straight-line basis over the term of the lease.

Operating lease (the Group as lessor)

An operating lease is a lease other than a finance lease. Assets leased out under an operating lease, are presented within property and equipment in the statement of financial position, less accumulated depreciation. They are depreciated over their expected useful lives on a basis consistent with similar owned Property and equipment. Income is recognised on a straight-line basis over each lease term.

(18) Provisions

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

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.

(19) Short-term employee benefits

Short term employee benefits, including salaries and social security contributions, bonuses and vacation benefits are included in net operation expenses on an accrual bases. The Group and the Bank pay fixed security contributions to the State Social Fund on behalf of its employees during the employment period in accordance with local legal requirements and the Group and the Bank will have no obligations to pay further contributions relating to retired employees.

(20) Assets under management

Assets managed by the Bank and the Group on behalf of customers are not treated as assets of the Bank and the Group. The Group and the Bank assume no risk in relation to these assets.

(21) New standards and interpretations

(a) Changes in accounting policies

Except for the changes below, the Group and the Bank have consistently applied the accounting policies set out in Note 3 to all periods presented in these consolidated and separate financial statements.

The Group and the Bank have adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2017.

- **Amendments to IAS 7**

The amendments require new disclosures that help users to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes (such as the effect of foreign exchange gains or losses, changes arising for obtaining or losing control of subsidiaries, changes in fair value). For the disclosure please refer to Note 22, 30 and 33.

The following guidance with effective date of 1 January 2017 did not have any impact on these consolidated and separate financial statements:

(b) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2017, and have not been applied in preparing these consolidated financial statements. Those which may be relevant to the Group and the Bank are set out below. The Group and the Bank do not plan to adopt these standards early.

(i) IFRS 9: Financial instruments (effective for annual periods beginning on or after 1 January 2018)

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 Financial Instruments. It replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group plans to apply IFRS 9 as of 1 January 2018.

In October 2017, the IASB issued Prepayment Features with Negative Compensation (Amendments to IFRS 9). The amendments are effective for annual periods beginning on or after 1 January 2019, with early adoption permitted.

The Bank and the Group adopted the following IFRS 9 implementation strategy and process:

The IFRS 9 implementation process has been managed by a working group including representatives of risk management, financial, operational and IT units. The working group meets once a week to discuss key assumptions, approve relevant decisions and follow up on the status implementation progress. To support timely decision making, The Bank's and the Group's senior management also receive regular updates on the implementation progress.

As at the date of approval of these separate and consolidated financial statements, the Bank and the Group have substantially completed their transition date assessment of the effects of the IFRS 9 adoption and are now working on the design, setup and refining of the underlying models, systems, processes and internal controls.

Classification and measurement

From classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on an approach taking into consideration the business model in which the assets are managed and their cash flow characteristics. The existing classification categories of IAS 39 are to be replaced by the following three categories: Fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI), and amortised cost. The new standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

- It is held within a business model whose objective is to hold assets to collect contractual cash flows, and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.
- A financial asset is measured at FVOCI only if tit meets both of the following conditions and is not designated as at FVTPL:
- It is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL. IFRS 9 also allows entities to irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or FVOCI as FVTPL, if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

On initial recognition, an equity instrument other than held for trading, may be irrevocably designated as FVOCI, with no subsequent reclassification of profit or losses to the income statement.

The accounting for financial liabilities is to be largely the same as under the existing requirements of IAS 39, except for the treatment of gains or losses arising from the Bank's and the Group's own credit risk relating to liabilities designated as FVPL. Such movements will be presented in OCI with no subsequent reclassification to profit or loss, unless an accounting mismatch in profit or loss would arise.

Business model assessment

The Bank and the Group made an assessment of the objective of the business model in which a financial asset is held at portfolio level because this best reflects the way the business is managed and information is provided to management. The information that is considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice, including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;
- how the performance of the portfolio is evaluated and reported to the Bank's and the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank and the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis will be measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Impairment of financial assets, loan commitments and financial guarantee contracts

IFRS 9 will also fundamentally change the loan loss impairment methodology. The standard will replace IAS 39's "incurred loss" model with a forward-looking "expected credit loss" (ECL) model. The Bank and the Group will be required to recognise an impairment allowance for expected credit losses for all loans and other debt financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts. Investments in equity instruments are outside the impairment requirements, as they are accounted for either at FVTPL or at FVOCI.

IFRS 9 requires a loss allowance to be recognized at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

The Bank and the Group will recognize loss allowances at an amount equal to lifetime ECLs, except financial instruments for which credit risk has not increased significantly since initial recognition, for which the amount recognized will be the 12-month ECLs:

Accordingly, the Bank and the Group have established a policy to perform an assessment at the end of each reporting period as to whether a given asset's credit risk has increased significantly since initial recognition. When determining whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank and the Group will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Bank's and the Group's historical experience and forward-looking information. The Bank and the Group will primarily identify whether a significant increase in credit risk has occurred for an exposure by comparing the remaining lifetime probability of default (PD) as at the reporting date, with the remaining lifetime PD for this point in time that was estimated on initial recognition of the exposure.

The Bank and the Group will estimate ECLs based on a probability-weighted estimate of the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e. the difference between: the contractual cash flows that are due to the Bank and the Group under the contract, and the cash flows that they expect to receive, discounted at the effective interest rate of the loan.

The Bank and the Group are planning to group their loans into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

- Stage 1 – Performing loans: when loans are first recognized, the Bank and the Group recognize an allowance based on twelve months expected credit losses. Under IAS 39, the Bank and the Group recognized an allowance for incurred But Not Identified (IBNI) impairment losses. The change is expected to increase the impairment allowance compared to the current IBNI approach.
- Stage 2 – Loans with a significant increase in credit risk: when a loan shows a significant increase in credit risk since initial recognition, the Bank and the Group recognize an allowance for the lifetime expected credit loss. Since this is a new concept compared to IAS 39, it will result in a substantial additional increase in the allowance, as most such assets are not considered to be credit-impaired under IAS 39.
- In addition, a significant increase in credit risk is assumed to have taken place if the borrower falls more than 30 days past due in making its contractual payments, an alarm signal is reported concerning the loan that indicates a significant increase in credit risk, the Bank and the Group expect to grant the borrower forbearance, or the facility is placed on their watch list.
- Stage 3 – Impaired loans: Financial assets will be recognized in Stage 3 when there is objective evidence that the loan is impaired. The lifetime expected credit losses will be recognized for these loans and in addition, the Bank and the Group will accrue interest income on the amortised cost of the loan net of allowances. The criteria of the objective evidence of impairment are the same as under the current IAS 39 methodology, and accordingly, the Bank expects the population to be generally the same under both standards. The individual impairment allowance will continue to be calculated on the same basis as under IAS 39, and collateral values will be adjusted to reflect the amounts that can be expected to be realized.

The Bank and the Group will recognize impairment for FVOCI debt securities as applicable, depending on whether they are classified as Stage 1, 2 or 3, as explained above. However, the expected credit losses will not reduce the carrying amount of these financial assets in the statements of financial position, which shall remain to be stated at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost will be recognized in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

When estimating lifetime ECLs for undrawn loan commitments, the Bank and the Group will estimate the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment, and, for that portion, will calculate the present value of cash shortfalls between the contractual cash flows that are due to the Bank and the cash flows that the Bank expects to receive.

For financial guarantee contracts, the Bank and the Group will estimate their lifetime ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that is incurred less any amounts that the guarantor expect to recover from the holder, the debtor or any other party.

Forward-looking information

The Bank and the Group will incorporate forward-looking information in their assessment of significant increase in credit risk and the measurement of ECLs. In this process, they plan to use statistical data on official macroeconomic indicators as the basis on which to adjust the relevant probability of default. Both the Risk and Finance management teams will need to approve the forward-looking assumptions before they are applied for different scenarios.

Limitation of estimation techniques

The models applied by the Bank and the Group may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to be needed until the base models are updated. Although the Bank and the Group will use data that are as current as possible, models used to calculate ECLs will be based on data that are one month in arrears and adjustments will be made for significant events occurring prior to the reporting date.

Capital management

Regulation (EU) 2017/2395 of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures has entered into force. The Bank decided to apply the transitional arrangements of the Regulation to mitigate the impact of the introduction of IFRS 9 on own funds.

Transition and estimated adjustments associated with the adoption of IFRS 9

As at the date of approval of these separate and consolidated financial statements, the Bank and the Group are in the final stages of the assessment of the estimated adjustment of the adoption of IFRS 9 on the opening balance of the Bank's and the Group's equity as at 1 January 2018.

Among other things, the Bank and the Group have performed their transition date SPPI testing for all financial asset portfolios and believe that the testing will not present significant challenges as to the Bank's ability to identify correctly the attributes of SPPI for all the financial assets.

Having completed its initial assessment, the Bank and the Group concluded that:

- The majority of loans and advances to the Bank, loans and advances to customers, cash collateral for reverse repo agreements and balances with financial institutions that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9.
- Financial assets and liabilities held for trading and financial assets and liabilities designated at FVTPL are expected to continue to be measured at FVTPL.
- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at FVOCI.
- Debt securities classified as held to maturity are expected to continue to be measured at amortised cost.

In overall terms, any movements between categories of financial instruments under IAS 39 and IFRS 9 are not expected to have a material effect on the separate and consolidated financial statements of the Bank and the Group, respectively.

Accordingly, substantially all of the estimated impact is expected to be related to the implementation of the new impairment requirements, and will come from the release of the existing credit loss allowances and recognition of new allowances in line with IFRS 9, resulting in an estimated net increase of EUR 1.5 million for the Group and the Bank. The increase is attributed mainly to loans and off-balance-sheet commitments, with a corresponding reduction in capital and reserves. In accordance with the performed assessment, the effect of modification is insignificant and therefore is not reflected in the financial statements.

The above assessment is still preliminary because not all transition work has been finalized, as previously discussed Also, the new accounting policies, assumptions, judgments and estimation techniques employed are subject to change until the Bank and the Group finalize their first separate and consolidated financial statements that include the date of initial application.

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively. However, the Group and the Bank is using the exemption from restatement of prior period comparatives to reflect changes in classification and measurement (including impairment) and changes in the carrying amounts of financial assets and financial liabilities caused by the implementation of IFRS 9 are charged to retained earnings and reserves as at 1 January 2018.

(ii) IFRS 15 Revenue from contracts with customers (Effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted)

The new Standard provides a framework that replaces existing revenue recognition guidance in IFRS. Entities will adopt a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised 1) over time, in a manner that depicts the entity's performance; or 2) at a point in time, when control of the goods or services is transferred to the customer. IFRS 15 also establishes the principles that an entity shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. The management does not expect that the new Standard, when initially applied, to have a material impact on the Group and Bank's financial statements. The timing and measurement of the Group and Bank's revenues are not expected to change significantly under IFRS 15 because of the nature of Group and Bank's operations and the types of revenues it earns.

(iii) IFRS 16 Leases – (Effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15)

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use (ROU) asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard- i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases - Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16.

The Group and the Bank have started an initial assessment of the potential impact on its consolidated and separate financial statements. So far, the most significant impact identified is that the Group and the Bank will recognise new assets and liabilities for its operating leases of office premises. In addition, the nature of expenses related to those leases will now change because IFRS 16 replaces the straightline operating lease expense with a depreciation charge for ROU assets and interest expense on lease liabilities. The Group and the Bank have not yet decided whether they will use the optional exemptions. The Group and the Bank are also in the process of assessing the impact on its CET1 ratio, particularly in respect of ROU assets in leases where the Group and the Bank are as lessees.

Transition

The Group and the Bank currently plan to apply IFRS 16 initially on 1 January 2019. As a lessee, the Group and the Bank can either apply the standard using a:

- retrospective approach; or
- modified retrospective approach with optional practical expedients.

The lessee applies the election consistently to all of its leases. The Group and the Bank have not yet determined which transition approach to apply. As a lessor, the Group is not required to make any adjustments for leases except where it is an intermediate lessor in a sub-lease.

The Group and the Bank have not yet quantified the impact on its reported assets and liabilities of the adoption of IFRS 16. The quantitative effect will depend on, inter alia, the transition method chosen, the extent to which the Group and the Bank use the practical expedients and recognition exemptions, and any additional leases that the Group and the Bank enter into. The Group and the Bank expect to disclose its transition approach and quantitative information before adoption.

4. RISK MANAGEMENT

Within the framework of the internal control system, the Group and the Bank have developed and follow the risk management policy or fundamental principles approved by the Council, which are defined below:

1) general guidelines observed by the Group and the Bank in their activities aimed at decreasing all types of risks which may lead to losses;

2) description of risk transactions and other risks to which the Group and the Bank are exposed;

3) identification and management of the significant risks, including measurement, evaluation, control, and preparation of risk reports;

4) setting limits and restrictions for risk transactions together with regular control and development;

5) updating of normative documents regarding the risk management process according to market changes.

The risk management policy describes and determines the aggregate of measures to ensure that the possibility of suffering losses is minimized in the event the invested resources are not repaid in due time or the Bank or the Group suffers other losses.

The development of the risk management system as described by the risk management policy is ensured by the Management Board of the Bank, the key decisions are made by the Investment Committee, Credit Committee, Non-financial Risk Management Committee and Customer Activity Compliance Control Committee according to their regulations. Risk Officer is responsible for the overall control and monitoring of the risk management system. Risk management on a daily basis is ensured by independent risk management departments. The risk management system is monitored by the Internal Audit Service on a regular basis is being continuously developed pursuant to the development of the Group and the Bank and activities on financial markets. Risk management is carried out both on the Group and Bank level.

(1) Credit risk

Credit risk is the risk of potential loss resulting from the non-fulfilment of contractual obligations by the Group's or 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, mitigation and control.

The management of risks related to ordinary loans involves the 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 and the Group 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 and the Bank's investments in debt securities, is controlled by the Bank's Investment Committee that sets limits for transactions with each counter party and issuer.

The Bank and the Group monitor the concentration of significant assets, liabilities, as well as contingent liabilities and commitments' credit risk by geographical regions (i.e. countries, groups of countries, specific regions within the countries etc.), customer groups (i.e. central governments, local authorities, state enterprises, private enterprises, private individuals, etc.) and industries. Credit risks are presented in Note 43.

(2) Currency risk

Foreign exchange risk is the risk of potential loss as a result of the revaluation of assets, liabilities, as well as contingent liabilities and commitments denominated in foreign currencies due to change in exchange rates.

The Bank and the Group continuously monitor the open positions of foreign currencies and regularly assesses the structure of assets and liabilities by currency.

An analysis of sensitivity of the Bank's net profit or loss for the year and comprehensive income to changes in the foreign currency exchange rates based on positions existing as at 31 December 2017 and 2016 and a simplified scenario of a 20% change in the USD to EUR exchange rates is as follows:

EUR'000	2017		2016	
	Profit or loss	Shareholders' equity	Profit or loss	Shareholders' equity
20% appreciation of USD against EUR	17	17	61	61
20% depreciation of USD against EUR	(17)	(17)	(61)	(61)

An analysis of the foreign currency position is presented in Note 41.

(3) Interest rate risk

Interest rate risk is related to potential losses incurred by the Group and the Bank due to movements in interest rates.

For the purpose of controlling the interest rate risk, the Investment Committee performs regular analyses of assets and liabilities by maturity and type of interest. A change of interest rates by 100 basis points would result in the following changes in profit or loss and capital and reserves:

	2017	2016
	EUR'000	EUR'000
EUR	2 403	1 642
USD	703	1 780

The interest reprising analysis is disclosed in Note 42.

(4) Debt securities price risk

Debt securities price risk is the potential loss that may arise to the debt securities included in the trading portfolio due to the decline in market prices as a result of changes in market factors.

The debt securities price risk is managed by the Bank by setting limits on the total amount of the trading portfolio, as well as purchasing debt securities with relatively short maturities that are less sensitive to price risk.

