
Latvenergo
2017
SUSTAINABILITY
AND ANNUAL REPORT

Energy production starts with a relationship with nature. By using opportunities provided by the environment responsibly and ensuring an efficient and up-to-date energy supply, we achieve sustainable growth for the wellbeing of our environment and customers.

CONTENTS

ABOUT LATVENERGO GROUP

CORPORATE GOVERNANCE

OPERATING SEGMENTS

PERFORMANCE INDICATORS

ANNEXES TO THE SUSTAINABILITY REPORT

LATVENERGO GROUP CONSOLIDATED AND LATVENERGO AS ANNUAL REPORT

ABOUT LATVENERGO GROUP

Dear Readers,

102-14 Change and modernisation have been the key words of the first year of the Latvenergo Group Strategy (2017-2020). It has been full of events and new challenges that will play an important role in the further development of the energy industry. Our sector is undergoing dynamic change which is altering current business models quickly and radically. The technological leap of our time and the requirements of proactive users also bring new opportunities, and we are prepared to use them.

Therefore, as the period of the Latvenergo Group strategy continues, the modernisation process initiated in 2017 will be developed further by introducing completely new directions, such as e-mobility, micro network development, consumption management and, in production, development of zero emission generation capacities based on commercial principles. The smart meter programme will be completed in the near future and investments in transmission assets will be provided.

Nowadays, digitalisation, automation and robotization occur not only in such characteristic areas of the industry as energy production and distribution, but also in trade and customer service. This means that a company willing to succeed in the future needs to set a very high standard of technological development for itself. Technologies operated by skilled personnel will perform the majority of work in the future in the large modernisation projects that we implement at our production facilities and distribution networks.

Energy utilities worldwide are currently expanding and reviewing their scope of operation by offering innovative approaches and services. Changes in the energy sector also impact the national economy of Latvia; in particular, interconnections have expanded the possibilities of operating on the free market, daily electricity consumption includes smart services, and liberalisation of the energy market means increasing integration and mutual complementing among traditionally individual industries. The dynamic industry environment that presents the opportunities Latvenergo operational strategy is based on is developing now. The strategy provides for utilisation of the trends of the energy industry to further strengthen the leading positions of Latvenergo Group in the Baltics and development perspectives on the Nordic level by creating new products and encouraging synergy of production and trade. Today we can already see that the directions of development defined by Latvenergo strategy were gauged and justified accurately.

Andris Ozoliņš
Chairman of the Supervisory Board of Latvenergo AS

Āris Žīgurs
Chairman of the Management Board
and Chief Executive Officer of Latvenergo AS

The year 2017 is most vividly characterised by events that made Latvenergo Group and Latvia visible internationally. Last year, Latvenergo Group was the first company in the Baltics to receive the Nasdaq Baltics exchange award for the Best Investor Relations among Bond Issuers, in addition to being invited by the exchange to ring the traditional trading session opening bell at Nasdaq MarketSite in New York's Times Square. The moment when both the logo of Latvenergo Group and the symbols of Latvia were displayed on the façade of the exchange building was very important not only in the business world, but also for every one of us as patriots of our country. The five years since Latvenergo AS issued bonds have passed quickly and on 15 December 2017 we made the first repayment, EUR 70 million, of the principal amount of the bonds issued by Latvenergo that had reached maturity.

In 2017, Latvenergo Group received the prize for the most valuable Latvian company for the tenth time, was ranked among the top three Baltic companies and was recognised as the most valuable Baltic power utility for the first time.

Latvenergo Group has attested its importance for the national economy as a responsible electricity generator whose decisions have helped in reducing the amount of the mandatory procurement component. Amendments to the Cabinet Regulations entered into force in October 2017 stipulating that cogeneration plants with installed capacity above 100 MW may partially decline support payments, receiving a one-off compensation instead. Latvenergo AS applied for the receipt of such a one-off compensation from the state by declining the receipt of 75% of the annual electricity capacity payment to cogeneration plants Riga CHPP-1 and Riga CHPP-2 in future.

