

9. Companies listed in Riga

9.1 On the Riga Stock Exchange we find an official and second list. Only official list companies have been required to apply IAS/IFRS to date. There are four companies on the official list at the present time. To date, the companies on the second list have been required to apply local GAAP. As of 2005 they are required to apply IFRS when preparing their consolidated accounts in accordance with exchange regulations.

9.2 Local GAAP consists of three laws regulating accounting – the Law on Accounting, Law on Annual Accounts of Undertakings and Law on Consolidated Annual Accounts, which are in line with the European accounting directives and the standards promulgated by the Accounting Standards Board. The new Board, established in 2003 has issued two standards, which are in line with IAS - LAS 1 – Presentation of Financial Statements and LAS 2 – Cash Flow Statements.

9.3 Listed companies may apply IFRS in their separate accounts, if and only if, IFRS is in conformity with Latvian GAAP. We do not believe that this judgment call should be left to individual companies and believe that few will make this call. Latvian GAAP is tax-driven, regardless of the fact that the reconciliation method is used for tax reporting.

9.4 The financial statements of listed companies posted on the Riga exchange's website included an MD&A section and financial statements. However, some of the current list MD&A's reviewed, consisted of 1-2 pages and either included the minimum information required by law or less. It should be noted that second list companies are required to come into the IFRS fold for the first time at year-end 2004, in accordance with exchange regulations.

9.5 We expect a number of companies on the second list to run into significant problems when applying IFRS. The major problem is the lack of disclosure. There are those who would say that the less they disclose the less we can find to criticize. This is in fact true, but only regarding the reviewers. Without the narratives and explanations we have no way of knowing how they arrived at a particular number in the financial statements and cannot judge whether they have or have not complied with IFRS. Investors are discerning and will just walk away from these companies.

9.6 A number of companies' financial statements explicitly express a "spirit" of noncompliance and nondisclosure. Though we did not set out to rank, we must admit that the financials audited by smaller audit firms disclose less, are badly translated and often include information, which is inexplicable. In one case every single debtor and creditor is shown by name in an attached table, but there are no accounting policy descriptions, narratives or explanations.

9.7 We encourage companies to read each other financial statements. SAF Tehnika's IFRS statements issued in October 2004 make for excellent reading. For the section on accounting policies, we suggest that second list companies look to the main list companies and use exactly the same wording (at least in English). This is a cut and paste exercise. The Big 4 have standardized templates so we would expect all the clients of one firm to use the same wording for accounting policies. This is

economically rational. We do however expect companies' to include entity-specific narratives in the notes.

9.8 The columns to the right in the table below confirm whether segmental data and the financial risks to be disclosed under IAS 32 (credit, fair value, interest rate, etc) were included in the financials. The final column has been used to show whether there was a MD&A section, whether it featured share price movements or if only a cursory description of the entity's establishment and operations were provided in the notes. MSR under MD&A means that management included a statement of responsibility for preparing the financial statements. Please note that only two companies included a MSR. A British company audited one of them and MSRs are standard in the UK. The second has Estonians on its supervisory board and MSRs are standard in Estonia.

Company Name	Business	GAAP	Eng	Consolidated	Auditor	Seg	Risks	MD&A
Latvijas Gazē	Fuel	Lat GAAP Should be IFRS?	Yes	Y	PwC	N	N	Y
Latvijas Kuģniecība Latvian Shipping Company	Shipping	IFRS	Yes	Y	Moore Stephens	Y	Y	Y MSR EPS
SAF Tehnika	Micro-wave technology for mobile services industry	Lat GAAP in 2003, IFRS in 2004	Yes	Y	PwC	Y	Y	Y MSR EPS
Venspils Nafta	Oil and oil products, printing, publishing, real estate	IFRS and Lat GAAP	Yes	Y G&P	E&Y Emphasis	Y	Y	Y EPS
Secondary list								
Ditton Pievadķēžu rūpnīca	Manufacturing of vehicle components – primary, chains	Lat GAAP	No	No Two subsidiaries = long-term investments.	BDO Invest Riga Daugavpils	N	N	1 pg.
Grindeks	Pharma-	Lat GAAP	Yes	Y	D&T	N	V	Yes. EPS