EUR'000	2017		2016	
	Peļņa vai zaudējumi	Pārējie visaptverošie ienākumi	Peļņa vai zaudējumi	Pārējie visaptverošie ienākumi
10% increase in securities prices	825	5 366	296	6 801
10% decrease in securities prices	(825)	(5 366)	(296)	(6 801)

(5) Liquidity risk

Liquidity risk is the risk of potential loss as a result of sales of assets or acquisition of resources at unfavourable prices in order for the Group and the Bank to fulfil its liabilities to creditors and depositors.

The Bank focuses on a conservative approach to liquidity management. The Bank allocates funds (attracted mainly from deposits) to assets in order to maintain an asset structure that is appropriate to support the Bank's operations (executing of customers' transactions) and comply with regulatory requirements concerning the liquidity ratio even in case of a significant outflow of customer deposits or a significant decrease in liquidity on the securities market.

Liquidity risk management procedures are described in the Liquidity Management Policy and consist of several components: liquidity risk indicator system, balance sheet planning, stress testing, and limits for investments in assets of limited liquidity.

The purpose of liquidity risk indicators is to reflect the actual level of the Bank's liquidity risk and quickly identify any increase in liquidity risk. The Bank's Liquidity Risk Management Policy determines specific actions to improve the Bank's liquidity position when liquidity risk indicators reach certain levels.

The aim of liquidity risk stress testing is to measure the deficit or surplus of the Bank's liquid assets that may occur due to significant outflows of customer deposits or a significant decrease in liquidity on the securities market. Based on the results of stress testing, the Bank's Investment Committee sets limits on investments in assets of limited liquidity.

Details of the reported ratio of net liquid assets versus current liabilities at the reporting date were as follows:

	2017	2016
As at 31 December	76.61%	70.03%

Net liquid assets include cash and cash equivalents, bonds and receivables from credit institutions net of current liabilities.

Liquidity Coverage Ratio (LCR) at the reporting date was as follows:

	2017	2016
As at 31 December	230.69%	303.60%

In accordance with 'Normative regulations on establishing a capital and liquidity adequacy assessment process' No. 199 of the FCMC, the Bank carries out the assessment of the liquidity reserve adequacy necessary for its operations within the liquidity adequacy assessment process (ILAAP). Liquidity analysis is presented in Note 40.

(6) 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 Group and the Bank perform an assessment of the influence of economic, social, political and legal circumstances on the residents' ability to fulfil their obligations.

(7) Operational risk

Operational risk is the risk of losses resulting from inadequate or improper internal processes, human and systems error, or external events, including legal risk but excluding strategic and reputational risk.

The principles of managing operational risk at the Group and the Bank are implemented via internal regulations, which stipulate:

- The organizational structure, division of authorisations and principles of delegations, functional duties, procedure for the exchange of information among the structural units and employees;
- The order, conditions and procedures, and the accounting procedure, for operations and other transactions, and the organisation of internal processes;

- Compliance control regarding the limits set for banking operations and other transactions;
- Regulations, procedures and processes for the functioning of information systems (technical, informational, etc.);
- Procedure for granting access rights to information and material assets;
- Procedure for reporting and preparation of other information;
- Procedure for motivating employees and other matters.

To ensure efficient conditions for the identification and assessment of operational risk at the Group and the Bank, the Bank has established Operational Risk Management Board, which is responsible for training staff on operational risk matters. The Operational Risk Management Board has an operational event data base in place which helps receive information about operation risk events which enables appropriate recording, management and addressing of risks.

A systemic approach is applied to the identification and management of risk pertaining to new financial services and products as part of the approval process. This process involves all units engaged in control and support functions together with units of the relevant business lines to carry out an assessment of a new financial service or product in line with their business.

The Bank has also developed an action plan for various crisis situations. The Bank and the Group have set up an independent "Internal Audit Service" (IAS) whose primary function is to ensure that the activities of the Bank and the Group comply with effective laws and regulations, approved plans, policies and other internal documents of the Bank and to review the conformity with the internal control procedures governing the functions of the Group's and the Bank's departments.

(8) Management of money laundering and terrorist financing risk and the Customer Policy

(a) General Policy

The Group's and the Bank's existing business model has been to provide banking services to client portfolio that involves substantial share of non-resident customers, thereby involving heightened risks of money laundering and terrorism financing. Accordingly, the Group and the Bank devote significant efforts to ensuring compliance with the relevant regulations on the prevention of money laundering and terrorism financing, both international and specific to the Republic of Latvia. There is an approved by the management Money Laundering and Terrorism Financing Risk Management Policy in place at the Bank that details the basic principles for the management of money laundering and terrorism financing risk as well as the risk identification, mitigation and control mechanisms. The Money Laundering and Terrorism Financing Risk Management Policy has been implemented by means of approved by the management internal documents and an appropriate organisational structure based on three-tier protection and control principles:

- Tier 1 controls - effected by the employees of the business units attracting and servicing customers to ensure compliance with the 'Know Your Customer' ('KYC') principle both at the customer acceptance stage and during business relationships;
- Tier 2 controls - effected by customer transaction monitoring and support units that perform an analysis of customer acceptance and transactions using several tools, including automated ones, and monitor and report on transactions, and
- Tier 3 control - effected by the Internal Audit Service performing independent and regular assessments of AML/CFT risk management practices.

The internal control system, built on the principle of segregation of duties and responsibilities between structural units and employees, outlines requirements for decision-making, sets responsibilities for monitoring of customer activities and the basis for the operations of the compliance unit. A Customer Compliance Control Committee has been established for the organisation and control of the monitoring measures regarding the overall internal control.

The primary goal of the above-mentioned policy is to lay down guidelines for initiating cooperation with customers and matters of customer due diligence, requirements for the identification of customers and their beneficial owners, analysis of their businesses and business partners. In addition to the customer identification requirements, the Customer Policy requires relevant staff to conduct interviews, meet the customer or its authorised representative(s) face-to-face and receive information from the customer necessary for the review. Based on the information gathered during the customer due diligence, the initial risk grading is established for the customer, to be then further automatically and independently reviewed by the risk scoring system during the business relationship based on a number of risk factors. As the relationship between the customer and the Bank progresses, the Bank gathers information on the customer's actions. The customer's case file is supplemented and updated on a regular basis with the results of research of the customer's actions and transactions. In management's view, through knowing the customer's business activities, monitoring their transactions and refraining from the performance of suspicious financial transactions, the Group and the Bank minimize the risk that the Group and the Bank may get involved in potential laundering of proceeds derived from criminal activity and terrorism financing.

(b) Implementation of the action plan in response to the results of the reviews conducted in 2016 by US consultants

Following recommendations of the Financial and Capital Market Commission ("the Commission") in 2016, the Bank entered into an agreement with a US advisory firm, Lewis Baach Kaufmann Middlemiss. The consultant's task was to evaluate the Bank's anti money laundering and counter terrorism financing and sanctions programme for compliance with the US Bank Secrecy Act, Patriot Act, the OFAC sanctions program and the requirements of other binding acts or regulatory guidance, and to identify gaps and recommendations for improvement.

The evaluation was focused on the following key areas: management and accountability in the anti money laundering and counter terrorism financing programme, internal controls, training measures, independent testing, and information systems used for anti money laundering and counter terrorism financing procedures. A number of recommendations were included in the resulting report, based on which the Bank's Board of Directors approved an action plan with measures aimed at improving the internal control system for anti money laundering and counter terrorism financing in the area of customer transaction monitoring, risk assessment and management, and to improve information systems.

The Bank started implementing the above action plan during the first half of 2017 and achieved improvements in its internal control system and internal regulations, and provided additional training to staff. Among other things, a decision was taken by the Board of Directors to implement two new information systems for monitoring of customer transactions. Given the time-consuming nature of the implementation process, the expected implementation completion of these new systems for customer monitoring was mid-2018.

(c) Customer due diligence and transaction monitoring deficiencies and a fine paid in 2017

At the beginning of 2017, the Commission carried out an off-site examination of payments made by certain of the Bank's customers between 2008 and 2013. As a result of the examination, it was indicated by the Commission that a number of transactions carried out by three of the Bank's non-resident customers appear to have been carried out, and the Bank appears to have been used, to circumvent international sanctions. The Commission also indicated that the Bank's internal control system did not include sufficient customer due diligence measures. Consequently, the Commission initiated administrative proceedings .

In the course of the above proceedings, the Commission concluded that the Bank, along with a number of other banks, was used to conduct criminal transactions by way of complicated transaction schemes aimed at circumventing sanctions and using transfers between customers of banks of several countries. However, the transfers, when executed, were not made by or received on behalf of persons included in the sanctions lists, as admitted by the Commission. It was also recognised by the Commission that in the circumstances the identification of a direct connection between the breach of the sanctions regime and the Bank's inadequate customer due diligence procedures could not have been established. Accordingly, in the particular circumstances, while the Bank was indirectly used to circumvent the sanction regime, no deliberate breach was identified in its actions. The Bank's own internal investigation into the payment details did not reveal direct matches to persons included in international sanctions lists.

In the course of the administrative proceedings, the Commission and the Bank signed an Administrative Agreement, dated 26 June 2017, which effectively terminated the proceedings initiated by the Commission and imposed a specific set of measures aimed at improving the Bank's internal control system. By signing the Administrative Agreement, the Bank committed to further improving its internal control system over the monitoring of customer transactions and compliance with international sanctions, which included the commitment to conduct an independent review of the sanctions programme and consider purchasing a real-time transaction-control system within a specified period of time. The Bank also agreed to pay a fine of EUR 35.6 thousand to the Latvian state. Entering into the Administrative Agreement represents the Bank's voluntary decision to seek settlement and undertake improvements aimed at eliminating deficiencies in customer due diligence and transaction monitoring.

In the wake of the above developments, in the second half of 2017, the Bank's Board of Directors approved purchase of a real-time transaction-monitoring system, provided staff training on compliance with international sanctions, improved its internal regulations, and was subjected to an independent review of its internal control system for anti-money-laundering and counter-terrorism-financing and compliance with sanctions carried out by an independent audit firm, as discussed below.

(d) Results of the independent review of the internal control system for AML/CTF conducted in 2017 and the resulting action plan

As discussed above, according to the Administrative Agreement signed in 2017 with the Commission, the Bank undertook to commission an independent review of the Bank's internal control system for AML/CTF and sanctions risk management. An independent audit firm was engaged by the Bank in September 2017 to conduct this review, which was completed till the end of 2017. As a result of the review it was indicated that the Bank should continue improving its internal control system, with the following measures to be taken:

- improving corporate governance and introducing an internal requirement to conduct regular independent external AML reviews and process quality assurance in the form of second line of defence AML controls, and periodic testing of the transaction-screening system;
- completing the implementation of all regulatory requirements set by the Commission and EBA (European Banking Authority) guidance;
- introducing a documented quality-assurance and follow-up process to manage AML/CTF risk and sanctions risk;
- supplementing the internal regulations with periodic testing of the transaction-monitoring system and regular testing of the alert-generating system, and
- improving the customer risk evaluation process by including evaluation of the indirect sanction risk factor.

Although the sanctions risk management principles have been described within the regulations already in force at the Bank, the auditors believed that it would be more efficient to introduce a dedicated policy for sanctions risk management.

After evaluating the results of the review, at the beginning of 2018, the Bank's Board of Directors approved an additional action plan for improvement of the internal control system. The largest share of the measures are to be performed in the first half of 2018 by making amendments to AML/CTF regulations and completing the implementation of the new customer transaction monitoring systems, as discussed in (b) above.

(e) Review conducted by the FCMC in 2017

Further to the reviews outlined above, in the second half of 2017, the Commission conducted a full scope AML/CTF review at the Bank in order to evaluate Bank's compliance with the Latvian AML/CTF Law and to verify whether the Bank's practice was compliant with the regulations of the Commission and other relevant regulators. As at the date of issue of these separate and consolidated financial statements, the Bank has received preliminary results and findings of the review, prepared its responses and comments, which are intended to partly address and satisfy the Commission's findings, and presented to the Commission a set of documents supporting the Bank's position.

The key findings from the review concerned the following aspects of the internal control system for AML/CTF, which require significant improvements:

- gathering documents and information on the source of wealth of the customers' beneficial owners and documentation of the evaluation process,

- customer risk scoring,
- customer due diligence process and documentation, and
- customer transaction monitoring and documentation of decisions.

As at the date of issue of these separate and consolidated financial statements, the review by the Commission has not yet been completed. Section 78(3) of the law currently in force on the prevention of laundering of proceeds derived from criminal activity and terrorism financing stipulates that whenever the Commission identifies a breach of AML/CTF laws and regulations it has the right to impose a fine on the Bank in the amount of up to 10% of the its annual unconsolidated turnover based on the latest audited financial statements, not to exceed EUR 5,000,000, and also to introduce measures limiting the Bank's operating activity, including the right to revoke the banking licence.

Following the receipt of the final review report from the Commission, the Bank will approve further amendments to its action plan for the elimination of the deficiencies. At the same time, the Bank has begun improving its customer risk scoring system and introduced a set of new customer risk assessment factors in the customer risk scoring system in April 2018.

The Bank continues improving its AML/CTF processes and policies and the Board of Directors expects that these processes and the measures being taken to eliminate business with certain customer categories, as referred to in Note 47 Going concern, will result in a significantly lower risk exposure in this area.

(9) Capital management

The Bank’s Capital Adequacy Management Policy requires maintenance of a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business as well as to ensure the Bank’s capital at an adequate level for covering potential risks arising from current and future operations.

Under the capital requirements introduced by Regulation (EU) No 575/2013 of the European Parliament and of the Council and the FCMC banks need to maintain a ratio of capital to risk weighted assets (“statutory capital ratio”) above the prescribed minimum level. Although the minimum required level as at 31 December 2017 was 8%, according to a special request by the FCMC the Bank was required to ensure a higher capital adequacy of 11.60% during the period from 1 December 2017 to 30 November 2018 (13.75% for the period from 1 October 2016 to 30 November 2017). In addition to the above capital requirement for the overall risk coverage, the Bank is required to maintain compliance with the total capital reserve requirement calculated in accordance with Section 3522, 3523, 3524 or 3525 of the Credit Institution Law (Capital conservation buffer – 2.50%, institution-specific countercyclical capital buffer – 0.02% (as at 31.12.2017), systemic risk buffer – 1% for risk transactions with Estonian residents). The requirements of the total capital reserve should be met using Tier 1 capital.

As at 31 December 2017 the Bank and the Group were in compliance with the capital adequacy and the minimum capital requirement specified in the Law On Credit Institutions and the rules of the FCMC, as well as in compliance with the higher ratio required by the FCMC. For the calculation of capital adequacy refer to Note 44.

In addition to the calculation of the capital adequacy ratio in accordance with ‘Normative regulations on establishing a capital and liquidity adequacy assessment process’ No. 199 of the FCMC, the Bank regularly conducts its own internal capital adequacy assessment in order to ensure that it covers all the risks assumed by the Bank and whether they are covered by the capital.

5. USE OF ESTIMATES AND JUDGMENTS

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

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

Judgements

These consolidated and separate financial statements include financial information of subsidiaries. The annual evaluation described in Note 3(1) (i) of the Group structure and identification of entities in which the Group has control requires judgement to be made by the Group management.

These consolidated and separate financial statements are prepared on going concern basis. Please refer to Note 47 for further discussion on the application of going concern principle.

Key sources of estimation uncertainty:

(i) Allowances for doubtful debts

For financial assets carried at amortised cost, impairment is determined based on the accounting policy described in Note 3.

Financial assets are evaluated for impairment individually for each counterparty and it is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about the counterparty's financial situation and potential net realizable value of any underlying collateral. Each impaired asset is assessed individually and the Credit Risk Function approves the workout strategy and the estimate of cash flows considered recoverable.

(ii) Valuation of financial instruments

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in the accounting policies, Note 3. For financial instruments that trade infrequently and have no observable prices, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. The Bank uses valuation models based on quoted market prices of similar products.

To determine the amount of impairment loss the Bank's management makes estimates of any expected changes in future cash flows from a specific financial instrument based on an analysis of the financial position of the issuer of the financial instrument.