In 2017, we are particularly satisfied with the high electricity output, generating 5.7 TWh of electricity. Productive electricity generation by the Daugava hydropower plants (HPPs) played the most important role; after several years of comparatively low water levels in the Daugava River, the water inflow was high last year and thus it was a very successful year for electricity generation. The relative share of renewable energy resource use in Latvia is among the highest in the European Union and this is mainly ensured by our large-scale HPPs. In 2017, 75% of the total electricity output was generated from renewable sources. In order to further improve the efficiency of utilising this indispensable resource, the Daugava HPP reconstruction project continues and the reconstruction of 13 hydropower units out of a total of 23 has been completed. Reconstruction work performed within the investment programme is scheduled to be completed in 2022 and the total investment is expected to amount to more than EUR 200 million.

In 2017, Latvenergo Group's retail sale of electricity amounted to 6.9 TWh and the Group's market share in the Baltics was 27%. The Elektrum brand is developing new products and services, expanding the traditional range of the electricity trade by adding conceptually new offers. Energy risk insurance is offered to household customers and the innovative services *Elektrum Smart House* and *Elektrum Solar* were introduced on the market. Our customers can use the opportunities presented by modern technologies on a daily basis through remote control of household devices and home heating systems or through solar panels installed at their properties for generation and use of green energy. We have verified that our customers justly appreciate these new services we offer.

The provisions of the Energy Law entered into force in 2017 and the natural gas market in Latvia was opened. In step with these new opportunities, Latvenergo Group fully satisfies its demand as the largest gas consumer in Latvia. Natural gas is also supplied from alternative sources, including the Klaipēda gas terminal, for the Group's energy production needs. At present, Latvenergo AS is the second largest gas consumer in the Baltics and the largest one in Latvia. At the same time, the Group successfully commenced sales of natural gas in Latvia and Estonia.

The financial indicators of Latvenergo Group have improved considerably in recent years; the value of assets was more than EUR 4.4 billion and equity exceeded EUR 2.8 billion at the end of 2017. The Group's profit amounted to EUR 322.0 million in 2017. It consisted of the result of economic activity in the amount of EUR 172.9 million and the deferred corporate income tax as a result of the tax reform in the amount of EUR 149.1 million. Overall, this year was among the most successful years in the Group's operations in recent years. The strong capital structure allows to pay out a significant share of the profit in dividends; the Group's strategy sets the dividend payout ratio at more than 80% of the profit. The international credit rating agency Moody's has maintained the credit rating of Latvenergo AS on the Baa2 level with a stable future assessment.

Large-scale modernisation measures are being implemented at Sadales tīkls AS. 78% of energy consumed was being metered by smart meters at the end of 2017. The operational efficiency programme is being implemented; it provides for development of a smart network based on digital technologies, improvement of company efficiency, and improvement of the power supply's quality and security.

The *Kurzeme Ring* project is developing successfully within Latvenergo Group's investment programme and approximately 50% of the total work scope has been completed. The total cost of the project is expected to amount to approximately EUR 220 million and its final stage is scheduled for completion in 2019. Construction of the third Latvia-Estonia interconnection, scheduled for completion by the end of 2020, will increase the maximum transmission capacity between the Latvian and Estonian power systems by 600 MW; thus, the maximum available throughput will increase to 1,750 MW. This will result in further levelling of electricity prices between the Baltic countries and the Nordic countries.

Our corporate social responsibility activities and the results achieved in this area have also been progressing. This was the fifth consecutive year in which Latvenergo AS received the Platinum category of the Latvian Sustainability Index, which is the highest evaluation according to international requirements regarding all the areas of corporate social responsibility. Through various projects we promote education in physics and encourage young people to focus on the exact sciences. Last year was also rich in voluntary environmental activities undertaken by the Group.

We are pleased to have received several high evaluations and awards and to have invested effort in making our offers even broader and more attractive.

Improvements in the corporate governance of the Group were successfully implemented during the report period. The first year of work for the Supervisory Board of Latvenergo was characterised by a highly dynamic and variable work environment. The capacity of the Audit Committee was strengthened through two Members of the Supervisory Board joining it. The Supervisory Board of Latvenergo AS established the Human Resources Committee, whose main tasks are related to the personnel selection process, wages, performance assessment and merging of positions.

Latvenergo Group is working to improve its operational efficiency and the internal control system. This will allow the Group to improve its competitiveness, thus providing higher quality services to our customers.