	ceuticals							
Latvijas Balzāms	Alcoholic beverages	Lat GAAP	Yes	Y	PwC	N	N	1pg.
Liepājas Metalurģis	Ferrous metallurgy	Lat GAAP	Yes	Y. E/Lat not identical	BDO Invest Riga	N	N	Y
Olaines ķīmiski - farmaceitiskā rūpnīca	Pharmaceuticals	Lat GAAP	Yes	No. 27pp. Cost by nature	KPMG Emph	N	N	Y
Rīgas Kuģu būvētavā	Shipyards	Lat GAAP	Yes	No	KSIA Orients N Emph	N	N	Y MSR
Rīgas Transporta flote	Shipping	Lat GAAP	Yes	Y	Evald Figur-nov	N	N	Y
Valmieras stikla šķiedra	Marbles and fiberglass	IFRS and Lat GAAP	Yes	No Cost by nature	D&T	N	N	Y EPS

10 Issues

10.1 Basis of preparation

IFRS requires that the financial statements include an unreserved declaration of compliance with IFRS. If Latvian legislation allows companies to apply IFRS then this should be the explanation used. The reference to accounting data being compiled in accordance with Latvian legislation leads us to believe that this is a restated financial statement. This confuses the user. A company either is or is not in compliance with IFRS.

Basis of preparation

The financial statements have been prepared in accordance with the law of the Republic of Latvia, International Financial Reporting Standards (IFRS) and the Company's articles of association. The financial statements have been prepared on the basis of accounting data in accordance with the legislation of the Republic of Latvia. The financial statements have been prepared on the historical cost accounting basis.

The accompanying financial statements are presented in the national currency of Latvia, the lat ("LVL").

10.2 Allowances for obsolete inventories and doubtful receivables

Consolidated profit and loss account for the year ended 31 December 2003

	Notes	2003 Ls	2002 Ls
1. Net sales	1	119,434,607	106,243,521
2. Cost of sales	2	(99,940,927)	(86,605,430)
3. Gross profit		<u>19,493,680</u>	<u>19,638,091</u>
5. Administrative expenses	3	(4,799,218)	(5,051,433)
6. Other operating income	4	186,235	237,802
7. Other operating expenses	5	(813,747)	(759,986)
8. Profit from investments in subsidiary undertakings and associated companies	26	319,306	-
9. Income from disposal of long term financial investments	12	-	230,955
10. Interest and similar income	6	1,741,977	1,640,765
11. Revaluation of long term financial investments and short term securities	7	644	(127)
12. Interest and similar expense	8	(18,558)	(466,093)
14. Provisions for bad and doubtful debts, net	14	80,028	(102,183)
15. Provisions for obsolete and slow moving inventories, net	13	(195,574)	(71,088)
16. Profit before taxes		<u>15,994,773</u>	<u>15,296,703</u>
17. Corporate income tax for the reporting year	9	(2,709,728)	(2,844,818)
18. Other taxes	21	(269,635)	(259,510)
19. Current year's profit		<u>13,015,410</u>	<u>12,192,375</u>

Notes on pages from 14 to 28 form an integral part of these consolidated financial statements.

One wonders why “provisions” for receivables and inventory are shown after financial items. Provisions under IAS 37 are liabilities. We suggest calling impairment losses on inventory or receivables allowances. These allowances are clearly related to operations and should affect operating income. The positioning above seems to imply that these are extraordinary items. There is nothing extraordinary about either of these items. IFRS no longer allows any items to be designated as extraordinary (revisions December 2003).

We encourage companies to group their expenses appropriately and take notice of the fact that extraordinary items are bygone.

10.3 Provisions contra allowances

Vacation pay and bonus accruals are not provisions according to IAS 37. We believe that the simplest way to explain provisions is that one party reports a liability but nobody else can report a receivable. Let's take the case of accrued vacation pay. The entity reports a liability and the physical person, should they compile a balance sheet, could report a receivable. This is a contractual obligation between two determinable parties. Bonuses are also contractual obligations. Deferred taxes are

however a provision as one party records a liability but no one else can record a receivable, as there is no legal claim.

We encourage companies to disaggregate accrued liabilities from provisions.

IAS 37

11. Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

(a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, **amounts relating to accrued vacation pay**). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

(k) Provisions

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

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave based on actual number of outstanding days of paid leave as at the end of the reporting period multiplied by the average daily salary over the last six months of each employee.