(iii) Impairment of non-financial assets

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

When measuring the recoverable value of the property or movable assets, management relies on external valuations based either on income valuation method or comparative valuation method and assesses the reliability of such valuation in light of the current market situation. Income method is based on discounted estimated future cash flows from the property. Comparative method is based on recent market transactions with comparable property.

Since the corporate assets, including headquarters, do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. If there is an indication that a corporate asset may be impaired, recoverable amount is determined for the cash-generating unit or group of cash-generating units to which the corporate asset belongs, and is compared with the carrying amount of this cash-generating unit or group of cash-generating units.

The value of a corporate asset, which cannot be reasonably and consistently attributed to cash-generating units, identifies the smallest cash-generating unit the asset belongs to (in this case, most likely, the Bank or the Group as a whole) and compares the carrying amount of this cash-generating unit, in which the corporate asset is included, with its recoverable amount. An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognized in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

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

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(iv) Recognition of deferred tax asset

A deferred tax asset is recognized to the extent that it is probable that taxable profit will be available against which the deductable temporary differences can be recognized. According to the new Law on Enterprise Income Tax of the Republic of Latvia adopted on 28 July 2017, and effective as of 1 January 2018, a 20% rate is only applied to distributed profits while a 0% rate is expected to be applied to undistributed profits. Therefore, deferred tax assets and liabilities are recognisable at nil amount in the Group and the Bank's financial statements for the year ended 31 December 2017.

6. NET INTEREST INCOME

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Interest income				
Interest income on assets at amortized cost:	8 328	8 328	7 752	7 752
Deposits with credit institutions	*385*	*385*	*794*	*794*
Loans and receivables	*7 943*	*7 943*	*6 958*	*6 958*
including interest income on impaired loans	*690*	*690*	*1 467*	*1 467*
Interest income from securities at fair value through profit or loss	379	379	414	414
Interest income from available-for-sale financial assets	325	325	445	445
Interest income from held-to-maturity securities	1 818	1 818	2 492	2 492
Total interest income	**10 850**	**10 850**	**11 103**	**11 103**
Interest expense				
Interest expense from liabilities measured at amortized cost:	489	489	440	440
Deposits	*489*	*489*	*440*	*440*
Interest expense on issued bonds	1 379	1 379	1 170	1 170
Payments to the Deposit Guarantee Fund and other funds	909	909	882	882
Other interest expense	1 058	1 058	667	667
Total interest expense	**3 835**	**3 835**	**3 159**	**3 159**
Net interest income	**7 015**	**7 015**	**7 944**	**7 944**

7. NET COMMISSION AND FEE INCOME

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Fee and commission income				
Payments	5 039	5 039	6 891	6 891
Corporate banking fee income	743	743	594	594
Securities transactions	2 344	2 344	1 614	1 614
Trust operations	1 142	1 142	707	707
Account servicing	2 498	2 501	3 116	3 120
Cash transactions and payment card transaction	5 252	5 252	10 360	10 360
Total fee and commission income	**17 018**	**17 021**	**23 282**	**23 286**

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Fee and commission expense				
Correspondent accounts	603	603	719	719
Cash transactions and payment card transaction	4 025	4 025	6 849	6 849
Securities transactions	357	357	337	337
Total fee and commission expenses	**4 985**	**4 985**	**7 905**	**7 905**
Net fee and commission income	**12 033**	**12 036**	**15 377**	**15 381**

During the reporting year, commission fee income from servicing of customer payment operations and from payment card servicing in the e-commerce business decreased significantly. The key reasons for this are the AML requirements introduced in 2017 with regard to international customers. After implementation of stricter requirements, the number and volume of customer transactions reduced significantly.

8. NET PROFIT/LOSS FROM TRADING AND REVALUATION OF FINANCIAL INSTRUMENTS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Net profit/(loss) from trading with financial assets and liabilities held-for-trading	276	276	439	439
Net profit from revaluation of financial assets and liabilities	197	197	145	145
Net profit from sale of available-for-sale financial assets (shares)	–	–	1 958	1 958
Net profit from trading and revaluation of financial instruments	**473**	**473**	**2 542**	**2 542**

During 2016, Visa Inc. purchased Visa Europe shares from all European participating banks. As a result of this sale the Bank realized a profit of EUR 1 958 thousand upon partial settlement in cash and partial deferred consideration.

9. PROCEEDS FROM TRADING AND REVALUATION OF FOREIGN EXCHANGE

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Net profit from foreign exchange transactions	7 888	7 888	7 331	7 332
Net profit/(loss) from revaluation of foreign exchange	(3)	(2)	50	48
Net foreign exchange gains	**7 885**	**7 886**	**7 381**	**7 380**

10. OTHER OPERATING INCOME

	Note	2017		2016	
		Group	Bank	Group	Bank
		EUR'000	EUR'000	EUR'000	EUR'000
Fines received		83	81	67	66
Profit from disposal of real estate		78	78	–	–
Gain on disposal of property and equipment		2	–	1	–
Dividends received		2	2	2	2
Social tax refund from the budget		–	–	30	30
Recovery of written-off assets		1	1	2	2
Gain from initial recognition of financial asset	18	397	397	–	–
Other		209	153	233	182
Total other operating income		**772**	**712**	**335**	**282**

11. ADMINISTRATIVE EXPENSES

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Salaries to the members of the Board and Council	619	619	663	663
Staff remuneration	8 728	8 410	8 278	7 868
Compulsory state social security contributions	2 192	2 133	2 045	1 983
Other staff costs	194	189	297	282
Communications and transport	368	349	500	456
Professional services	1 581	1 556	1 586	1 561
Rent, public utilities and maintenance	1 398	1 265	1 219	1 245
Depreciation and amortization costs	807	665	480	327
Computer network	631	631	431	431
Advertisement and marketing expenses	409	408	134	131
Other taxes	911	814	813	733
Insurance	115	114	111	109
Audit fee	56	56	65	65
Other	826	420	529	221
Total administrative expenses	**18 835**	**17 629**	**17 151**	**16 075**

The average number of employees in the Group in 2017 was 349 (2016 – 311) and that in the Bank was 335 (2016 – 295).

In 2017, the auditor received a fee of EUR 56 thousand, of which EUR 50 thousand was for the audit of the financial statements (consolidated annual report) and EUR 6 thousand for other audit related engagements. In 2016, the fee amounted to EUR 65 thousand, of which EUR 52 thousand was for the audit of the financial statements (consolidated annual report) and EUR 13 thousand for other audit related engagements.

a) Information on the remuneration by category of positions in 2017

Group	Fixed remuneration EUR'000	Average number of employees	Variable remuneration EUR'000	Average number of employees
Board, Council	561	6	58	4
Material risk takers	1 719	50	289	31
Other employees	6 347	293	373	166
Total	**8 627**	**349**	**720**	**201**

Information on the remuneration by category of positions in 2017

Bank	Fixed remuneration EUR'000	Average number of employees	Variable remuneration EUR'000	Average number of employees
Board, Council	561	6	58	4
Material risk takers	1 719	50	289	31
Other employees	6 029	279	373	166
Total	**8 309**	**335**	**720**	**201**

Information on the remuneration by category of positions in 2016

Group	Fixed remuneration EUR'000	Average number of employees	Variable remuneration EUR'000	Average number of employees
Board, Council	637	6	26	3
Material risk takers	1 359	47	216	28
Other employees	6 101	258	602	220
Total	**8 097**	**311**	**844**	**251**

Information on the remuneration by category of positions in 2016

Bank	Fixed remuneration EUR'000	Average number of employees	Variable remuneration EUR'000	Average number of employees
Board, Council	637	6	26	3
Material risk takers	1 359	47	216	28
Other employees	5 691	242	602	220
Total	**7 687**	**295**	**844**	**251**

b) Operating lease payments (Group)

	31.Dec.2017 '000 EUR	31.Dec.2016 '000 EUR
Less than one year	45	298
Between one and five years	7	1
More than 5 years	–	–
	52	**299**

The Group leases a number of premises under operating lease. The leases typically run for 1 to 5 years, with an option to renew the lease after that date. None of the leases includes contingent rentals.

During the current year EUR 302 thousand was recognised as an expense in the profit or loss in respect of operating leases (2016: EUR 382 thousand).

Operating lease payments (Bank)

	31.Dec.2017 '000 EUR	31.Dec.2016 '000 EUR
Less than one year	94	380
Between one and five years	173	234
More than 5 years	620	467
	887	**1 081**

The Bank leases a number of premises under operating lease. The leases typically run for 1 to 5 years, with an option to renew the lease after that date. None of the leases includes contingent rentals.

During the current year EUR 366 thousand was recognised as an expense in the profit or loss in respect of operating leases (2016: EUR 485 thousand).

12. OTHER OPERATING EXPENSES

	2017		2016	
	Group EUR'000	Bank EUR'000	Group EUR'000	Bank EUR'000
Membership fees	227	227	192	192
Fees for real estate management	21	11	117	15
Fines	37	37	1	1
Royalties for the use of a trademark	1 283	1 283	1 189	1 189
Other	208	493	177	636
Result of disposal of repossessed movable property	–	–	20	20
Total other operating expenses	**1 776**	**2 051**	**1 696**	**2 053**

In 2017, as part of its operating activities the Bank made payments of EUR 1 283 thousand (2016: EUR 1 189 thousand) for the use of the registered trademarks BlueOrange and Baltikums to the owner of this trademark (licensor).

13. IMPAIRMENT OF FINANCIAL AND NON-FINANCIAL ASSETS

	2017 EUR'000	2016 EUR'000
Total allowances as at the beginning of the reporting period	**15 158**	**7 579**
Increase in the impairment allowance for loans	1 176	5 013
Increase in the impairment allowance for other assets	2 118	2 395
Release of allowances for other assets	(167)	–
Allowances for investments in associates	–	63
Release of provisions for loans	(2 597)	(27)
Release of allowances for held-to-maturity financial assets	–	(139)
Impairment of goodwill	–	564
Increase in the impairment allowance for non-fixed income securities	312	–
Increase in the impairment allowance for investment property	1 043	114
Change for the year	**1 885**	**7 983**
Loans written off during the year	(543)	(376)
Investment property written off during the reporting year	(1 463)	–
Other assets written off during the year	(2 373)	(44)
Change of allowances due to currency fluctuations	(41)	16
Total allowance as at the end of the reporting period	**12 623**	**15 158**

Impairment of assets for the Bank

	2017 EUR'000	2016 EUR'000
Total allowances as at the beginning of the period	**15 406**	**8 018**
Increase in the impairment allowance for loans	1 176	5 013
Increase in the impairment allowance for other assets	2 112	2 390
Increase in the impairment allowance for investment properties	850	–
Increase in the impairment allowance for investments in subsidiaries	700	490
Release of provisions for loans	(2 597)	–
Increase in the impairment allowance for non-fixed income securities	312	(27)
Release of allowances for other assets	(167)	(139)
Change for the year	**2 386**	**7 727**
Loans written off during the year	(543)	(376)
Investment property written off during the reporting year	(1 463)	–
Other assets written off during the year	(2 373)	(44)
Change of allowances due to currency fluctuations	(41)	81
Total allowance as at the end of the reporting period	**13 372**	**15 406**

14. CORPORATE INCOME TAX

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Deferred tax	(795)	(795)	795	795
Corporate income tax	(436)	(430)	(667)	(658)
Total current year tax expense	**(1 231)**	**(1 225)**	**128**	**137**

The table below shows the reconciliation between the current tax expense and the theoretically calculated tax amount using the basic tax rate, which was 15% in 2017 and 2016.

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Profit before tax	5 682	6 056	6 749	7 674
Theoretically calculated tax at rate 15%	(852)	(908)	(1 012)	(1 151)
Non-deductible expenses	(817)	(753)	(778)	(628)
Exempt income	1 233	1 231	1 123	1 121
Deferred tax changes	(795)	(795)	795	795
Total corporate income tax	**(1 231)**	**(1 225)**	**128**	**137**

Deferred tax assets and liabilities

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax assets and liabilities as of 31 December 2017 and 2016.

The Group and the Bank

EUR '000	Assets		Liabilities		Net	
	2017	2016	2017	2016	2017	2016
Property and equipment	–	–	–	(135)	–	(135)
Investment property	–	597	–	–	–	597
Other assets	–	333	–	–	–	333
Total deferred tax asset/(liabilities)	**–**	**930**	**–**	**(135)**	**–**	**795**

According to the new Law on Enterprise Income Tax of the Republic of Latvia adopted on 28 July 2017, and effective as of 1 January 2018, a 20% rate is only applied to distributed profits while a 0% rate is expected to be applied to undistributed profits. Therefore, deferred tax assets and liabilities are recognisable at nil amount as of 31 December 2017. The rate of tax applicable for deferred tax was 15% in 2016.

15. CASH AND DUE FROM THE CENTRAL BANK

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Cash	1 302	1 302	361	361
Balance with the Bank of Latvia (including the minimum reserve deposit)	232 501	232 501	153 504	153 504
Total	**233 803**	**233 803**	**153 865**	**153 865**

According to the regulations of the Financial and Capital Markets Commission, the total amount of funds on the account with the Central Bank should not be less than the amount of the obligatory reserves calculated from the average amount of customer deposits during the month. The obligatory reserve as at 31 December 2017 was EUR 4 277 thousand (2016: EUR 5 676 thousand).

16. DEPOSITS WITH CREDIT INSTITUTIONS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Demand deposits with credit institutions				
Credit institutions registered in Latvia	5 476	5 476	3 620	3 620
Credit institutions registered in OECD countries	40 581	40 581	72 658	72 658
Credit institutions of other countries	66 466	66 438	42 608	42 569
Total demand deposits with credit institutions	**112 523**	**112 495**	**118 886**	**118 847**
Loans issued to credit institutions	**4 986**	**4 986**	**5 047**	**5 047**
Term deposits with credit institutions	**521**	**521**	**57 247**	**57 247**
Total deposits with credit institutions	**118 030**	**118 002**	**181 180**	**181 141**

In 2017, the growth of the loan portfolio and low interest rates on the interbank market contributed to the decrease in the amounts due on demand from credit institutions registered in OECD countries and term deposits with credit institutions.

The Bank's demand deposits with credit institutions based on rating agency ratings are as follows:

	2017 '000 EUR	2016 '000 EUR
Rated from AAA to A-	55 169	95 682
Rated from BBB+ to BBB-	2 181	3 379
Rated from BB- to BB+	19 978	21 928
Rated below BB-	10 061	15 522
Not rated	30 613	44 630
Total deposits with credit institutions	**118 002**	**181 141**

As at 31 December 2017, the Bank had correspondent accounts with 33 banks (2016: 43). The largest account balances were with BANK OF CHINA – EUR 34 757 thousand (2016: EUR 27 231 thousand), with the total amount exceeding 10% of total deposits with credit institutions.

As 31 December 2017, EUR 4,514 thousand was pledged with ED AND F MAN CAPITAL MARKETS LIMITED as a security for customer derivative transaction contracts.

17. HELD-FOR-TRADING FINANCIAL ASSETS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Fixed income securities:				
Eurobonds issued by other financial institutions in Latvia	2 062	2 062	471	471
Eurobonds issued by companies and credit institutions of OECD countries	1 959	1 959	1 305	1 305
Eurobonds issued by companies and credit institutions of non-OECD countries	4 232	4 232	1 179	1 179
Total	**8 253**	**8 253**	**2 955**	**2 955**

An analysis of the credit quality of held-for-trading financial assets. based on rating agency ratings where applicable, is as follows:

	2017 EUR'000	2016 EUR'000
Fixed income securities		
-Corporate bonds and securities of credit institutions		
Rated from AAA to A-	2 594	–
Rated from BB- to BB+	2 722	1 505
Rated below BB-	2 937	524
Not rated	–	926
Total corporate bonds and securities of credit institutions	**8 253**	**2 955**
Total fixed income securities	**8 253**	**2 955**

18. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

In January 2016, the Bank acquired claim rights of the Bank's client (the borrower), a Lithuanian company SUBARE, against an insurance company S.C. Certasig – Societate De Asigurare Si Reasigurare S.A. (Certasig).