1.2. ABOUT THE REPORT

102-48	**Reporting period**	**1 January 2017 – 31 December 2017**
102-50	Reporting frequency	Annually, since 2009, in accordance with Global Reporting Initiative (GRI) guidelines.
102-51	Publication date	18 April 2018
102-52	Global Reporting Initiative	The Sustainability Report 2017 has been prepared in accordance with the GRI Standards Core option and includes non-financial information as stated by Directive 2014/95/EU of the European Parliament and of the Council and the Law on the Financial Instruments Market.
102-53	Scope of the report	The report discloses information about Latvenergo Group (see the section "About the Group")
102-54	Principles for defining report content	In the report, Latvenergo Group discloses information about the topics and indicators that are important for its operations and sustainable development. General Standard Disclosures about the operations of Latvenergo Group are fully covered in the report according to the Core option requirements. Based on the materiality assessment, 22 material sustainability topics and 33 Specific Standard Disclosure indicators are disclosed (see the GRI Index table). The report preparation process is described in the section "Materiality Assessment". The methods for measuring data included in this report have not been significantly altered compared to earlier reports.
	Independent auditor's assurance report	The assurance report on the Sustainability Report 2017 has been prepared by Ernst & Young Baltic SIA.
	Report format	A pdf version of the report is available: ▪ on the Latvenergo website, www.latvenergo.lv (in Latvian and English); ▪ in the GRI Sustainability Disclosure Database, http://database.globalreporting.org/ (in English).
	Contact information	Please send any questions or suggestions regarding the Sustainability Report to: sustainability@latvenergo.lv

GRI Standards Application Requirements		
	Core	Comprehensive
General Standard Disclosures *(GRI 100)*	At least 33 disclosures from *GRI 102*	All disclosures from *GRI 102*
Specific Standard Disclosures *(GRI 200, 300, 400)*	At least one topic-specific disclosure for each material topic	All topic-specific disclosures for each material topic

1.3. ABOUT THE GROUP

Latvenergo Group – the most valuable energy company in the Baltics

102-1 102-2 102-3 Latvenergo Group is the largest power supplier in the Baltics. It operates in electricity and thermal energy generation and trade, electricity distribution services, and the leasing of transmission system assets.

102-4 102-5 102-6 102-7 Latvenergo Group comprises the parent company Latvenergo AS and seven subsidiaries. Information about subsidiaries and headquarters is disclosed in Notes 1 and 15 to the Financial Statements. All shares of Latvenergo AS are owned by the Republic of Latvia and held by the Ministry of Economics of the Republic of Latvia.

102-10 102-16 102-45 Latvenergo Group divides its operations into three operating segments: generation and trade, distribution, and lease of transmission system assets. More information on the operating segments of Latvenergo Group is disclosed in the section "Operating Segments".

Vision, mission and values of Latvenergo Group

Latvenergo Group

Headquarters

Generation and trade

Daugava hydropower plants

Riga combined heat and power plants

Ainazi wind power plant

Liepaja plants

Kegums boiler house

Aiviekste hydropower plant

Electricity trade

Distribution

Sadales tīkls AS

Lease of transmission system assets

Latvijas elektriskie tīkli AS

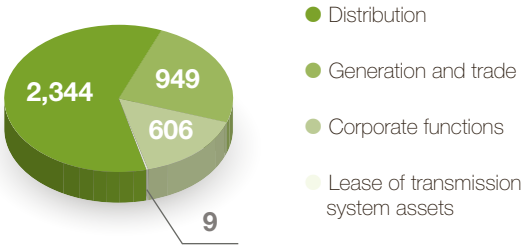
Facts 2017

Financial figures

	2017	2016
Revenue	925.6	931.6 MEUR
Profit	322.0	130.6 MEUR
Assets	4,415.7	3 901.2 MEUR
Investments	243.8	200.7 MEUR
Moody's credit rating	Baa2 (stable)	Baa2 (stable)