(19) Provisions	Provision for deferred taxes	Provisions for unused annual leave	Provisions for bonuses for reporting year's financial results	Provisions for liabilities	Total
	Ls	Ls	Ls	Ls	Ls
At the beginning of the reporting year	705,715	411,911	1,215,597	670,000	3,003,223
Increase	500,334	16,706	1,068,987	-	1,586,027
Decrease	-	(2,675)	(1,075,984)	-	(1,078,659)
Decrease due to sale of investment in subsidiary	(49,340)	(105,036)	-	-	(154,376)
At the end of the reporting year	<u>1,156,709</u>	<u>320,906</u>	<u>1,208,600</u>	<u>670,000</u>	<u>3,356,215</u>

10.4 Cash flows and “provisions”

Consolidated Annual Accounts
for the year ended 31 December 2003

Consolidated cash flow statement for the year ended 31 December 2003

	Notes	2003 Ls	2002 Ls
Cash flow from operating activities			
Profit before taxes		15,994,773	15,296,703
<u>Adjustments for:</u>			
- depreciation and amortisation	2, 3, 5	4,341,423	3,840,534
- impairment charge of fixed assets	11	3,537,800	-
- profit from sale of investment in subsidiary	26	(319,306)	-
- other taxes	21	(269,635)	(259,510)
- provisions for inventories	13	195,574	71,088
- provisions for bad and doubtful debts	14	(80,028)	102,183
- provisions for long-term financial investments	12	(644)	127
- provisions for bonuses for reporting year's financial results	19	(6,997)	(231,396)
- provisions for unused annual leave	19	14,031	(168,721)
- other provisions	19	-	670,000
- (profit) / loss from disposal of fixed assets	4	16,277	(124,230)
- profit from disposal of securities	12	-	(230,955)
Cash flow from operating activities before changes in net current assets		23,423,268	18,965,832
Inventories (increase) / decrease		(3,535,362)	7,267,882
Trade debtors' (increase) / decrease		1,393,778	(798,069)
Other debtors' (increase) / decrease		397,308	(275,633)
Other creditors' increase		2,405,809	1,180,069
Trade creditors' increase / (decrease)		1,830,530	(74,740)
Cash generated from operations		25,915,331	26,265,332
Corporate income tax paid	21	(2,923,240)	(3,303,309)
Net cash flow from operating activities		22,992,091	22,962,023

IAS 7 states that under the indirect method for presenting cash flows from operations income should be adjusted for

- (a) changes during the period in inventories and operating receivables and payables;
- (b) non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed profits of associates, and minority interests; **and**
- (c) **all other items** for which the cash effects are investing or financing cash flows.

At first glance we failed to understand why “provisions” and vacation pay accruals are added/deducted as these items clear out via the changes in working capital calculation. We suspect that the reason lies in the word **provision**. These items are not provisions in accordance with IAS 37. They are allowances. Accruing vacation pay does not result in a reserve. It is an accrual. Please see IAS 37, 11b.

The down-side of adding back allowances and accruals is that the user cannot confirm the amount presented for changes in working capital by comparing the opening and closing balances (net of allowances and including accruals) of working capital line items in the balance sheet.

We encourage management to reconsider adding back “provisions” and vacation pay accruals when using the indirect method.

10.5 Materiality

Please consider the capitalization threshold for fixed assets against the backdrop of total assets shown below. We encourage management to review this accounting policy.

Group's policy is to capitalise tangible assets with cost exceeding Ls 50 and useful life exceeding 1 year.

<u>Total assets</u>	<u>113,345,849</u>	<u>105,008,081</u>
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10.6 Management's Statement of Responsibility

Below please find an example of best practice. Similar statements were provided in the financial statements of two Latvian listed companies. However, we would expect these to be signed.

STATEMENT OF BOARD'S RESPONSIBILITY

The Board of SAF Tehnika A/S (the Company) is responsible for the preparation of the consolidated financial statements of the Company and its subsidiary (the Group).

The financial statements on pages 4 to 26 are prepared in accordance with the source documents and present fairly the financial position of the Group as of 30 June 2004 and the results of its operations and cash flows for the year ended 30 June 2004.