Claim rights are based on an insurance policy of EUR 1 200 000, which SUBARE used to insure the towing of the ship Georg Buchner from Rostock in Germany to Klaipėda in Lithuania. The ship sunk on 30 May 2013 (an actual insurance event occurred), however the insurance company (Certasig) refused to pay the claim.

Fair value of the claim right against the insurance company Certasig as estimated by the Bank is EUR 397 350. This estimate is based on the assumptions made by the Bank's specialists after consulting Thomas Cooper, a law firm hired by the Bank.

19. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2017		2016	
	Group EUR'000	Bank EUR'000	Group EUR'000	Bank EUR'000
Fixed income securities				
Eurobonds issued by credit institutions	23 391	23 391	28 765	28 765
Eurobonds issued by central governments of Republic of Latvia	4 082	4 082	–	–
Eurobonds issued by central governments of OECD countries	2 001	2 001	5 329	5 329
Eurobonds issued by central governments of Non-OECD countries	23 750	23 750	–	–
Eurobonds issued by international organisations	436	436	33 915	33 915
Total fixed income securities	**53 660**	**53 660**	**68 009**	**68 009**
Shares and other non-fixed income securities				
Shares in VISA INC	518	518	394	394
Shares of Viduskurzemes AAO SIA	530	530	530	530
SWIFT shares	65	65	65	65
Total	**1 113**	**1 113**	**989**	**989**
Impairment allowance	(312)	(312)	–	–
Total of shares and other securities with non-fixed income	**801**	**801**	**989**	**989**
Total available for sale financial assets for sale	**54 461**	**54 461**	**68 998**	**68 998**

In 2017, the eurobonds of international organisations held in the Bank's liquidity portfolio were redeemed and eurobonds issued by central governments of OECD countries were purchased.

Available-for-sale financial assets based on rating agency ratings are as follows:

	2017	2016
	EUR'000	EUR'000
Fixed income securities		
- Eurobonds issued by credit institutions		
Rated from AAA to A-	17 831	23 714
Rated from BBB+ to BBB-	5 034	5 051
Rated from BB- to BB+	526	–
Total Eurobonds issued by credit institutions	**23 391**	**28 765**
- Eurobonds issued by central governments of LR		
No rate	4 082	–
Total eurobonds issued by central governments of LR	**4 082**	**–**
- Eurobonds issued by central governments of OECD countries		
Rated from AAA to A-	–	5 329
Rated from BBB+ to BBB-	2 001	–
Total Eurobonds issued by central governments of OECD countries	**2 001**	**5 329**
Eurobonds issued by central governments of Non-OECD countries		
Rated from AAA to A-	22 350	–
No rate	1 400	–
Total Eurobonds issued by central governments of Non-OECD countries	**23 750**	**–**
- Eurobonds issued by international organisations		
Rated from AAA to A-	–	33 915
Rated from BB- to BB+	436	–
Total Eurobonds issued by international organisations	**436**	**33 915**
Total fixed income securities	**53 660**	**68 009**

12. LOANS AND RECEIVABLES

(a) Loans

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Financial institutions	4 749	4 749	5 459	5 459
Corporates	148 641	148 641	110 824	110 824
Individuals	11 644	11 644	4 676	4 676
Total loans and receivables	**165 034**	**165 034**	**120 959**	**120 959**
Impairment allowance	(4 034)	(4 034)	(6 039)	(6 039)
Net loans and receivables	**161 000**	**161 000**	**114 920**	**114 920**

(b) Analysis of loans by type

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Loan portfolio				
Corporate loans	87 478	87 478	56 596	56 596
Industrial loans	49 535	49 535	41 357	41 357
Payment cards loans	1 089	1 089	834	834
Mortgage loans	12 303	12 303	8 104	8 104
Finance lease	1 939	1 939	1 956	1 956
Other loans	–	–	–	–
Total loan portfolio	4 710	4 710	1 332	1 332
Kredītportfelis Total	**157 054**	**157 054**	**110 179**	**110 179**
Securities-backed loans				
Reverse repo	7 980	7 980	10 780	10 780
Total securities-backed loans	**7 980**	**7 980**	**10 780**	**10 780**
Total loans and receivables	**165 034**	**165 034**	**120 959**	**120 959**
Impairment allowance	(4 034)	(4 034)	(6 039)	(6 039)
Net loans and receivables	**161 000**	**161 000**	**114 920**	**114 920**

(c) Geographical segmentation of the loans

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Loans to residents of Latvia	83 450	83 450	55 566	55 566
Loans to residents of OECD countries	43 994	43 994	26 057	26 057
Loans to residents of non-OECD countries	37 590	37 590	39 336	39 336
Total loans and receivables	**165 034**	**165 034**	**120 959**	**120 959**
Impairment allowance	(4 034)	(4 034)	(6 039)	(6 039)
Net loans and receivables	**161 000**	**161 000**	**114 920**	**114 920**

(d) Ageing structure of the loan portfolio

Bank	Total EUR'000	Of which not past due on the reporting date	Of which past due by the following terms				Net carrying amount of overdue loans
			Less than 30 days	31-90 days	91-180 days	More than 180 days	
As at 31 December 2017							
Net carrying amount	**161 000**	159 012	19	966	613	390	1 988
Out of which impaired	**12 063**	11 057	–	3	613	390	1 006
31 December 2016							
Net carrying amount	**114 920**	106 912	6 199	2	2	1 805	8 008
Out of which impaired	**23 415**	16 041	6 199	2	2	1 171	7 374

The Group's ageing structure is not materially different from that of the Bank.

The amounts shown in the table are the carrying values of loans and do not necessarily represent the fair value of collateral. Impaired or overdue loans of EUR 1 875 thousand (2016: EUR 7 999 thousand) are secured by a collateral with a fair value of EUR 3 088 thousand (2016: EUR 13 523 thousand). Loans of EUR 113 thousand (2016: EUR 9 thousand) that are not impaired, secured by collateral or it is impracticable to determine the fair value of collateral are overdrafts.

(e) Impaired loans

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Impaired loans, gross	16 097	16 097	29 454	29 454
Impairment allowance	(4 034)	(4 034)	(6 039)	(6 039)
Net loans and receivables	**12 063**	**12 063**	**23 415**	**23 415**

The repayment of certain loans in 2017 resulted in decrease in the amount of impaired loans. There is one large exposure which constitutes 73% of total impaired loans, which is not past due on the reporting date, which was partly repaid at the beginning of 2018. The remaining exposure of this large loan is covered by related collateral. The remaining 27% of total impaired loans are secured by collaterals.

(f) Movements in the impairment allowance

Movements in the loan impairment allowance for the year ended 31 December 2017 and 2016 are as follows:

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Opening balance	**6 039**	**6 039**	**1 354**	**1 354**
Increase in the impairment allowance for loans and receivables	1 176	1 176	5 013	5 013
Reversal of impairment loss	(2 597)	(2 597)	(27)	(27)
Loan write-offs	(543)	(543)	(376)	(376)
Effect of foreign currency translation	(41)	(41)	75	75
Closing balance	**4 034**	**4 034**	**6 039**	**6 039**

Due to the deterioration of borrowers' solvency, additional impairment allowance of individual loans were recognised during the year. At the same time the Group and the Bank have received partial repayment for the previously impaired loan which led to partial reversal of impairment.

(g) Industry analysis of the loan portfolio of the Group and the Bank

	2017	2016
	EUR'000	EUR'000
Water transport	26 578	16 946
Financial services	7 453	12 088
Wholesale	54 664	44 923
Real Estate	17 189	3 884
Leisure, recreation, sports	589	596
Overdrafts	4 660	2 641
Metal manufacture	9 105	8 089
Transport and storage	5 014	11 511
Private customers – mortgage loans and consumer loans	10 780	2 522
Manufacture of food products	2 095	1 867
Other services	22 873	9 853
Net loans and receivables	**161 000**	**114 920**

(h) Analysis of loans by type of collateral (Group and Bank)

EUR'000	31 December 2017	% of loan portfolio	31 December 2016	% of loan portfolio
Commercial buildings	48 725	30	28 660	25.2
Real estate – first mortgage	13 645	8	5 994	5
Commercial assets pledge	45 952	29	27 988	24
Commercial assets: water transport	16 029	10	16 946	14.9
Trading securities	7 980	5	10 780	9.4
Guarantee	3 650	2	1 907	1.6
Deposit	57	–	57	0.1
Inventories	16 949	11	19 820	17.4
No collateral	8 013	5	2 768	2.4
Net loans and receivables	**161 000**	**100**	**114 920**	**100**

(j) Restructured loans

As at 31 December 2017 and 2016, the loans restructured by the Group and the Bank possessed the following signs of restructuring:

EUR'000	2017	2016
	EUR'000	EUR'000
Reduced interest rate	589	596
Loan holidays	15 376	11 308
Total restructured loans	**15 965**	**11 904**

(k) Repossessed assets

In 2017, loan collateral in the amount of EUR 610 thousand was repossessed. No collaterals were repossessed during 2016.

(l) Significant credit exposures

As at 31 December 2017 the Bank had no borrowers or groups of related borrowers, respectively, whose total loan balances exceeded 10% of loans and receivables from customers.

As at 31 December 2016, the Bank had 1 borrower whose loan balances exceeded 10% of loans and receivables from customers and the balance represented EUR 12 916 thousand.

According to regulatory requirements, the Bank is not allowed to have a credit exposure to one customer or group of related customers of more than 25% of Bank's equity. As at 31 December 2017 and 2016, the Bank was in compliance with this requirement.

21. FINANCIAL ASSETS HELD-TO-MATURITY

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Debt securities and other fixed income securities				
Eurobonds issued by companies and credit institutions of LR	2 049	2 049	2 278	2 278
Eurobonds issued by companies and credit institutions of other countries	29 486	29 486	80 508	80 508
Total debt securities	**31 535**	**31 535**	**82 786**	**82 786**

Quality analysis of held-to-maturity financial assets, based on rating agency ratings, is as follows:

	2017	2016
	EUR'000	EUR'000
Debt securities and other fixed income securities		
- Corporate bonds		
Rated from AAA to A-	2 532	33 650
Rated from BBB+ to BBB-	4 695	13 577
Rated from BB- to BB+	19 647	22 214
Rated below BB-	1 957	10 259
No rate	2 704	3 086
Total corporate bonds	**31 535**	**82 786**
Debt securities and other fixed income securities	**31 535**	**82 786**

22. INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES

(a) Investments in subsidiaries (Group)

Company	Capital contribution	Carrying amount at 31.12.2017	Carrying amount at 31.12.2016
		EUR'000	EUR'000
SIA BlueOrange International	100%	5 009	3 209
Impairment allowance		*(2 249)*	*(1 549)*
SIA Zapdvina Development	100%	12 024	7 024
Impairment allowance		*(806)*	*(806)*
SIA CityCap Service	100%	548	546
Impairment allowance		*(158)*	*(158)*
UAB Kamaly Development	100%	3	3
AS Pils Pakalpojumi	100%	15 281	9 821
Non-reciprocal capital contribution by a parent into subsidiary (See note 33)		*(2 400)*	*(2 400)*
Impairment allowance		*(548)*	*(548)*
SIA Jēkaba 2	100%	4 049	4 049
Impairment allowance		*(106)*	*(106)*
SIA Mateli Estate	100%	81	–
SIA Darzciems Estate	100%	63	–
SIA Mazirbe Estate	100%	88	–
SIA Lielie Zaki	100%	84	–
SIA Pulkarne Entity	100%	175	–
		31 138	**19 085**

In 2017, the Bank increased the share capital of its subsidiary, SIA Zapdvina Development, by EUR 5 000 000. After this increase, the share capital of SIA Zapdvina Development consisted of 11 498 018 shares with nominal value of EUR 1 amounting to EUR 11 498 018. In previous years the Bank recognised an impairment allowance for its investment in SIA Zapdvina Development in the amount of EUR 806 thousand triggered by impairment of this subsidiary's assets. In 2017, based on the appraisal, no additional impairment allowances were not recognised. SIA Zapdvina Development owns a land plot in Daugavpils.

In 2017, the Bank increased the share capital of its subsidiary, SIA CityCap Service by EUR 2 100. After this increase, the share capital of SIA CityCap Service consisted of 20 706 shares with nominal value of EUR 28 amounting to EUR 579 768. In previous years, the Bank recognised an impairment allowance for its investment in SIA CityCap Service in the amount of EUR 158 thousand triggered by impairment of this subsidiary's assets. Based on the appraisal, in 2017 impairment allowances were not recognised.

In 2017, the Bank's subsidiary SIA Baltikums International changed its name to SIA BlueOrange International. In 2017, the Bank increased the share capital of its subsidiary, SIA BlueOrange International by 1 800 000 shares with nominal value of EUR 1 for a total of EUR 1 800 000. After this increase, the share capital of SIA Baltikums International consisted of 4 986 658 shares with nominal value of EUR 1 amounting to EUR 4 986 658.

In 2017, the Bank recognised an impairment allowance for its investment in SIA BlueOrange International in the amount of EUR 700 thousand EUR triggered by impairment of this investment in subsidiaries. Impairment allowances were recognised since the investment in SIA BlueOrange International exceeded net assets of its subsidiaries.

In previous years, the Bank recognised an impairment allowance for its investment in SIA BlueOrange International in the amount of EUR 1 549 thousand triggered by impairment of this investment in subsidiary. SIA BlueOrange International has four subsidiaries and an associate.

In previous years, the Bank recognised an impairment allowance for its investment in SIA Jēkaba 2 in the amount of EUR 106 thousand.

(b) Investments in subsidiaries by the Bank's subsidiary SIA BlueOrange International

Company	Ieguldījums kapitālā	Carrying amount at 31.12.2017	Carrying amount at 31.12.2016
		EUR'000	EUR'000
KamalyDevelopment EOOD (Bulgaria)	100%	692	692
Impairment allowance		*(364)*	*(100)*
Foxtran Management Ltd. (Belize) – special purpose entity	100%	1 984	334
Impairment allowance		*(559)*	*(283)*
Enarlia International Inc. (Belize) - special purpose entity	100%	363	213
Impairment allowance		*(353)*	*(175)*
		1 763	**681**

In 2017, SIA BlueOrange International increased the share capital of its subsidiary Foxtran Management Ltd. By EUR 1 650 thousand. After this increase, the share capital of Foxtran Management Ltd. consists of 2 379 757 shares with the nominal value USD 1 amounting to USD 2 379 757 or EUR 1 984 thousand (according to the central bank rate of 1.1993).

In 2017, SIA BlueOrange International increased the share capital of its subsidiary Enarlia International Inc by EUR 150 thousand. After this increase, the share capital of "Enarlia International Inc. consists of 435 439 shares with the nominal value USD 1 amounting to USD 435 439 or EUR 363 thousand (according to the central bank rate of 1.1993).

In 2017, an impairment allowance for the investment in Foxtran Management Ltd. was recognised in the amount of EUR 276 thousand and for the investment in Enarlia International Inc. an impairment allowance in the amount of EUR 178 thousand was recognised. Allowances were recognised since the investment in SIA BlueOrange International exceeded net assets of Foxtran Management Ltd and Enarlia International Inc.

In the previous years, an impairment allowance for the investment in Foxtran Management Ltd. was recognised in the amount of EUR 283 and for the investment in Enarlia International Inc. an impairment allowance in the amount of EUR 175 thousand was recognised. Allowances were recognised since the investment in SIA BlueOrange International exceeded net assets of Foxtran Management Ltd and Enarlia International Inc.

In 2017, SIA BlueOrange International recognised impairment allowances for the investment in KamalyDevelopment EOOD in the amount of EUR 264 thousand. KamalyDevelopment EOOD owns a property for which the fair value was established using the market method. Market approach relies on considering similar offers. Based on the appraisal, in 2017 impairment allowances were recognised.

In prior years SIA BlueOrange International recognised impairment allowances for the investment in KamalyDevelopment EOOD in the amount of EUR 100 thousand based on discounted cash flow method which used a 5% capitalisation rate and market method which relied on considering similar offers.