Employees

2017	2016
3,908	4,131



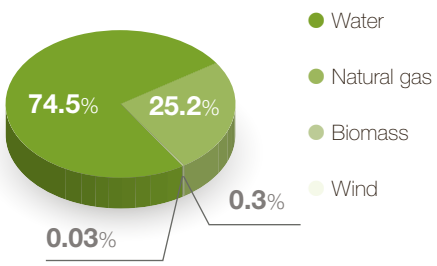
Generation and trade

	2017	2016
Retail electricity supply	6,923	7,666 GWh
Market share in the Baltics	27	30%
Retail customers	834	855 thsd.
Electricity output	5,734	4,707 GWh
Thermal energy output	2,612	2,675 GWh
Installed electrical capacity	2,569	2,569 MW
Installed thermal capacity	1,842	1,842 MW

Generation efficiency

	2017	2016
Daugavas HPPs	18.6	18.9 m^3/kWh
Rigas CHPPs	88%	83%

Resources used in electricity generation



Distribution

	2017	2016
SAIDI	261	286 min
SAIFI	2.8	3.1 number
Line length	93,560	93,813 km
Transformer capacity	5,913	5,892 MVA

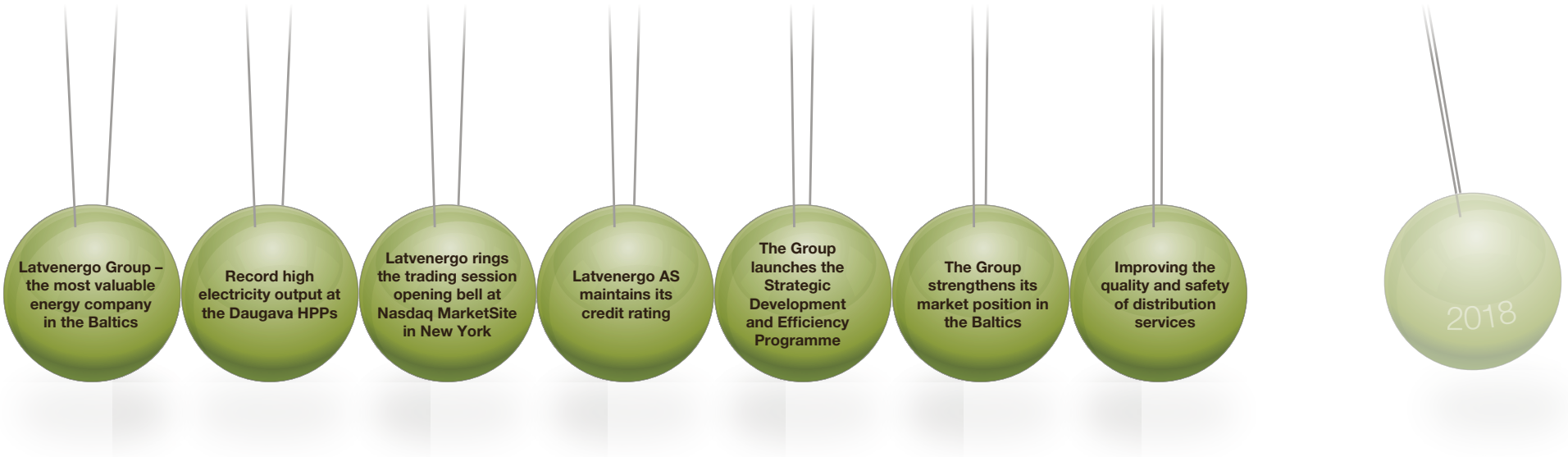
Lease of transmission system assets

	2017	2016
Line length	5,240	5,237 km
Transformer capacity	9,021	8,950 MVA

Customer satisfaction index

	2017	2016
Business customers	3.7	3.7 (1–6)
Households	3.9	4.0 (1–6)

Highlights 2017



For the tenth time, Latvenergo AS has been acknowledged as the most valuable company in the Top 101 Most Valuable Companies of Latvia compiled by Prudentia AS and Nasdaq Riga. Latvenergo AS also ranks third on the list of Top 10 Most Valuable Companies in the Baltics.

In 2017, the total electricity output at the Daugava HPPs was 4,270 GWh, which is the third highest in the Group's history. Such an output level was last achieved in 1998.

Latvenergo AS is the first company in the Baltics to receive the Nasdaq exchange award "Best Investor Relations in the Baltics among Bond Issuers". Along with accepting the award on August 14, Āris Žīgurs, Chief Executive Officer of Latvenergo AS, rang the traditional Nasdaq MarketSite trading session opening bell at Times Square, New York.