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

The Board of SAF Tehnika A/S is responsible for the maintenance of proper accounting records, the safeguarding of the Group's assets and the prevention and detection of fraud and other irregularities in the Group. They are also responsible for operating the Group companies in compliance with the legislation of their domicile countries (the Republic of Latvia and Sweden).

On behalf of the Board,

Normunds Bergs
Chairman of the Board

14 October 2004

10.7 Goodwill

The amortization of positive or negative goodwill has never been a financial item as goodwill is not a financial instrument. It was an operating item. We use the past tense, as goodwill is no longer amortized under IFRS.

In accordance with the new standard on business combination, IFRS 3, negative goodwill should not exist. If the fair values of the net assets acquired exceed the cost of the investment, the fair values of the identified assets and liabilities should be reviewed. Special attention should be given to liabilities, ensuring that all liabilities have been accounted for. If the excess of fair values over cost remains, negative goodwill is taken to income.

6. Other Financial Items

	US \$ '000s	
	2003	2002
Gain on disposal of available –for-sale investment	602	-
Negative Goodwill	151	-
Mortgage fee and insurance	(71)	(75)
Prepaid financing expenses amortization	(98)	(111)
Bank charges	(566)	(493)
TOTAL	18	(679)

10.8 Allowances

Though this entity reported under Latvian GAAP, the reviewers find it highly unusual to find that there were no allowances – either for inventories or uncollectible receivables.

18. OTHER OPERATING EXPENSES

	2003	2002
	LVL	LVL
Infrastructure expenses	80,973	100,744
Sponsorship	55,749	47,928
Loss of disposal of fixed assets	-	965,373
Penalties paid	6,460	2,396
Social expenses	4,135	1,595
Bad debts written off	-	98,825
Previous period expenses	-	92,258
Provisions for bad debts	-	77,664
Provision for slowing moving stock	-	14,129
Other	283,937	235,565
Total	431,254	1,636,477

10.9 Deferred income

Though the company reported under Latvian GAAP, it should be pointed out that the treatment described below is not in line with IFRS. Under IFRS, cost = the consideration given and liabilities incurred.

The company will be a first-time adopter for year-end 2004. The cost of the land is equal to the cost of the vouchers and any additional cash paid. As a first-time adopter, the company may use cost under previous GAAP or fair value as deemed cost when preparing their IFRS opening balance sheet. However, the “Deferred income” item must be derecognized.

In 2000 PJSC “Grindeks” concluded 3 contracts with the Latvian Republic Privatisation Agency about the purchase of state land for its cadastral value. According to purchase contracts, payments were made by state compensation vouchers and in cash. PJSC Grindeks recorded the difference between the purchase price of the state property, which approximates nominal value of state compensation vouchers, and the cost of vouchers in the account “Deferred income” which will be amortized over 5 years. In 2003 LVL 20,904 was recorded as income.

10.10 Cash flows

The following cash flow statement is inexplicable.

Consolidated annual report for year 2003

CASH FLOW BY DIRECT METHOD

1. Cash flow of economic activity:	year 2003
income	292295521
expenses	284901048
net cash income of the economic activity	7394473
2. Cash flow of investment activities	
income	1736
expenses	3940342
net income from investment operations	-3938606
3. Cash flow of financial activities	
income	1636754
expenses	3138355
net income from financial activities	-1501601
4. Cash income surplus over cash expenses	1954266
5. Balance of cash and it's equivalent at the beginning of review period	184997
6. Balance of cash and it's equivalent at the end of review period	2139263

Cash flows from operations can be presented using either the direct or indirect methods. Neither method seems to be in evidence. Cash flows from investing and financing activities are presented on a gross basis per category of assets and liabilities. The company has only presented total income and expenses per activity, as well as the difference between these two items. This is in itself a misnomer, as

the cash flow statement should present cash flows – not income or expenses. No additional explanations are provided.

10.11 Equity and Subscribed Capital

Survey of equity capital changes for year 2003

	Fixed capital	Revaluation reserve of long-term investments	Other reserves	Reserves stated by the Law and Statutes	Undistributed profit of the previous years	Undistributed profit of the review year	Equity capital TOTAL
As at 01.01.2003.	17476033	15371318	0	435116	-164214	1246235	34364488
Profit of year 2002 counted in reserves or transmitted from other reserves			1325429	-58503	73306	-1246235	93997
Dividends for year 2002							
Undistributed profit of the review period						2418927	2418927
Fixed capital decreased for the unpaid share	-495000						-495000
The losses covered from reserves							
Decrease of revaluation reserve		-53018					-53018
Incomes from participation in daughter or associated enterprises			54024				54024
As at 31.12.2003.	16981033	15318300	1379453	376513	-90908	2418927	36383418

Please note that fixed capital and equity have been decreased in the amount of unpaid shares.