(c) Equity-accounted investments in associates (Group and Bank)

Company	Capital contribution	Carrying amount at 31.12.2017		Carrying amount at 31.12.2016	
		EUR'000		EUR'000	
		Group	Bank	Group	Bank
AS Termo biznesa Centrs	26.15%	1 848	–	1 848	–
Impairment allowance		*(1 021)*	–	*(1 021)*	–
Total		**827**	**–**	**827**	–

Group and Bank

	AS Termo biznesa Centrs	Total
Amount as at 31 December 2015	**890**	**890**
Impairment allowance	*(63)*	*(63)*
Amount as at 31 December 2016	**827**	**827**
Amount as at 31 December 2017	**827**	**827**

SIA BlueOrange International has an associate AS Termo biznesa Centrs. The property owned by AS Termo biznesa Centrs was appraised on the basis of discounted cash flow using a weighted average rate of 9.14%. Based on an appraisal, in 2017 an impairment allowance was not recognised (2016: 63 thousand was recognised)

Financial information of the associate AS Termo biznesa centrs:

	Current assets	Long-term invest-ments	Total assets	Current liabili-ties	Non-current liabili-ties	Total liabili-ties	Net assets	Income	Expens-es	Net loss	Group's share in net assets 26.15%	Group's share in loss 26.15%
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
31 December 2016												
AS „Termo biznesa Centrs"	58	343	401	(22)	(17)	(39)	362	216	(224)	(8)	(95)	(2)
31 December 2017												
AS „Termo biznesa Centrs"	**68**	**339**	**407**	**(34)**	**(14)**	**(48)**	**359**	**220**	**(221)**	**(1)**	**(94)**	**(0.26)**

	AS „Termo biznesa Centrs"
Group's share in net assets 26.15% as at 31 December 2016	**(95)**
Fair value adjustment for the building	*922*
Equity-accounted investments in associates as at 31 December 2016	**827**
Group's share in net assets 26.15% as at 31 December 2017	**(94)**
Fair value adjustment for the building	*921*
Equity-accounted investments in associates as at 31 December 2017	**827**

As losses for 2017 are insignificant they have no impact on the Group results.

(e) Acquisition of non-controlling interest in 2017

In August 2017, the Bank acquired 39% of the controlling interest in AS Pils Pakalpojumi from AS BBG, therefore the investment in share capital increased to 100%; to that date the Bank held a 61% investment.

The carrying amount of AS Pils Pakalpojumi's net assets in the Group's consolidated financial statements on the date of the acquisition was EUR 11 403 thousand.

In thousands of euro	
Carrying amount of NCI acquired (11 403 x 39%)	4 447
Consideration paid to NCI	5 460
Result of acquisition of NCI without a change in control	**(1 013)**

The decrease in equity attributable to owners of the Company comprised a decrease in other reserves of EUR 1 013 thousand.

	Current assets	Long-term invest-ments	Total assets	Current liabili-ties	Total liabili-ties	Net assetsi	Income	Expens-es	Net profit/ loss	Carrying amount of non-control-ling interest	Profit attribut-able to NCI
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
31 December 2016											
AS „Pils pakalpojumi"	187	11 227	11 414	(33)	(33)	11 381	497	(430)	67	4 438	26
31 July 2017											
AS „Pils pakalpojumi"	189	11 225	11 414	(11)	(11)	11 403	248	(226)	22	4 447	9

Reconciliation of movements of liabilities to cash flows arising from financing activities (acquisition of NCI) (no comparative available for 2016 as there was no such transaction)

EUR	Note	Assets
		Acquisition of NCI
Balance at 1 January 2017		**–**
Change from financing cash flows		–
Consideration paid		(5 460)
Total changes from financing cash flows		**(5 460)**
Balance at 31 December 2017		**–**

(d) Transactions under common control in 2017

In 2017, the Bank obtained 100% ownership of five subsidiaries under common control transaction:

Sabiedrības:	Shareholding obtained	Fair value of net assets as at the transaction date 31.07.2017	Consideration paid
SIA „Darzciems Estate"	100%	61	(61)
SIA „Mazirbe Estate"	100%	88	(88)
SIA „Pulkarne Entity"	100%	175	(175)
SIA „Lielie Zaķi"	100%	84	(84)
SIA „Mateli Estate"	100%	81	(81)
Total		**489**	**(489)**

In 2017, the Bank increased the share capital of its subsidiary, SIA Darzciems Estate by EUR 2,000. After this increase, the share capital of SIA Darzciems Estate consisted of 227 730 shares with nominal value of EUR 1 amounting to EUR 227 730.

23. INVESTMENT PROPERTY

Investment property of the Group and the Bank represents the following:

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Real estate in Latvia	2 200	155	3 516	1 940
Real estate in Lithuania	2 807	2 807	2 807	2 807
Real estate in Bulgaria	521	–	521	–
Impairment allowance	(2 740)	(1 607)	(3 160)	(2 220)
	2 788	**1 355**	**3 684**	**2 527**

	Group	Bank
	EUR'000	EUR'000
31 December 2016	**3 684**	**2 527**
Acquisition of investment property	469	–
Impairment allowance created (Lithuania and Bulgaria)	(1 043)	(850)
Disposals (property in Latvia)	(1 785)	(1 785)
Disposals - Impairment allowance (property in Latvia)	*1 463*	*1 463*
31 December 2017	**2 788**	**1 355**

Investment property is recognized at cost. Investment property consists of land and commercial properties.

In light of stagnation witnessed in the real estate market in Lithuania and Bulgaria, the Group in December 2017 recognised impairment allowance for investment properties in Lithuania in amount EUR 850 thousands and in Bulgaria – EUR 193 thousand. In December 2017, the Bank recognised impairment allowance for investment properties in Lithuania in amount EUR 850 thousand.

The recoverable amount was measured based on fair value less cost to sell. Fair value of investment property in Klaipeda was determined by external, independent property valuer based on comparable transaction method, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued. The fair value was determined for each piece of land included in this property.

The fair value of investment property in Bulgaria was determined internally based on comparable transaction method.

Direct operating expenses (including repairs and maintenance costs) incurred by the Group in connection with the investment property which has not earned a rental income during the reporting year amounted to EUR 21 thousand (2016: EUR 16 thousand).

Direct operating expenses (including repairs and maintenance costs) incurred by the Bank in connection with the investment property which has not earned a rental income during the reporting year amounted to EUR 11 thousand (2016: EUR 11 thousand).

The Group and the Bank did not earn any income on investment property neither in 2017 nor in 2016.

Group's investment

Type	Carrying amount 'EUR '000	Valuation method	Significant unobservable inputs Sales price* varies from EUR to EUR per m2 2017	 2016	Correlation between balance sheet data and fair value measurement, 'EUR '000
Land plot, Kungu iela, Liepāja, Latvia	60 (2016: 60)	Comparison approach	11,1–15,8	11,1–15,85	Fair value would increase (reduce) if the price per m2 was higher (lower)
Buildings and a land plot, Jurģu iela, Jūrmala, Latvia	95 (2016: 95)	Comparison approach	435–446	435–446	Fair value would increase (reduce) if the price per m2 was higher (lower)
Golf club divided into 103 adjacent land plots and warehouse, Klaipeda, Lithuania	1 200 (2016: 2 050)	Comparison approach	0,37–0,57 par zemes gabalu lielāku nekā 8,2 ha 5–5,8 par zemes gabalu lielāku nekā 1 ha 2,42–6,41 par zemes gabalu līdz 300 m^2	2,4 par zemes gabalu lielāku nekā 8,2 ha EUR 1 par visiem pārējiem zemes gabaliem	Fair value would increase (reduce) if the price per m2 was higher (lower)
Apartments, Bulgaria	328 (2016: 521)	Comparison approach	1 176 –1 506	1 900 –1 950	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot, Mūku purvs,	386 (2016: 386)	Comparison approach	28,7–41	28,7–41	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot, Akācijas iela, Daugavpils, Latvia	250 (2016: 250)	Comparison approach	7,8–8,71	7,8–8,71	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot in Ķekavas pagasts, Ķekavas novads, Latvia	170 (2016: none)	Comparison approach	3,02–3,21	–	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot, Kārsavas iela, Riga, Latvia	61 (2016: none)	Comparison approach	70,42–82,16	–	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot in Kolkas pagasts, Dundaga novads, Latvia	86 (2016: none)	Comparison approach	1,46–2,08	–	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot in Lejas akmeņi, Ķekavas novads, Latvia	82 (2016: none)	Comparison approach	0,55–0,58	–	Fair value would increase (reduce) if the price per m2 was higher (lower)
Land plot in Krāslavas novads, Kombuļu pagasts	70 (2016: none)	Comparison approach	0,08–0,11	–	Fair value would increase (reduce) if the price per m2 was higher (lower)
Total	**2 788**				

* sales prices are market prices for similar properties adjusted for certain criteria such as land plot footage adjustment, location area adjustment, property condition, offer price adjustment, resulting in the significant unobservable inputs.

Bank's investment

Type	Carrying amount, EUR '000	Valuation method	Significant unobservable inputs Sales price* varies from EUR to EUR per m2		Correlation between balance sheet data and fair value measurement, 'EUR 000
			2017	2016	
Land plot, Kungu iela, Liepāja, Latvia	60 (2016: 60)	Comparison approach	11,1–15,8	11,1–15,85	Fair value would increase (reduce) if the price per m2 was higher (lower);.
Buildings and land plot, Jurģu iela, Jūrmala, Latvia	95 (2016: 95)	Comparison approach	435–446	435–446	Fair value would increase (reduce) if the price per m2 was higher (lower);
Golf club divided into 103 adjacent land plots and warehouse, Klaipeda, Lithuania	1 200 (2016: 2 050)	Comparison approach	0.37-0.57 for land plot over 8.2 ha	2.4 for land plot over 8.2 ha	Fair value would increase (reduce) if the price per m2 was higher (lower);
			5 -5.8 for land plot 1 ha	1 EUR for the rest of the land plots	
			2.42 – 6.41 for land plots till 300 m2		
Total	**1 355**				

* sales prices are market prices for similar properties adjusted for certain criteria such as land plot footage adjustment, location area adjustment, property condition, offer price adjustment, resulting in the significant unobservable inputs.

24. PROPERTY AND EQUIPMENT

	Land and buildings		Leasehold improvements		Vehicles		Office equipment		Construction in progress		Total	
	EUR'000		EUR'000		EUR'000		EUR'000		EUR'000		EUR'000	
	Group	Bank	Group	Bank	Group	Bank	Group	Bank	Group	Bank	Group	Bank
Iegādes vērtība												
31 December 2015	**14 835**	**–**	**–**	**–**	**66**	**66**	**1 234**	**1 080**	**3 044**	**2 266**	**19 179**	**3 412**
Additions	–	–	–	–	–	–	532	308	4 955	2 131	5 487	2 439
Adjustment (write-off of a replaced component)	(114)	–	–	–	–	–	–	–	(3)	–	(117)	–
Disposals	–	–	–	–	–	–	(44)	(44)	–	–	(44)	(44)
31 December 2016	**14 721**	–	**–**	**–**	**66**	**66**	**1 722**	**1 344**	**7 996**	**4 397**	**24 505**	**5 807**
Additions	–	–	–	–	1 439	39	733	450	5 400	389	7 572	878
Transfer	4 783	–	–	4 786	–	–	(124)	(123)	(4 783)	(4 786)	(124)	(123)
Disposals	-	-	-	-	-	-	(124)	(123)	-	-	(124)	(123)
31 December 2017	**19 504**	–	**–**	**4 786**	**1 505**	**105**	**2 331**	**1 671**	**8 613**	**–**	**31 953**	**6 562**
Depreciation												
31 December 2015	**178**	–	–	–	**14**	**14**	**899**	**806**	**–**	**–**	**1 091**	**820**
Depreciation	125	–	–	–	14	14	115	89	–	–	254	103
Disposals	–	–	–	–	–	–	(44)	(44)	–	–	(44)	(44)
31 December 2016	**303**	**–**	**–**	**–**	**28**	**28**	**970**	**851**	**–**	**–**	**1 301**	**879**
Depreciation	295	–	–	166	17	17	167	155	–	–	479	338
Disposals	–	–	–	–	–	–	(118)	(118)	–	–	(118)	(118)
31 December 2017	**598**	–	–	166	**45**	**45**	**1 019**	**888**	**–**	**–**	**1 662**	**1 099**
Net carrying amount												
31 December 2016	**14 418**	**–**	**–**	**–**	**38**	**38**	**752**	**493**	**7 996**	**4 397**	**23 204**	**4 928**
31 December 2017	**18 906**	**–**	**–**	**4 620**	**1 460**	**60**	**1 312**	**783**	**8 613**	**–**	**30 291**	**5 463**

The two buildings that the Bank rents from its subsidiaries at Smilšu street and Jēkaba street are used as the Head office of the Bank. During 2017, the construction work at property at Jēkaba street has been finished. Currently, construction work is carried out at Smilšu iela and capitalised construction expenses on the Group level as at the end of 2017 amounted to EUR 8 613 thousand (2016: EUR 7 996 thousand). From the Group's perspective, these buildings are considered to be corporate assets and are classified as property and equipment. In 2017 and 2016, the management believes that there are no indications that these sites may be impaired.

25. INTANGIBLE ASSETS

Group	Goodwill EUR'000	Software EUR'000	Total EUR'000
Acquisition cost			
31 December 2015	**564**	**1 687**	**2 251**
Acquired in the reporting period	–	554	554
Disposed in the reporting period	–	(18)	(18)
Impairment of goodwill	(564)	–	(564)
31 December 2016	**–**	**2 223**	**2 223**
Acquired in the reporting period	–	434	434
Disposed in the reporting period	–	(6)	(6)
31 December 2017	–	**2 651**	**2 651**
Amortization for the reporting period			
31 December 2015	–	**798**	**798**
Amortization for the reporting period	–	226	226
Amortization of assets disposed in the reporting period	–	(17)	(17)
31 December 2016	–	**1 007**	**1 007**
Amortization for the reporting period	–	328	328
Amortization of assets disposed in the reporting period	–	(6)	(6)
31 December 2017	–	**1 329**	**1 329**
Net carrying amount			
31 December 2016	–	**1 216**	**1 216**
31 December 2017	–	**1 322**	**1 322**

Bank	Software EUR'000
Acquisition cost	
31 December 2015	**1 667**
Disposed in the reporting period	(17)
Acquired in the reporting period	554
31 December 2016	**2 204**
Disposed in the reporting period	(6)
Acquired in the reporting period	434
31 December 2017	**2 632**
Amortization	
31 December 2015	**783**
Amortization for the reporting period	224
Amortization of assets disposed in the reporting period	(17)
31 December 2016	**990**
Amortization for the reporting period	327
Amortization of assets disposed in the reporting period	(6)
31 December 2017	**1 311**
Net carrying amount	
31 December 2016	**1 214**
31 December 2017	**1 321**

26. OTHER ASSETS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Other financial assets				
Security deposit (MasterCard Europe, VISA Card)	7 686	7 686	7 987	7 987
Receivables under transactions with credit cards	974	974	3 608	3 608
Advance payment for acquisition of shares	–	–	2 730	2 730
Receivables under SPOT transactions	37	37	256	256
Other receivables	4 193	4 116	362	303
Deferred payment for VISA shares	121	121	121	121
Other non-financial assets				
Repossessed collaterals – movable property	3 552	3 552	6 634	6 634
Assets classified as held for sale	610	610	–	–
Overpaid taxes (VAT and other)	71	–	243	46
Total other assets	**17 244**	**17 096**	**21 941**	**21 685**
Allowances for other assets	(3 563)	(3 552)	(3 985)	(3 980)
Other assets, net	**13 681**	**13 544**	**17 956**	**17 705**

In 2017, security deposits of EUR 7 686 thousand (2016: EUR 7 987 thousand) were reserved for potential transactions connected with MasterCard Europe and VISA Card systems. In 2016, the Bank paid an advance of EUR 2 730 thousand for purchase of 39% shares of AS Pils Pakalpojumi, which form 50% of the purchase price. The deal was completed in 2017 (see Note 22).