Moody's has not revised the credit rating of Latvenergo AS at the Baa2 level with a stable future outlook. In their assessment, Moody's also took into account the planned changes in the support intensity for the Riga CHPPs and the planned Latvenergo AS capital release.

To achieve operational and financial targets set out in the Group's strategy 2017–2022, the Group has developed the Strategic Development and Efficiency Programme. While the strategic development section includes major strategic projects, the efficiency section provides for the revision, centralization and digitalization of the Group's processes. The programme aims to maintain the Group's profitability in the long term considering the increase in costs due to inflation.

After the opening of the gas market in 2017, Latvenergo Group, under the *Elektrum* brand, commenced natural gas sales to business customers in Latvia and Estonia. Also, two new products were introduced for the household segment – *Elektrum Smart House* and *Elektrum Solar.*

Compared to 2016, the System Average Interruption Duration Index (SAIDI) was reduced by 9% and the System Average Interruption Frequency Index (SAIFI) was reduced by 10%.

1.4. GROUP STRATEGY

Successful implementation of the objectives set in the strategy for 2017

The Group's strategic operational and financial goals and main development tasks for 2017–2022 are defined in the Latvenergo Group Strategy. The Organisation for Economic Cooperation and Development (OECD) Guidelines on Corporate Governance of State-Owned Enterprises were followed in the course of developing the strategy. The strategy is based on the overall strategic target set for Latvenergo AS by the Cabinet of Ministers of the Republic of Latvia.

Provision of goods and services within the energy sector in a sustainable, responsible and economically justified manner, which is important for the competitiveness and growth of the national economy and efficient management of the resources and infrastructure strategically important for national development and security, thus encouraging improvement of the security of the energy supply.

(The overall strategic objective set by the Cabinet of Ministers)

Considering the challenges expected in the energy industry and the business environment, the Latvenergo Group Strategy 2017–2022 defines three major objectives. In the reporting year, which was the first year of the strategy period, fulfilment of the objectives defined by the strategy was started successfully, thus making a considerable contribution to satisfying the needs of society while following the principles of sustainability.

The Group's strategic objectives

1. Strengthen a sustainable and economically sound market position on home markets (in the Baltics) while considering geographical and/or product/service expansion

This objective envisages excellence in the Group's trade operations and cost efficiency. It includes commencement of retail gas sales on home markets and development of new products.

In 2017, Latvenergo Group, with a sales volume of 6.9 TWh, was among the leaders in electricity sales in the Baltics. Electricity sales outside Latvia amounted to 2.3 TWh and accounted for 1/3 of the total retail sales of electricity. In the reporting year, the Group also started sales of natural gas to corporate customers in Latvia and in Estonia.

In the household segment in Latvia, two new electricity products were introduced: *Elektrum Smart House*, which provides remote control of home heating and electrical appliances, and *Elektrum Solar*, which provides an opportunity to consume independently generated electricity using solar light.

2. Development of a generation portfolio suitable for synergy with trade and increasing the Group's value

This objective envisages completion of the reconstruction of the Daugava HPP generation facilities to ensure their sustainable and reliable operation. Furthermore, the aim is to move towards diversification of the existing generation capacities and the development of new ones in line with the criteria for diversification of primary generation resources and "low" emission projects.

Pillars of sustainability

In 2017, Latvenergo Group successfully continued the reconstruction programme for the Daugava HPP hydropower units by investing EUR 41.8 million. The programme is aimed at improving the efficiency, security and competitiveness of the Daugava HPPs. At the end of 2017, one reconstructed hydropower unit of the Plavinas HPP was put into operation. The hydropower unit reconstruction process is scheduled for completion in 2022.

Along with the above project, research is being conducted regarding projects for new power generation facilities compliant with the criteria of diversification of primary resources and low emissions.

3. Development of a functional, safe and efficient network corresponding to customer needs

This objective envisages increasing operational and cost efficiency of the distribution network, enhancing the quality and safety of distribution services, and continuing active implementation of the digitalisation of the distribution network.

A large-scale project for improvement of the operational efficiency of Sadales tikls AS was started in 2017. Restructuring of the company is being implemented in the first stage, which will be concluded in 2018. The strategic and operational asset management processes will be centralised and made more efficient.

