*Notes to the Financial Statements*

## 1 INCORPORATION AND PRINCIPAL ACTIVITIES

AS DnB NORD Banka was established as Riga Commercial Bank on 26 June 1989. On 6 September 1991 it was incorporated in the Republic of Latvia as a joint stock company. The parent of the Bank is Bank DnB NORD A/S (Denmark) and the ultimate parent of the Bank is DnB NOR ASA (Norway).

The Bank offers a wide range of financial services to enterprises and individuals.

These financial statements were authorised for issue by the Supervisory Council and the Management Board on 12 March 2007.

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

*a) Reporting Currency*

The accompanying financial statements are reported in thousands of lats (LVL`000), unless otherwise stated.

*b) Basis of Presentation*

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in EU. The financial statements are prepared under the historical cost convention as modified by the revaluation of financial assets at fair value through profit or loss, derivative contracts and the Bank's buildings.

The preparation of financial statements in conformity with IFRS as adopted in EU requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

*c) Consolidation*

Subsidiary undertakings in which the Bank, directly or indirectly, has the power to exercise control over financial and operating policies, have been consolidated.

Subsidiaries are consolidated from the date on which effective control is transferred to the Bank and are no longer consolidated from the date of disposal. All intercompany transactions, balances and unrealised surpluses and deficits on transactions between Group companies have been eliminated.

*d) Income and Expense Recognition*

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest rate method. Interest income includes coupons earned on fixed income investment securities.

When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

*d) Income and Expense Recognition (continued)*

Commissions received or incurred in respect of assets or liabilities are deferred and recognised as an adjustment to the effective interest rate on the asset or liability. Other commissions and fees are credited and/ or charged to the income statement as earned/ incurred.

*e) Foreign Currency Translation*

Transactions denominated in foreign currencies are recorded in lats at actual rates of exchange set forth by the Bank of Latvia at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the rate of exchange prevailing at the end of the period. Any gain or loss resulting from a change in rates of exchange subsequent to the date of the transaction is included in the income statement as a profit or loss from revaluation of foreign currency positions.

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

| *Reporting date* | USD | EUR |
|---|---|---|
| As at 30 September 2007 | 0.497 | 0.702804 |
| As at 31 December 2006 | 0.536 | 0.702804 |

*f) Corporate income tax*

Corporate income tax for the reporting period is included in the financial statements based on the management's calculations prepared in accordance with Latvian Republic tax legislation.

Deferred tax is provided in full, using the liability method, on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The deferred tax liability is calculated using the tax rates that have been enacted or substantially enacted by the balance sheet date and that are expected to apply when the temporary differences reverse. The principal temporary differences arise from different fixed asset depreciation rates, as well as tax losses carried forward. Where an overall deferred taxation asset arises, it is only recognised in the financial statements to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

*g) Cash and Cash Equivalents*

For purposes of the cash flow statements cash and cash equivalents comprise cash balances, balances due from the Central Banks, due from other credit institutions with original maturity up to 3 months, less balances on demand due to other credit institutions.

*h) Loans and receivables and provisions for loan impairment*

Balances due from banks and loans and advances to customers are accounted for as loans and receivables and are carried at amortised cost. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active markets. All loans and advances are recognised in the balance sheet when cash is advanced to borrowers. For the purposes of these financial statements, finance lease receivables are included in loans and advances to non-banking customers.

A credit risk provision for loan impairment is established if there is objective evidence that the Group or the Bank will not be able to collect all amounts due. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of the loans.

The Group and the Bank first assess whether objective evidence of impairment exists individually for significant loans. Loans that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment. If the Group and the Bank determines that no objective evidence of impairment exists for an individually assessed loan, it is included in a group of loans

*h) Loans and receivables and provisions for loan impairment (continued)*

with similar credit risk characteristics and collectively assessed for impairment. For the purposes of a collective evaluation of impairment loans are grouped on a basis of similar credit risk characteristics.
The Group and the Bank review their loan portfolios to assess impairment on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Group and the

Bank make judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and current economic climate in which the borrowers operate. The methodology and assumptions used are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Nevertheless, it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the asset or liability affected.

When a loan is uncollectible, it is written off against the related provision for impairments; subsequent recoveries are credited to the income statement.

Provisions for loan impairment are made in the currency of the related asset and are subject to revaluation at period end at the rate set by the Bank of Latvia. Foreign exchange rate differences arising from such revaluation are recorded in the income statement as additional provisions or income from the recovery of existing provisions (if any). The corresponding result of revaluing the respective asset covered by the provisions is recorded as profit/ loss to foreign currency transactions.