Assets classified as held for sale in the amount of EUR 610 thousand, arose in 2017 as repossessed loan collateral (see Note 20(k)). Assets classified as held for sale are initially recognised at take-over value which set to be a notional cost. Subsequently, management has determined a recoverable amount which was fair value less cost to sell as at 31 December 2017 using market data.

As of 31 December 2017, the movable property includes one yacht (in 2016 – two yachts). Initially, movable property was recognised based on take-over value which set to be a notional cost. Subsequently, management reviewed movable property for impairment indicators and recognised assets based on its recoverable value which was fair value less cost to sell as at 31 December 2017 and 2016. The fair value was determined using market data.

In 2017, movable property - the yacht White Rose was invested in the share capital of the Bank's subsidiary BlueOrange International Ltd. at a market value of EUR 1 400 thousand and is classified as a fixed asset in the Group's financial statements. The yacht market value was determined on the basis of the certified judgment of the valuator.

Movements in the impairment allowance

Movements in the loan impairment allowance for the year ended 31 December 2016 and 2017 are as follows:

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Opening balance	**3 985**	**3 980**	**1 634**	**1 634**
Increase in the impairment allowance for repossessed collaterals	1 421	1 421	2 346	2 346
Increase in the impairment allowance for other assets	697	691	49	44
Other assets write-offs	(691)	(691)	(44)	(44)
Repossessed collaterals write offs	(1 849)	(1 849)	–	–
Closing balance	**3 563**	**3 552**	**3 985**	**3 980**

As at 31 December 2017, the Group and Bank recognised an additional impairment allowance of EUR 1 421 thousand for movable property (2016: EUR 2 346 thousand) and impairment allowance of EUR 691 thousand for receivable from e-commerce sellers (2016: nil). The estimated net fair value of the Group's and the Bank's movable property (yacht Silver Rose), taking into account the poor technical condition of the yacht (damage to the hull), was set at 0 EUR (in 2016 - EUR 1 421 thousand).

As at 31 December 2017, the fair value of other non-financial assets of EUR 610 thousand is categorized within Level 3 of the Fair Value Hierarchy (2016: EUR 2 654 thousand).

The table describes the valuation method used to arrive at the fair value of other assets, and the significant unobservable inputs 31 December 2017 and 31 December 2016:

Type	Carrying amount '000 EUR	Valuation method	Significant unobservable inputs		Saistība starp bilances datiem un patiesās vērtības novērtēšanu, '000 EUR
			2017	2016	
Apartment, Bulduru Prospekts, Jūrmala, Latvia	610 (2016: nav)	Comparison approach	Purchase price		Fair value would increase (reduce) if the price per m2 was higher (lower)
			610	–	
Moveable property, yacht White Rose	– (2016: 1 421)	Comparison approach	Sales price* varies from		Fair value would increase (reduce) if the price per m2 was higher (lower)
				1 421	
Moveable property, yacht White Rose	– (2016: 1 233)	Comparison approach	Sales price* varies from		Fair value would increase (reduce) if the price per m2 was higher (lower)
			–	1 233	
Total	**610 (2016: 2 654)**				

* sales price for moveable property are market prices for similar yachts adjusted for certain criteria such as size, age, yacht builder and yacht location, resulting in the significant unobservable inputs.

27. DUE TO CREDIT INSTITUTIONS ON DEMAND

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Credit institutions registered in Latvia	893	893	1 763	1 763
Credit institutions registered in OECD countries	449	449	212	212
Credit institutions registered in other countries (non-OECD)	86	86	1 529	1 529
	1 428	**1 428**	**3 504**	**3 504**

As at 31 December 2017 the Bank had four credit institutions whose account balances each exceeded 10% of total deposits on demand with other credit institutions. Total balances of these credit institutions as at 31 December 2017 amounted to EUR 1 338 thousand.

As at 31 December 2016, the Bank had two credit institutions whose account balances each exceeded 10% of total deposits on demand with other credit institutions. Total balances of accounts of these credit institutions as at 31 December 2016 amounted to EUR 3 017 thousand.

28. DUE TO CREDIT INSTITUTIONS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Credit institutions registered in other countries (non-OECD)	96	96	–	–
	96	**96**	**–**	**–**

29. FINANCIAL LIABILITIES CARRIED AT AMORTIZED COST: DEPOSITS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Current accounts:				
Financial institutions	31 104	31 269	27 306	27 448
Corporate entities	381 632	383 702	430 468	432 787
Individuals	82 118	82 118	83 285	83 285
	494 854	**497 089**	**541 059**	**543 520**
Term deposits:				
Subordinate liabilities	4 561	4 561	5 112	5 112
Other financial institutions	1 482	1 482	1 076	1 076
Corporate entities	25 005	25 005	13 656	13 656
Individuals	43 165	43 165	1 939	1 939
	74 213	**74 213**	**21 783**	**21 783**
Total deposits	**569 067**	**571 302**	**562 842**	**565 303**

Geographical segmentation of the deposits

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Deposits of residents registered in Latvia	39 648	41 818	26 876	29 239
Deposits of residents registered in OECD countries	237 847	237 862	197 499	197 500
Deposits of residents registered in other countries (non-OECD)	291 572	291 622	338 467	338 564
Total deposits	**569 067**	**571 302**	**562 842**	**565 303**

As at 31 December 2017, the Bank maintained customer deposit balances of EUR 10 002 thousand which were reserved by the Bank as collateral for loans and other credit instruments granted by the Bank (as at 31 December 2016: EUR 11 841 thousand).

As at 31 December 2017, the Bank had no customers/customer groups with deposits exceeding 10% of the total customer deposits (as at 31 December 2016: none).

30. FINANCIAL LIABILITIES CARRIED AT AMORTIZED COST: SUBORDINATED DEBT SECURITIESI

Subordinated bonds have a fixed term at their origination. Subordinated bonds are repayable before maturity only on winding up or bankruptcy of the Bank. Subordinated bonds rank before shareholders' claims.

This issue is offered to a limited number of investors and it does not represent a public offer in the understanding of the Financial Instruments Market Law of Latvia.

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Issued subordinated bonds	24 511	24 511	19 626	19 626
Accrued interest payments	515	515	311	311
Total	**25 026**	**25 026**	**19 937**	**19 937**

The table below summarises issued bonds with the following maturities and carrying amount:

ISIN	Currency	Issue size	Par value	Date of issue	Date of maturity	Discount/ coupon rate, %	Group/ Bank 31/12/2017	Group/ Bank 31/12/2016
Subordinated bonds								
LLV0000801082	USD	880	1 000	05.12.2012	12.11.2019	6.0	733	835
LV0000801074	EUR	10 000	1 000	05.12.2012	12.11.2019	6.0	3 200	3 200
LV0000801629	EUR	10 000	1 000	25.11.2014	28.11.2021	6.0	10 000	10 000
LV0000801611	USD	10 000	1 000	25.11.2014	28.11.2021	6.0	98	111
LV0000801728	EUR	20 000	1 000	16.04.2015	24.04.2022	6.0	10 480	5 480
Issued debt securities, Total ('000 EUR)							**24 511**	**19 626**

Reconciliation of movements of liabilities to cash flows arising from financing activities (bonds)

EUR	Note	Liabilities
		Bonds issued
Balance at 1 January 2017		**19 937**
Change from financing cash flows		
Proceeds from bonds issued		5 000
Total changes from financing cash flows		**5 000**
The effect of changes in foreign exchange rates		(115)
Liability - related		
Interest expense	6	1 379
Interest paid		(1 175)
Total liability-related other changes		**204**
Balance at 31 December 2017		**25 026**

EUR	Note	Liabilities Bonds issued
Balance at 1 January 2016		**17 825**
Change from financing cash flows		
Proceeds from bonds issued		2 000
Total changes from financing cash flows		**2 000**
The effect of changes in foreign exchange rates		30
Liability - related		
Interest expense	6	1 170
Interest paid		(1 088)
Total liability-related other changes		**90**
Balance at 31 December 2016		**19 937**

31. OTHER LIABILITIES

	2016		2015	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Other financial liabilities				
Credit card payments	580	580	983	983
Financing transactions	456	456	–	–
Receivables under VP transactions	9	9	33	33
Money in transit	6	6	8	8
Suspense accounts	–	–	995	995
Other liabilities, balances of closed customers' accounts	200	200	199	199
Other non-financial liabilities				
Operating and other liabilities	232	169	48	10
Tax settlements	5	5	4	4
VAT payable	4	–	4	–
Other liabilities related to contrition work	735	334	472	321
	2 227	**1 759**	**2 746**	**2 553**

32. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

Group and Bank	2017 EUR'000		2016 EUR'000	
	Carrying amount	Nominal value	Carrying amount	Nominal value
Assets				
Future contracts	119	55 680	90	16 463
Total derivative financial assets	**119**	**55 680**	**90**	**16 463**
Liabilities	232	55 793	136	16 509
Future contracts	**232**	**55 793**	**136**	**16 509**
Total derivative liabilities				

As at 31 December 2017 the Bank had 22 outstanding foreign exchange forward contracts and none with related parties (in 2016 – 7 contracts, including none with related parties).

33. SHARE CAPITAL AND RESERVES

As of 31 December 2017, the authorized share capital comprised 28 209 653 ordinary shares (2016: 28 209 653 ordinary shares). As at 31 December 2017, share capital comprised 28 209 653 shares with total nominal value of EUR 39 493 514.20. Nominal value of one share is EUR 1.40. The structure of shareholders holding ordinary shares did not change. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at the shareholders' meetings. All shares rank equally with regard to the Bank's residual assets.

	2017		2016	
	Quantity	EUR'000	Quantity	EUR'000
Share capital				
Ordinary shares with voting rights	28 209 653	39 493	28 209 653	39 493
	28 209 653	**39 493**	**28 209 653**	**39 493**

The reserve capital of EUR 24 thousand is not subject to any restrictions and can be distributed to the shareholders following an appropriate decision.

As at 31 December 2017, The Bank's reserves consisted of the non-reciprocal contribution into the subsidiary's capital in the amount of EUR 2 400 thousand (2016: EUR 2 400 thousand). As at 31 December 2017, the Group's reserves consisted of the non-reciprocal contribution into the subsidiary's capital in the amount of EUR 2,400 thousand and the result of the disposal of the non-controlling interest in the subsidiary of EUR 1 013 thousand, and a currency revaluation reserve was recognised in the amount of EUR 1 thousand. As at 31 December 2016, the Group's reserves consisted of the non-reciprocal contribution into the subsidiary's capital in the amount of EUR 2 400 thousand and a currency revaluation reserve was recognised in the amount of EUR 17 thousand.

Dividends

Dividends payable are restricted to the maximum retained earnings of the Bank, which are determined according to the legislation of Latvia. In accordance with the legislation of the Republic of Latvia, the amount of reserves available for distribution at the reporting date is EUR 22 766 thousand (2016: EUR 21 935 thousand).

During 2017, dividends of EUR 4 million were distributed (2016: EUR 3.7 million).

Reconciliation of movements of liabilities to cash flows arising from financing activities (dividend)

EUR	Note	Liabilities
		Dividend
Balance at 1 January 2017		–
Dividend declared		4 000
Change from financing cash flows		
Dividend paid		(4 000)
Total changes from financing cash flows		**(4 000)**
Balance at 31 December 2017		**–**

EUR	Note	Liabilities
		Dividend
Balance at 1 January 2016		–
Dividend declared		3 750
Change from financing cash flows		
Dividend paid		(3 750)
Total changes from financing cash flows		**(3 750)**
Balance at 31 December 2016		**–**

34. CASH AND CASH EQUIVALENTS

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Cash and balances due from central banks	233 803	233 803	153 865	153 865
Due from credit institutions on demand and within 3 months	112 625	112 597	181 180	181 141
Due to credit institutions on demand and within 3 months	(1 428)	(1 428)	(3 504)	(3 504)
Total cash and cash equivalents	**345 000**	**344 972**	**331 541**	**331 502**

35. CONTINGENT LIABILITIES AND COMMITMENTS

At any time the Bank has outstanding commitments to extend credit. These commitments take the form of approved loans and credit card limits and overdraft facilities.

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years.

The contractual amounts of commitments are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognized at the reporting date if counterparties failed to completely perform as contracted.

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Unused loan facilities	51 319	51 319	53 273	53 273
Unused credit card facilities	2 111	2 123	2 076	2 088
Guarantees	12 759	12 759	98	98
	66 189	**66 201**	**55 447**	**55 459**

The total contractual amounts of the above loan commitments may differ from the cash flow that may actually be required in future as these commitments may expire before they are claimed.

36. LITIGATION

In the second half of 2017, the Financial and Capital Market Commission conducted a full scope AML/CTF review at the Bank in order to evaluate the Bank's compliance with the AML/CTF Law and to verify if the Bank's practice was compliant with the regulations of the FCMC and other regulations. As at the date of these financial statements, the review by the FCMC is not complete. For possible outcome of the review please refer to Note 4(8).

Management is unaware of any other significant actual, pending or likely claims against the Bank and its subsidiaries.

37. ASSETS AND LIABILITIES UNDER MANAGEMENT

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Assets under management				
Due from credit institutions registered in Latvia	1 497	1 497	2 858	2 858
Due from foreign credit institutions	–	–	223	223
Loans to customers	6 002	6 002	4 846	4 846
Non fixed income securities	12 846	12 846	3 595	3 595
Fixed income securities	8 767	8 767	8 977	8 977
of which: pledged under repo transactions	*1 437*	*1 437*	*1 931*	*1 931*
Other assets	1 971	1 971	1 961	1 961
Total assets under management	**31 083**	**31 083**	**22 460**	**22 460**
Liabilities under management				
Non-resident trust liabilities	19 869	19 869	16 010	16 010
Resident trust liabilities	11 214	11 214	6 450	6 450
Total liabilities under management	**31 083**	**31 083**	**22 460**	**22 460**

As the number of customers grew in 2017 so did the amount of assets under management. The largest share of assets under management were invested in non-fixed income securities. As at 31 December 2017 there were no assets under management from related parties (as at 31 December 2016: none).

38. RELATED PARTY TRANSACTIONS

Related parties are defined as shareholders who have a significant influence over the Bank, companies in which they have a controlling interest, members of the Council and the Board, key management personnel, their close relatives and companies in which they have a controlling interest, as well as associated companies. All transactions with related parties have been carried out at an arm's length.

Loans, deposits and other claims and liabilities to related parties include the following:

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Loans to related parties				
incl. the parent company	–	–	1 750	1 750
incl. members of the Council and the Board	371	371	138	138
incl. other	2 498	2 498	163	163
Other requirements	4	5	2 734	2 767
Total loans and other claims	**2 873**	**2 874**	**4 785**	**4 818**
Term and demand deposits and loans				
incl. from the parent company	195	195	152	152
incl. from subsidiaries of the parent company	–	–	18	18
incl. from subsidiaries	–	2 235	–	2 461
incl. from the members of the Council and Board	614	614	553	553
incl. from others	1 664	1 664	2 436	2 436
Other liabilities	170	171	191	199
Total deposits and liabilities	**2 643**	**4 879**	**3 350**	**5 819**
Contingent liabilities and commitments	**2 970**	**2 982**	**1 710**	**1 722**
	Group Interest rate %	**Bank Interest rate %**	**Group Interest rate %**	**Bank Interest rate %**
Loans to related parties	1.00	1.003	1.03	1.03
Term and demand deposits	0.01	0.01	0.01	0.01

Remuneration to the member of Council and Board during 2017 amounted to EUR 619 thousand (2016: EUR 663 thousand) (see Note 11).