By implementing the planned investment and organisational measures, a considerable improvement in the continuity of power supply was attained in 2017. In comparison to 2016, the aggregate System Average Interruption Duration Index (SAIDI) was reduced by 9% and the System Average Interruption Frequency Index (SAIFI) was reduced by 10%.

Considerable progress has also been achieved in network digitalisation. At the end of the reporting year, smart meters accounted for 36% of the total fleet of meters and were metering 78% of the total volume of electricity consumed by customers.

Overall in 2017, a high volume of work was done to focus further on the tasks defined by the strategy and plan them in detail. Taking into consideration the defined development directions, the Group has also approved the Strategic Development and Efficiency Programme.

The strategic development section of the programme contains major strategic projects. The efficiency section provides for review, centralisation and digitalisation of the Group's processes. The estimated gain of the efficiency programme is up to EUR 30 million, and this is the largest Group optimisation plan of the last decade. Implementation of the programme will allow the Group to maintain its competitiveness in the long term and also minimise the negative impact of the increase in competition and expected increase in costs on the Group's results in the coming years.

The Group's financial objectives

The 2017–2022 strategy also sets Latvenergo Group's financial objectives, which are divided into three groups: profitability, capital structure and dividend policy. The Group's financial results have improved considerably in recent years, which indicates its strong financial position and development.

The year 2017 should be assessed as among the most successful years in the Group's operations in recent years. Latvenergo Group's profit amounted to EUR 322.0 million in 2017. It consisted of the result of economic activity in the amount of EUR 172.9 million and the deferred corporate income tax as a result of the tax reform in the amount of EUR 149.1 million. The return on equity (ROE) of the profit before the deferred tax was 7.0%. This result exceeded the financial goal of 6% set for 2022 and can be considered a good achievement compared to industry profitability ratios.

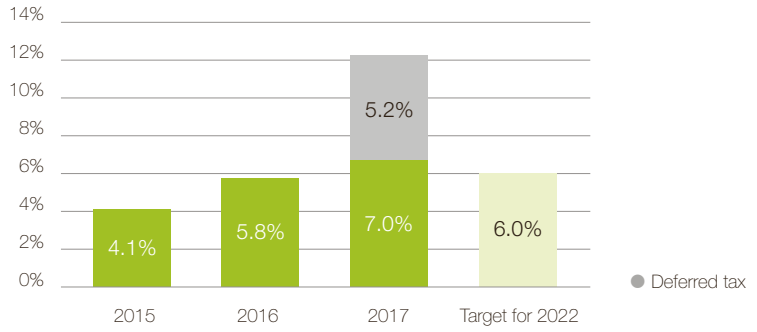
The 2017 financial indicators of the capital structure also ensured achievement of the set goals, exceeding average industry indicators as well. The strong capital structure provides for dividend payments larger than the industry average. The dividend policy defined in the strategy sets the dividend payout ratio at more than 80% of the profit, while each year's dividend payout is set by the Shareholder Meeting upon evaluation of the actual results.

The Group's financial objectives

Target group	Ratio	2016	2017	2022	Industry average ratio*
Profitability					
ambitious, yet achievable profitability, which is consistent with the average ratios of benchmark companies in the European energy sector and provides for an adequate return on the business risk	Return on equity (ROE)	5.8%	12.2%	> 6%	5 – 8%
Capital structure					
an optimal and industry-relevant capital structure that limits potential financial risks	Net debt to equity	25%	21%	< 50%	30 – 50%
	Net debt to EBITDA	1.7	1.1	< 3	2.5 – 3
Dividend policy					
a dividend policy that is consistent with the planned investment policy and capital structure targets	Dividend payout ratio**	77.4 MEUR	90.1 MEUR	> 80%	60 – 70%

* based on the data at the time of development of the strategy
** dividends are paid in compliance with the legislation of the Republic of Latvia