*i) Leases - when the Group or the Bank is a lessor*

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

Assets under operating leases are recognised as fixed assets at historical cost net of accumulated depreciation. Depreciation is calculated on a straight-line basis to write off the cost of each asset to its residual value over the estimated useful life of fixed assets that is determined based on useful lives of similar assets of the Group and the Bank. Rentals receivable under operating leases are credited to the income statement on a straight-line basis over the lease term.

If a sale and leaseback transaction results in an operating lease and the sales price is above fair value of the asset sold, the excess over fair value is deferred and amortised over the period for which the asset is expected to be used.

*j) Financial assets at fair value through profit or loss*

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management.

Financial assets at fair value through profit or loss are measured at fair value based on quoted bid prices. In the absence of the active market, the fair value of financial assets at fair value through profit or loss is derived from the value of an instrument that is substantially the same or from discounted cash flow models. Gains and losses arising from changes in the fair value of financial assets are recognised in the income statement.
Interest earned whilst holding financial assets at fair value through profit or loss is recorded as interest income.

All regular way purchases and sales of financial assets at fair value through profit or loss are recognised at trade date, which is the date that the Group and the Bank commits to purchase or sell the asset.

*k) Investment securities – held to maturity*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's and the Bank's management has the positive intention and ability to hold to maturity.

*k) Investment securities – held to maturity (continued)*

Were the Group or the Bank to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale. Held-to-maturity securities are carried at amortised cost.

*l) Subsidiaries*

Investments in subsidiaries in the Bank's financial statements are accounted for under the cost method.

The Bank recognises income from investment only to the extent that the Bank receives dividends from the accumulated profit of the subsidiaries arising after the date of acquisition.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill.

*m) Property and Equipment*

All property and equipment are recorded at cost or valuation less accumulated depreciation.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Depreciation is provided using the straight-line method to write off the cost or revalued amount of each asset to their residual value over the estimated useful life of the asset. The following depreciation rates have been applied:

| *Category* | *Annual Rate* |
|---|---|
| Buildings | 1% |
| Office equipment | 20% - 25% |
| Vehicles | 20% |

Maintenance and repair costs are charged to the income statement as incurred. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

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

*n) Intangible assets*

Acquired computer software licences are recognised as intangible assets on the basis of the costs incurred to acquire and bring to use the software. These costs are amortised on the basis of their expected useful lives, not exceeding five years.

*o) Derivative financial instruments and hedging*

Derivative financial instruments including foreign exchange contracts and interest rate swaps are initially recognised at cost and subsequently are re-measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Changes in the fair value of derivatives are reported in the income statement.

The Group and the Bank document, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as risk management objective and strategy for undertaking the hedge transaction. The Group and the Bank also document its assessment, both at hedge inception and on an ongoing

*o) Derivative financial instruments and hedging (continued)*

basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged liability that is attributable to the hedged risk.

The Group uses cash flow hedges to hedge partly or in full the variability of cash flows of the hedged item.

The portion of a loss of the hedging instrument that is determined to be an effective hedge is recognised directly in equity as "Revaluation reserve".

The fair values of financial instruments that are not quoted on active markets are determined using valuation techniques (for example, models). Models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

*p) Borrowings*

Borrowings are recognised initially at fair value net of transaction costs incurred (fair value of consideration received). Borrowings are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

*q) Employee benefits*

The Group and the Bank pay social security contributions for state pension insurance and to the state funded pension scheme in accordance with Latvian legislation. State funded pension scheme is a defined contribution plan under which the Group and the Bank pay fixed contributions determined by the law and they will have no legal or constructive obligations to pay further contributions if the state pension insurance system or state funded pension scheme are not able to settle their liabilities to employees. The social security contributions are recognised as an expense on an accrual basis and are included within staff costs.

The provision for employee holiday pay is estimated for the Group's and the Bank's personnel based on the total number of holidays earned but not taken and average salary of employees including social security expense.

*r) Off-balance sheet items*

In the ordinary course of business, the Group and the Bank have been involved with off-balance sheet financial instruments consisting of commitments to extend loans and advances, financial guarantees and commercial letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

*s) Fair values of financial assets and liabilities*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Where in the opinion of the management, the fair values of financial assets and liabilities differ materially from their book values, such fair values are separately disclosed in the notes to the accounts.