	2017		2016	
	Group	Bank	Group	Bank
	EUR'000	EUR'000	EUR'000	EUR'000
Income from related party transactions				
Commission revenue	36	40	40	44
Interest income	33	33	88	88
Other income	–	–	3	3
Expenses from related party transactions				
Interest expenses	11	11	11	11
Other expenses	37	399	53	516
Rent payments	204	416	204	503

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (BANK)

The table below reflects the maturity analysis of financial assets and liabilities based on the term from the reporting date until the maturity dates of the respective assets and liabilities. The remaining period to maturity of assets and liabilities as at 31 December 2017 was as follows:

2017 EUR'000	Up to 1 month including	From 1 to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	5 years and over, or no maturity	Total, EUR'000
Financial assets							
Cash and demand deposits with central banks	233 803	–	–	–	–	–	**233 803**
Deposits with credit institutions	112 597	–	4 986	419	–	–	**118 002**
Financial assets at fair value through profit and loss	–	–	397	–	–	397	**397**
Held-for-trading financial assets	5 371	50	10	2 941	–	–	**8 372**
Available-for-sale financial assets	53 660	–	–	–	–	801	**54 461**
Loans and receivables	7 531	13 590	11 333	43 364	77 589	7 593	**161 000**
Held-to-maturity financial assets	22 872	607	902	2 872	4 282	–	**31 535**
Other financial assets	7 096	–	–	–	–	5 838	**12 934**
Total financial assets	**442 930**	**14 247**	**17 231**	**49 596**	**81 871**	**14 629**	**620 504**
Financial liabilities							
Demand deposits with credit institutions	1 428	–	–	–	–	–	**1 428**
Derivatives	71	161	–	–	–	–	**232**
Financial liabilities carried at amortized cost	501 128	268	3 655	36 687	54 446	240	**596 424**
Other financial liabilities	1 251	–	–	–	–	–	**1 251**
Total financial liabilities	**503 878**	**429**	**3 655**	**36 687**	**54 446**	**240**	**599 335**
Maturity gap	**(60 948)**	**13 818**	**13 576**	**12 909**	**27 425**	**14 389**	**21 169**
Contingent liabilities and commitments	**53 441**	**–**	**453**	**–**	**12 307**	**–**	**66 201**

The maturity analysis of the Group is not significantly different from that of the Bank disclosed above.

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (BANK) (CONTINUED)

The table below reflects the maturity analysis of financial assets and liabilities based on the term from the reporting date until the maturity dates of the respective assets and liabilities. The remaining period to maturity of assets and liabilities as at 31 December 2016 was as follows:

2016 EUR'000	Up to 1 month including	From 1 to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	5 years and over, or no maturity	Total, EUR'000
Financial assets							
Cash and demand deposits with central banks	153 865	–	–	–	–	–	**153 865**
Deposits with credit institutions	168 244	12 897	–	–	–	–	**181 141**
Financial assets at fair value through profit and loss	1 506	117	11	1 411	–	–	**3 045**
Available-for-sale financial assets	68 009	–	–	–	–	989	**68 998**
Loans and receivables	29 288	3 860	7 253	19 328	51 471	3 720	**114 920**
Held-to-maturity financial assets	35 595	7 432	6 340	4 632	28 787	–	**82 786**
Other financial assets	–	–	–	–	–	15 005	**15 005**
Total financial assets	**456 507**	**24 306**	**13 604**	**25 371**	**80 258**	**19 714**	**619 760**
Financial liabilities							
Demand deposits with credit institutions	3 504	–	–	–	–	–	**3 504**
Derivatives	29	107	–	–	–	–	**136**
Financial liabilities carried at amortized cost	547 554	636	2 946	3 431	24 833	5 840	**585 240**
Other financial liabilities	2 218	–	–	–	–	–	**2 218**
Total financial liabilities	**553 305**	**743**	**2 946**	**3 431**	**24 833**	**5 840**	**591 098**
Maturity gap	**(96 798)**	**23 563**	**10 658**	**21 940**	**55 425**	**13 874**	**28 662**
Contingent liabilities and commitments	**55 401**	**34**	**10**	**14**	**–**	**–**	**55 459**

The maturity analysis of the Group is not significantly different from that of the Bank disclosed above.

40. FINANCIAL RISK MANAGEMENT

Liquidity risk (Bank)

Residual contractual maturities of financial liabilities of the Bank are presented below. The Group's residual contractual maturities of financial liabilities have not been presented as the difference to the Bank's analysis is insignificant.

EUR'000 31 December 2017	Carrying amount	Gross nominal inflow / (outflow	Less than 1 month	1– 3 months	3 months to 1 year	1-5 years and more
Non-derivative liabilities						
Demand deposits with credit institutions	1 428	(1 428)	(1 428)	–	–	–
Financial liabilities carried at amortized cost	596 424	(603 383)	(501 322)	(657)	(42 050)	(59 354)
Total non-derivative liabilities	**597 852**	**(604 811)**	**(502 750)**	**(657)**	**(42 050)**	**(59 354)**
Derivative liabilities						
Trading: outflow	49 007	(49 007)	(8 322)	(40 685)	–	–
Trading: inflow	(48 775)	48 775	8 251	40 524	–	–
Total derivative liabilities	**232**	**(232)**	**(71)**	**(161)**	**–**	**–**
Contingent liabilities and commitments	66 201	(66 201)	(53 441)	-	(453)	(12 307)
Total Liabilities	**664 285**	**(671 244)**	**(556 262)**	**(818)**	**(42 503)**	**(71 661)**

EUR'000 31 December 2016	Carrying amount	Gross nominal inflow / (outflow)	Less than 1 month	1– 3 months	3 months to 1 year	1-5 years and more
Non-derivative liabilities						
Demand deposits with credit institutions	3 504	(3 504)	(3 504)	–	–	–
Financial liabilities carried at amortized cost	585 240	(591 583)	(547 684)	(894)	(7 503)	(35 502)
Total non-derivative liabilities	**588 744**	**(595 087)**	**(551 188)**	**(894)**	**(7 503)**	**(35 502)**
Derivative liabilities						
Trading: outflow	15 095	(15 095)	(3 604)	(11 491)	–	–
Trading: inflow	(14 959)	14 959	3 575	11 384	–	–
Total derivative liabilities	**136**	**(136)**	**(29)**	**(107)**	**–**	**–**
Contingent liabilities and commitments	55 459	(55 459)	(55 401)	(34)	(24)	–
Total liabilities	**644 339**	**(650 682)**	**(606 618)**	**(1 035)**	**(7 527)**	**(35 502)**

41. CURRENCY ANALYSIS OF ASSETS AND LIABILITIES (BANK)

The Latvian banking legislation requires that the total foreign currency open position may not exceed 20% of the equity.

The EUR equivalent of assets and liabilities as at 31 December 2017 by the currencies in which they are denominated is as follows:

2017	EUR	USD	Citas valūtas	Total
EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Financial assets				
Cash and demand deposits with central banks	233 519	228	56	**233 803**
Loans and receivables from banks	23 704	82 996	11 302	**118 002**
Financial assets at fair value through profit and loss	397	–	–	**397**
Held-for-trading financial assets	3 595	4 773	4	**8 372**
Available-for-sale financial assets	45 445	8 054	962	**54 461**
Loans and receivables	81 874	77 487	1 639	**161 000**
Held-to-maturity financial assets	14 251	17 284	–	**31 535**
Other financial assets	6 974	5 396	564	**12 934**
Total financial assets	**409 759**	**196 218**	**14 527**	**620 504**
Financial liabilities				
Demand deposits with credit institutions	294	1 134	–	**1 428**
Derivatives	232	–	–	**232**
Financial liabilities carried at amortized cost	352 576	227 588	16 260	**596 424**
Other financial liabilities	248	950	53	**1 251**
Total financial liabilities	**353 350**	**229 672**	**16 313**	**599 335**
Assets (liabilities) arising from currency exchange				
Spot and forward transaction receivables	33 307	70 313	3 663	**107 283**
Spot and forward transaction liabilities	(68 907)	(36 774)	(1 679)	**(107 360)**
Net long/short currency position	**20 809**	**85**	**198**	**21 092**

The currency analysis of the Group is not significantly different from that of the Bank disclosed above.

41. CURRENCY ANALYSIS OF ASSETS AND LIABILITIES (BANK) (CONTINUED)

The Latvian banking legislation requires that the total foreign currency open position may not exceed 20% of the equity.

The EUR equivalent of assets and liabilities as at 31 December 2016 by the currencies in which they are denominated is as follows:

2016	EUR	USD	Other currencies	Total
EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Financial assets				
Cash and demand deposits with central banks	153 697	107	61	**153 865**
Loans and receivables from banks	41 782	120 630	18 729	**181 141**
Financial assets at fair value through profit and loss	301	2 654	90	**3 045**
Available-for-sale financial assets	21 373	47 625	–	**68 998**
Loans and receivables	38 329	75 133	1 458	**114 920**
Held-to-maturity financial assets	51 141	31 645	–	**82 786**
Other financial assets	12 382	2 561	62	**15 005**
Total financial assets	**319 005**	**280 355**	**20 400**	**619 760**
Financial liabilities				
Demand deposits with credit institutions	123	3 381	–	**3 504**
Derivatives	134	–	2	**136**
Financial liabilities carried at amortized cost	247 872	316 487	20 881	**585 240**
Other financial liabilities	997	1 000	221	**2 218**
Total financial liabilities	**249 126**	**320 868**	**21 104**	**591 098**
Assets (liabilities) arising from currency exchange				
Spot and forward transaction receivables	7 164	49 173	1 503	**57 840**
Spot and forward transaction liabilities	(48 705)	(8 354)	(571)	**(57 630)**
Net long/short currency position	**28 338**	**306**	**228**	**28 872**

The currency analysis of the Group is not significantly different from that of the Bank disclosed above.

42. REPRICING MATURITY ANALYSIS (BANK)

Interest rate risk relates to the changes in the value of the financial instrument as a result of changes in the market rates. As at 31 December 2017, interest rate re-pricing categories were:

2017 EUR'000	Up to 1 month including	From 1 to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	Over 5 years	Non interest bearing	Total, EUR'000
FINANCIAL ASSETS								
Cash and demand deposits with central banks	232 501	–	–	–	–	–	1 302	**233 803**
Loans and receivables from banks	–	–	4 980	417	–	–	112 605	**118 002**
Financial assets at fair value through profit and loss	–	–	–	–	–	–	397	**397**
Held-for-trading financial assets	99	20	–	–	6 348	1 756	149	**8 372**
Available-for-sale financial assets	3 334	428	4 677	5 026	39 985	–	1 011	**54 461**
Loans and receivables	62 376	10 610	13 306	38 763	34 301	999	645	**161 000**
Held-to-maturity financial assets	1 664	2 153	4 037	8 610	14 604	–	467	**31 535**
Other financial assets	–	–	–	–	–	–	12 934	**12 934**
Total financial assets	**299 974**	**13 211**	**27 000**	**52 816**	**95 238**	**2 755**	**129 510**	**620 504**
FINANCIAL LIABILITIES								
Demand deposits with credit institutions	–	–	–	–	–	–	(1 428)	**(1 428)**
Derivative financial instruments	(71)	(161)	–	–	–	–	–	**(232)**
Financial liabilities carried at amortized cost	(3 980)	(250)	(2 760)	(36 561)	(45 542)	(240)	(507 091)	**(596 424)**
Other financial liabilities	–	–	–	–	–	–	(1 251)	**(1 251)**
Total financial Liabilities	**(4 051)**	**(411)**	**(2 760)**	**(36 561)**	**(45 542)**	**(240)**	**(509 770)**	**(599 335)**
Interest rate risk net position	**295 923**	**12 800**	**24 240**	**16 255**	**49 696**	**2 515**	**(380 260)**	**21 169**
Interest rate risk gross (cumulative) position	**295 923**	**308 723**	**332 963**	**349 218**	**398 914**	**401 429**	**21 169**	**42 338**

The reprising maturity analysis of the Group is not significantly different from that of the Bank disclosed above.

42. REPRICING MATURITY ANALYSIS (BANK) (CONTINUED)

Interest rate risk relates to the changes in the value of the financial instrument as a result of changes in the market rates. As at 31 December 2016, interest rate re-pricing categories were:

2016 EUR'000	Up to 1 month including	From 1 to 3 months	From 3 to 6 months	From 6 months to 1 year	From 1 to 5 years	Over 5 years	Non interest bearing	Total, EUR'000
FINANCIAL ASSETS								
Cash and demand deposits with central banks	153 504	–	–	–	–	–	361	**153 865**
Loans and receivables from banks	49 333	12 897	–	–	–	–	118 911	**181 141**
Financial assets at fair value through profit and loss	1	89	–	–	2 851	49	55	**3 045**
Available-for-sale financial assets	14 286	23 749	14 194	–	15 324	–	1 445	**68 998**
Loans and receivables	64 399	2 761	5 578	15 281	25 552	1 134	215	**114 920**
Held-to-maturity financial assets	5 012	22 778	6 206	18 009	29 220	–	1 561	**82 786**
Other financial assets	–	–	–	–	–	–	15 005	**15 005**
Total financial assets	**286 535**	**62 274**	**25 978**	**33 290**	**72 947**	**1 183**	**137 553**	**619 760**
FINANCIAL LIABILITIES								
Demand deposits with credit institutions	–	–	–	–	–	–	(3 504)	**(3 504)**
Derivative financial instruments	(29)	(107)	–	–	–	–	–	**(136)**
Financial liabilities carried at amortized cost	(5 187)	(588)	(1 534)	(3 317)	(24 779)	(5 835)	(544 000)	**(585 240)**
Other financial liabilities	–	–	–	–	–	–	(2 218)	**(2 218)**
Total financial Liabilities	**(5 216)**	**(695)**	**(1 534)**	**(3 317)**	**(24 779)**	**(5 835)**	**(549 722)**	**(591 098)**
Interest rate risk net position	**281 319**	**61 579**	**24 444**	**29 973**	**48 168**	**(4 652)**	**(412 169)**	**28 662**
Interest rate risk gross (cumulative) position	**281 319**	**342 898**	**367 342**	**397 315**	**445 483**	**440 831**	**28 662**	**57 324**

The reprising maturity analysis of the Group is not significantly different from that of the Bank disclosed above.

43. MAXIMUM CREDIT ANALYSIS

The Bank's maximum exposure to credit risk is set out below. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

Maximum credit exposure

At 31 December EUR'000	Notes	Gross maximum credit exposure	
		Bank	Bank
		2017	2016
Cash and balances with central banks	15	233 803	153 865
Loans and receivables from banks	16	118 002	181 141
Financial assets at fair value through profit and loss	18	397	–
Held-for-trading financial assets	17, 33	8 372	3 045
Available-for-sale financial assets	19	53 660	68 009
Loans and receivables	20	161 000	114 920
Held-to-maturity financial assets	21	31 535	82 786
Other financial assets	26	12 932	15 005
Total financial assets		**619 701**	**618 771**
Outstanding letters of credit	34	–	–
Unused loan facilities	34	51 319	53 273
Unused credit card facilities	34	2 123	2 088
Guarantees	34	12 759	98
Total guarantees and commitments		**66 201**	**55 459**
Total maximum credit risk exposure		**685 902**	**674 230**

The maximum credit risk exposure analysis of the Group is not significantly different from that of the Bank disclosed above.

44. CAPITAL ADEQUACY CALCULATION (BANK)

	2017 EUR'000	2016 EUR'000
Tier 1		
Share capital	**39 493**	**39 493**
Statutory reserves	24	24
Retained earnings for the previous periods	**17 935**	**14 124**
Profit for the reporting period	4 831	7 811
Revaluation reserve – AFS financial assets	129	–
Other reserves	(2 418)	(2 400)
Intangible Assets	(1 321)	(1 214)
Other deductions	(169)	(104)
Reduction of Tier 1 capital (Pillar 2 adjustments)	**(279)**	**(430)**
Total Tier 1	**58 225**	**57 304**
Subordinated debt	**20 812**	**20 631**
Reduction of Tier 2 capital (Pillar 2 adjustments)	(279)	(430)
Tier 2 capital	**20 533**	**20 201**
Equity	**78 758**	**77 505**
Risk-weighted value		
Banking portfolio	**349 358**	**307 050**
Trading portfolio	13 769	5 317
Operating risk	58 549	55 975
Total risk exposure amount loan adjustment	16	–
Total risk weighted assets	**421 692**	**368 342**
Total capital as a percentage of risk weighted assets (total capital ratio)	**18.68%**	**21.04%**
Total tier 1 capital expressed as a percentage of risk-weighted assets ("tier 1 capital ratio")	**13.81%**	**15.56%**

As at 3l December 2017,the Bank's capital adequacy ratio was 18.68% (2016: 21.04%) which corresponds to the requirements set in the Basel Capital Accord and the regulations of the FCMC of Latvia.