As there are no explanations in the notes to the financial statements, we can only speculate regarding the problem.

In accordance with the European company directives, equity can be increased in two ways.

1. New shares are subscribed. If new shares are subscribed, we credit share capital and debit a receivable against the subscriber. By subscribing, the subscriber has a right to receive the shares and the company has the right to receive payment for the shares. There is a line item for this receivable in the balance sheet formats presented in the fourth company directive. Companies are required to create a reserve for this amount, but this is just a matter of reallocating retained earnings.

This would mean that share capital would not equal registered share capital. Depending on the conditions of the subscription, the subscriber may have up to a year to pay. This is considered a problem, as the share capital increase

cannot be registered until the shares are paid for. This has been a problem in all three Baltic States and has been tackled in different ways. There were those that have proposed that the obligation to deliver shares should be a liability. The obligation to deliver shares is an equity instrument under IAS 32 and 39. The solution found in Estonia is that the unpaid issue is shown on a separate line item under equity. This is also in line with IFRS.

2. An increase is declared without being subscribed. This increase in share capital is recorded on a cash basis.

10.12 Related parties

We were impressed with the detail with which the affiliations of management and supervisory boards were disclosed.

30. Participation and duties of the Board and Council members and management of the Company and other companies

Name, surname	Company name	Participation of Olainfarm in the share capital of a company, %	Management function (position held)
Valērijs Maligins	SIA Olmafarm	100.00	General Manager
	A/s Aroma	100.00	President
	SO Aid foundation of Latvian Academic Library	-	
	Nature renewal foundation	-	
	Vitkupe	-	
	SIA Olfa Press	45.00	
	SIA Carbochem	50.00	
Juris Savickis	A/s Nordeka	48.09	Chairman of Council
	A/s Sibur Itera	-	Deputy Chairman of Council
	A/s VEF banka	-	Deputy Chairman of Council
	A/s Latvijas Gāze	-	Deputy Chairman of Council
	A/s Latvijas Krājbanka	1.02	
	SIA Elssa-SIA	55.00	President
	SIA Itera Latvija	-	President, Board of Directors
	SIA SMS Elektro	34.00	
	SIA SWH Sets	22.22	
	SIA Ajura	50.00	
	SIA Blūza Klubs	50.00	
	SIA Bobrova Nams	21.25	
	SIA Salve INTL	30.00	
	SIA Hominus	25.00	
	SIA Trans Quadrant Rīga	51.02	
	SO Latvijas Tenisa savienība	-	President
BO Četri Pluss	-	Board	
SO tenisa klubs Prezidents	-	Board	
SO tenisa klubs Altitude	-	Chairman of Board	
Margarita Samoviča	SIA Legata	100.00	Director

10.13 Financial instruments

A number of companies stated that they have no financial instruments (FI) and did not disclose their accounting policies for FI. It should be pointed out that cash and

trade receivables are financial instruments and as such we would expect all companies to have financial instruments.

Below please find an example of the necessary disclosures. In addition we would like to see credit, liquidity and other risks disclosed under IAS 32.

Financial instruments

Financial assets and financial liabilities are recognized on the Company's balance sheet when the Company has become a party to the contractual provisions of the instrument.

Derivative financial instruments

The Company uses foreign currency forward contracts to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and forecasted transactions. Such derivatives are initially recorded at cost, if any, and are remeasured to fair value at subsequent reporting dates.

Changes in the fair value of derivative financial instruments are recognized in the income statement as they arise.

Trade receivables

Trade receivables are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

17. DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes currency derivatives to hedge significant future transactions and cash flows. The Company is a party to a variety of foreign currency forward contracts in the management of its exchange rate exposures. The instruments purchased are for Euro exchange into Lats at pre-agreed rate.

As at 31 December 2003, total notional amount of outstanding forward foreign exchange contracts that the Company has is EUR 9,250,000.