*t) Off-setting financial instruments*

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liability simultaneously.

## 3 ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS AND NEW ACCOUNTING PRONOUNCEMENTS

Certain new IFRSs became effective for the Group from 1 January 2006. Listed below are those new or amended standards or interpretations which are relevant to the Group's operations and the nature of their impact on the Group's accounting policies. All changes in accounting policies were applied retrospectively with adjustments made to the retained earnings as at 1 January 2005, where appropriate, unless otherwise described below.

a) *IFRIC 4, Determining whether an arrangement contains a lease (effective from 1 January 2006).* IFRIC 4 requires that determining whether an arrangement is, or contains, a lease be based on the substance of the arrangement. It requires an assessment of whether (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. The Group reassessed its arrangements and concluded that no adjustments are required as a result of the adoption of IFRIC 4.
b) *IAS 39 (amendment) – The Fair Value Option (effective from 1 January 2006).* IAS 39 (as revised in 2003) permitted entities to designate irrevocably on initial recognition practically any financial instrument as one to be measured at fair value with gains and losses recognised in profit and loss ("fair value through profit and loss"). The amendment changes the definition of financial instruments at "fair value through profit and loss" and restricts the ability to designate financial instruments as part of this category. The adoption of the amendment to the standard has not required the Group to change its accounting practices in respect of this category.
c) *IAS 39 (amendment) – Financial Guarantee Contracts (effective from 1 January 2006).* As a result of this amendment, the Group measures issued financial guarantees initially at their fair value, which is normally evidenced by the amount of fees received. This amount is then amortised on a straight-line basis over the life of the guarantee. At each balance sheet date, the guarantees are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at balance sheet date. This amendment did not have a significant effect on these financial statements.

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2007 or later periods which the Group has not early adopted:

a) *IFRS 7, Financial Instruments: Disclosures (effective from 1January 2007).* The IFRS requires disclosures to improve the information about financial instruments with an emphasis on quantitative aspects of risk exposures and the methods of risk management. IFRS 7 will require increased more quantitative sensitivity analysis and disclosure in the financial statements in relation to the Group's holdings of financial instruments.
b) *IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007);*
c) *IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006);*
d) *IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 March 2007);*
e) *IFRIC 11, IFRS 2 – Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007).*

## 4 FINANCIAL RISK MANAGEMENT

*a) Credit risk*

The Group and the Bank take on exposure to credit risk which is that a counterparty will be unable to pay amounts in full when due. The Group and the Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved by the Board.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

*b) Currency risk*

Upon normal business conditions the Group and the Bank take on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Currency risk is the risk that the Bank incurs losses as a consequence of unfavourable changes in foreign exchange rates. For assessment of this risk open FX positions are used. The Bank follows very conservative currency risk management policy. Currency risk is at low level due to insignificant volumes of open positions in foreign currencies.

*c) Interest rate risk*

Upon normal business conditions the Group and the Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk is the risk that the Group and the Bank incurs losses as a consequence of unfavourable changes in interest rates. For assessment and management of this risk sensitivity to changes in interest rates is calculated and limited (1 bp value). Such risks are monitored on a rolling basis and are subject to annual or more frequent review.

*d) Liquidity risk*

The Group and the Bank are exposed to possible cash flows inconsistency risk arising out of usage of available cash resources for further objectives: repayment of overnight deposits, current accounts liabilities management, repayment of maturing deposits, granting committed loans, guarantees, to fulfil margin and other liabilities related to derivatives. The Group and the Bank do not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

Note 40 analyses assets and liabilities of the Group and the Bank into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date. The Group's and the Bank's liabilities on demand exceed assets with similar duration, however, the Group`s and the Bank's liquidity ratio, calculated using the methodology approved by the Financial and Capital Market Commission (FCMC), is 45%. The FCMC requires that the liquidity ratio should not be less than 30%. In the opinion of the management of the Bank, the Group's and the Bank's liquidity is sufficient to meet its operating needs. Such risks are monitored on a rolling basis and are subject to annual or more frequent review. Liquidity risk is also assessed and managed according to the methodology, set by DnB NORD Group Asset and Liability Management Committee (ALCO). This risk is limited with the liquidity risk limits, approved by ALCO.

*e) Market risk*

Market risk – is the risk that the Group and the Bank incur losses as a consequence of changes of market variables (interest rates, foreign exchange rates, stock prices). Methodology and limits of market risk assessment and management are approved by DnB NORD Group ALCO.