45. FAIR VALUE OF FINANCIAL INSTRUMENTS

(a) Financial instruments measured at fair value

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised.

The Group and the Bank

31 December 2017	Published price quotations (1)	Valuation techniques based on market observable inputs (2)	Valuation techniques based on unobservable inputs (3)	Total
Financial assets				
Financial assets designated as at fair value through profit or loss:				
Fixed income securities	7 027	–	1 226	**8 253**
Financial assets	–	–	397	**397**
Derivatives	–	119	–	**119**
Available-for-sale assets				
Fixed income securities	53 660	–	–	**53 660**
Non fixed income securities and shares	–	583	218	**801**
	60 687	**702**	**1 841**	**63 230**
Financial liabilities				
Derivatives	–	232	–	**232**
	–	**232**	**–**	**232**

2016. gada 31. decembrī	Published price quotations (1)	Valuation techniques based on market observable inputs (2)	Valuation techniques based on unobservable inputs (3)	Total
Financial assets				
Financial assets at fair value through profit or loss:				
Fixed income securities	2 654	–	301	**2 955**
Derivatives	–	90	–	**90**
Available-for-sale assets				
Fixed income securities	68 009	–	–	**68 009**
Non fixed income securities and shares	–	459	530	**989**
	70 663	**549**	**831**	**72 043**
Financial liabilities				
Derivatives	–	136	–	**136**
	–	**136**	**–**	**136**

Included in category "Published price quotations" (Level 1) are financial assets and liabilities that are measured by reference to published quotes in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The main asset classes included in this category are financial assets for which the fair value is obtained via pricing vendors or binding broker quotes and assets for which the fair value is determined by reference to indices.

45. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Included in category 2 "Valuation methods based on market observable data" are financial assets and liabilities that are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions in the same instrument or based on available market data.

Not based upon market observable (Level 3) input means that fair values are determined in whole or in part using a valuation technique (model) base on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor are they based on available market data.

The following table shows the valuation techniques used in measuring Level 2 fair values:

Type	Valuation technique
Financial assets and liabilities designated as at fair value through profit or loss	Market comparison technique: The fair values are based on broker quotes. Similar contracts are traded in an active market and the quotes reflect the actual transactions in similar instruments.
Available-for-sale assets (VISA INC)	Valuation is based on financial indicators, including discounted cash flows and value of Bank's position with the price hedge

Under Level 3 of fair value hierarchy certain financial assets are classified, the fair value of which is measured based on estimated fair value of underlying assets.

Type	Valuation method	Significant unobservable inputs	Inter-relation between significant unobservable inputs and fair value measurement
Assets at fair value through profit or loss (illiquid bonds)	Valuation is based on financial indicators, including discounted cash flows.	Net assets	The estimated fair value would increase (decrease),if: Increase/(decrease) in net assets
Financial assets at fair value through profit or loss	Outlook of the court case and estimated proceeds	Court case's order	The estimated fair value would increase (decrease),if: Positive (negative) court case's order
Available-for-sale assets (Viduskurzemes AAO SIA)	Valuation is based discounted dividend model	Future net revenues; CAPEX	The estimated fair value would increase (decrease),if: revenue increases/ (decreases/ CAPEX decreases/ (increases

Changes in financial instruments of the Group/Bank classified as Level 3 in Fair Value Hierarchy:

31.12.2017

Financial assets at fair value	31.12.2016.	Acquired	Impairment allowance	31.12.2017.
Financial assets at fair value through profit or loss:				
Fixed income securities	301	925	–	**1 226**
Financial assets at fair value through profit or loss:		397		**397**
Available-for-sale assets				
Non fixed income securities and shares	530	–	(312)	**218**
Total financial assets at fair value	**831**	**1 322**	**(312)**	**1 841**

45. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

31.12.2016

Financial assets at fair value	31.12.2015.	Acquired	Impairment allowance	31.12.2016.
Financial assets at fair value through profit or loss:				
Fixed income securities	–	301	–	**301**
Financial assets at fair value through profit or loss:				
Available-for-sale assets				
Non fixed income securities and shares	530	–	–	530
Total financial assets at fair value	**530**	**301**	–	**831**

a. *Financial instruments not measured at fair value*

The table below analyses the fair values of financial instruments other than measured at fair value by the level in the fair value hierarchy into which each fair value measurement is categorised.

31 December 2017	Level 1:	Level 2:	Level 3:	Total fair value	Total carrying amount
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Financial assets					
Due from central banks	232 501	–	–	232 501	232 501
Loans and advances due from financial institutions	–	–	118 002	118 002	118 002
Loans to customers	–	–	161 000	160 768	161 000
Held-to-maturity instruments	28 979	–	2 556	31 880	31 535
Other financial assets	–	–	12 932	12 932	12 932
Financial liabilities					
Deposits and balances due to financial institutions	–	–	1 428	1 428	1 428
Deposits	–	–	596 424	596 475	596 424
Other financial liabilities	–	–	1 251	1 251	1 251

31 December 2016	Level 1:	Level 2:	Level 3:	Total fair value	Total carrying amount
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Financial assets					
Due from central banks	153 865	–	–	153 865	153 865
Loans and advances due from financial institutions	–	–	181 141	181 114	181 141
Loans to customers	–	–	114 209	113 937	114 209
Held-to-maturity instruments	80 001	–	2 785	83 553	82 786
Other financial assets	–	–	15 005	15 005	15 005
Financial liabilities					
Deposits and balances due to financial institutions	–	–	3 504	3 504	3 504
Deposits	–	–	585 240	585 281	585 240
Other financial liabilities	–	–	2 218	2 218	2 218

45. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following table shows the valuation techniques use in measuring Level 2 and Level 3 fair values, as well as the significant unobservable inputs used:

Veids	Vērtēšanas metode	Būtiski nenovērojami dati
Loans and advances due from financial institutions	Discounted cash flows	Discount rates
Loans	Discounted cash flows	Discount rates
Due to financial institutions	Discounted cash flows	Discount rates
Deposits	Discounted cash flows	Discount rates

46. EVENTS AFTER THE REPORTING PERIOD

Events, which occurred during 2018 through to the approval date of these separate and consolidated financial statements have adversely affected the stability of the financial sector of Latvia, and have also worsened its reputation, both locally and internationally.

On 13 February 2018, the Financial Crimes Enforcement Network (FinCEN) of the US Department of the Treasury issued a notice of proposed rulemaking (NPRM) under Section 311 of the US Patriot Act against one of the largest banks in Latvia. Following this announcement, that bank experienced an abrupt wave of withdrawal of deposits and a lack of access to USD funding. This resulted in that bank being unable to make payments in USD. On 19 February 2018, following an outflow of deposits from the said institution, the European Central Bank (ECB) instructed the Latvian prudential regulator to introduce a prohibition on outbound payments from that bank. On 23 February, ECB determined that that bank was failing or likely to fail in accordance with the Single Resolution Mechanism Regulation. On 26 February 2018, the shareholders of the said bank adopted a resolution to wind the bank up.

In response to the above developments, in March 2018, the Financial Sector Development Council of the Republic of Latvia proposed amendments strengthening the current AML/CTF (anti-money laundering and counter-terrorist financing) laws that are expected, among other things, to set a prohibition to service shell companies, which are considered to be companies without real substance as measured by certain criteria set out in law. Shell companies are primarily non-resident, and comprise part of the Bank's portfolio of non-resident customers.

The legislation, which is in the process of being drafted, is expected to be passed in April 2018 and come into force in May 2018with a specified transition period.

In addition, also since March 2018, the Bank has been in discussions with the Commission, who has expressed its expectation for the Bank to perform a further assessment of its customer portfolio as a basis for reducing over time its exposure to and business with customers not domiciled in the Republic of Latvia (non-resident customers), particularly those from CIS countries, in addition to the shell companies referred to above. No further criteria or timeframe have been specified in those discussions to date.

In this context, and given the fact that its past business model was substantially reliant on non-resident business, similarly to the bank described above (now in the process of liquidation), BlueOrange Bank is currently focusing its attention on all aspects of risk management, continues to make enhancements to its internal controls and other activities to develop its business and facilitate efficient detection of any signs of criminal transactions as described in Note 4(8) Management of money laundering and terrorist financing risk and the Customer Policy. The Bank is receiving ongoing consultations from Lewis Baach Kaufmann Middlemiss – an international company with substantial experience in AML/CFT procedures and compliance with international sanctions, and who have previously conducted readiness and compliance audits at the Bank in the past.

In 2018, through to the date of these separate and consolidated financial statements, the Bank's operations have been stable; the reputational and compliance crisis sparked by the developments in the financial market in Latvia has so far had no adverse financial effect on the Bank. The regulatory ratios for liquidity and capital adequacy have remained above those planned and above the minimum regulatory levels. Please refer to Note 47 Going concern for a description of further expedited measures planned by the Bank in relation to the pending changes in the AML/CTF laws and regulations and their impact on the Bank.

47. GOING CONCERN

(a) Assessed effects of the expected amendments to Latvian laws and regulations, and the Bank's response

As discussed in Note 46 Events after the reporting period, in March 2018, the government of the Republic of Latvia expressed its intent to strengthen the country's legal and regulatory framework for the banking sector. As part of the above, among other things, amendments are expected to be introduced to the country's anti-money laundering (AML/CFT) legislation during the first six months of 2018, as discussed in Note 46, specifically introducing the prohibition to service shell companies (entities without active business operations or significant assets). In addition to the above, discussions have been held by market participants, including the Bank, with the Commission, which may result in refocusing the Bank's business strategy away from, and further limiting its ability to conduct business with, other foreign (non-resident) customers.

In anticipation of the above pending legislative changes, and having evaluated the risks associated with further servicing of non-resident customers, the Bank has developed a plan, at the Commission's request, which assumes that it would, by 30th June 2018, cease servicing deposits of all shell companies and would also significantly reduce the number of other customers who are not residents of the Republic of Latvia.

As at the date of these financial statements the Bank has performed the process of customer segmentation and started giving notices to the relevant customers about the termination of their business relationship. To further foster the process and to limit any potential risk exposures, the Bank decided to restrict the provision of USD payment services to the majority of its non-resident customers from 20 April 2018. Please see the analysis of financial effects of these measures in section (b) of this note.

In addition, since the elevated reputational risks of the Latvian banking sector resulted in additional credit risk assessed in respect of each local bank, the Bank reduced the scope of cooperation with local banks (e.g. closing Loro accounts of certain local banks) and plans to keep it at such reduced level going forward.

The major market for the Bank will henceforth be Latvia and the EU and to this end the Bank plans to increase business with non-resident customers in EU and other OECD countries. The Bank plans to provide services to customers of all segments, including corporates, small and medium-sized companies and individuals. The key products currently offered on the local market are deposits, various types of loans, corporate finance, e-commerce services and POS terminals and credit cards. The bank is consistently expanding the range of services offered on the local market, in particular to the retail banking segment and to small and mid-sized businesses. Having considered the inherent market size limitations and the key success factors of the strategy introduced in 2016, the Board of Directors is currently considering the Bank's future business model to include the following key elements:

- By means of Internet platform solutions directed at EU-based individuals as well as small and mid-sized companies, offering products such as deposits, various types of loans and investment opportunities;
- Providing banking services to shipping companies, raw material traders and high net worth individuals domiciled in OECD countries. The product offering shall include various types of loans and wealth management services (portfolio management, broker services);
- Reducing the Bank's offering to customers in the CIS countries to an insignificant share of its total revenues. The Bank will principally focus on trading companies that use the Baltic transport infrastructure (ports, terminals), ship owners and high net worth individuals;
- Irrespective of the above measures, applying additional controls over the Bank's relationships with non-resident customers as part of its efforts to strengthen the overall internal control for AML/CTF risks (refer also to Note 4(8)); and,
- Significantly growing the lending business and the share of interest income. A large portion non-interest income is also expected to be comprised of income from servicing customer investments (brokerage and asset management).

(b) Effects of the de-risking measures on the Bank's projected future financial performance

The final results of the Bank's operations in 2017 indicate that the key financial objectives for the year under the base scenario set by the Bank management have been exceeded. The Bank's liquidity and capital adequacy ratios are above the planned as at 31 December 2017 – liquidity (actual 76.61% versus 65.2% planned) and capital adequacy (actual 18.68% versus 15.9% planned). Likewise, the developments in the Latvian financial market that took place in February and March 2018 have not so far had a significant impact on the Bank's or the Group's operational indicators and customer behaviour.

Nevertheless, following the closure of shell accounts, the Bank's self-imposed restriction on the provision of services in USD, and other measures as discussed in (a) above, the Board of Directors expects an outflow of deposits in the first six months of 2018 to amount to approximately EUR 320 million and for the level of customer deposits to remain stable thereafter, with the annual decrease in total assets amounting to EUR 210 million at the end of 2018 (at 31st December 2017, customer deposits in the Bank amounted to EUR 567 million and total assets to EUR 661 million). The Board of Directors has assumed that the outflow of customer deposits will result in a decrease in revenue (net interest and commission income) by 30%, and that a cut in administrative expenses of 50% would be needed to maintain profitability at the level compatible with 2017.

The Board of Directors believes that the planned fundamental changes in the Bank's business model, and also the restructuring and automation of internal processes, both as discussed in (a) above, will allow the Bank to implement the required cost cutting measures. The Bank plans to reduce its annual spending budget by EUR 9 million by, among others, closing of and/or cutting financial support for a number of foreign subsidiaries. Reducing staff costs and related expenses (workplace equipment, office machinery) by approximately 50% represent another measure to be implemented in the above context. In addition, the Board of Directors plans to reduce rent, advertisement and marketing, business trip and representation expenses.

As a result of the above, the liquidity ratio is expected to decrease, yet it is still expected to remain above the regulatory requirement (minimum of 60%). Likewise, the capital adequacy ratio is expected to be maintained above the regulatory levels.

In 2019, the Bank plans to further increase its loan portfolio and the related interest income. Regardless of the transformation of the business model, individual liquidity and capital adequacy ratios are expected to remain within the regulatory requirements and the Bank expects to generate profit in 2019. Assets at the end of 2019 are expected to amount to EUR 500 million.

(c) Going concern assumption

The Board of Directors believes that the activities and measures to be undertaken to fundamentally transform the Bank's business model should not have a material impact on its financial or operational stability. Among other things, as discussed above, all relevant statutory core ratios are expected to remain at the required minimum levels.

Nevertheless, the transformation is expected to have a direct effect on the expense and revenue structure, and will necessitate changes to the key business processes, as outlined above. The change in the customer base will enable the Bank to mitigate its compliance and reputational risks significantly.

Having considered the facts and circumstances laid out in the preceding paragraphs, management have prepared these separate and consolidated financial statements on the going concern basis, and they therefore do not include any adjustments that would have been required had the Bank not applied the going concern basis of accounting. As the transformation process is ongoing and the Bank, as previously outlined, is in discussions with the Commission regarding its high level development plan that is to transform into full business plan in the course of 2018, the management made certain judgements and assumptions related to future events disclosed above that form the basis for financial plans for 2018 and further years and allowed the management to conclude on the appropriateness of further application of the going concern basis in the preparation of these separate and consolidated financial statements. The Board of Directors recognises that material uncertainty exists in relation to the future outcomes of these events that may cast significant doubt on the Bank's and the Group's ability to continue as a going concern. The key sources of this uncertainty include:

- The outcomes of any potential fines and sanctions coming out of ongoing AML reviews conducted in the Bank (see Note 4(8) ***Management of the money laundering and terrorist financing risk and the Customer Policy);***
- The ability of the Bank and the Group to implement the measures, including their prior validation with the regulator in the course of development of full business plan, to reduce the regulatory, compliance and reputational risks in the timeframe outlined in paragraph (a) and (c) above;
- The ability of the Bank and the Group to demonstrate the practical viability of the new business model, including the attraction of business from new sources in a highly competitive environment and reduction in administrative expenses, outlined in paragraph (b) above.