Return on equity



1.5. CORPORATE SOCIAL RESPONSIBILITY

Enhanced stakeholder engagement

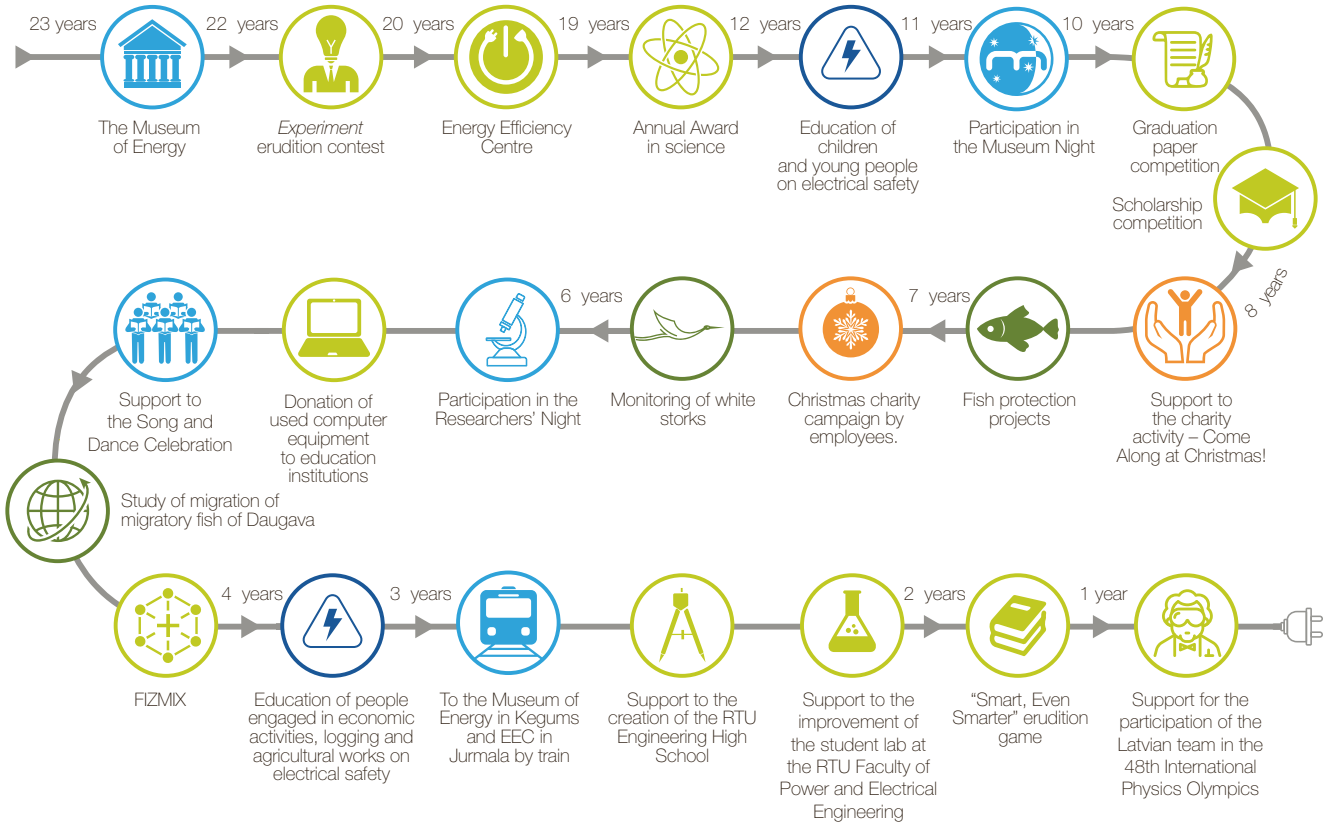
Latvenergo Group not only complies with statutory requirements, but also performs voluntary activities aimed at improving the public welfare and the environment and follows the principles of social responsibility in compliance with ISO 26000 in its daily operations.

Latvenergo Group Corporate Social Responsibility (CSR) Policy specifies the basic CSR forms, principles, directions and selection criteria for activities. The Group supports CSR activities in line with its operations and strategic goals, contributing to raising public awareness of responsible business conduct and the energy industry, making a substantial long-term impact and ensuring the involvement of large groups of society. CSR activities are implemented in the following areas:

- science and education;
- raising public awareness of electrical safety;
- environmental protection;
- culture, sports and energy industry heritage;
- social support and responsibility towards employees.

In order to expand cooperation with stakeholders and to involve experts of the relevant fields in taking decisions on donations, Latvenergo AS donates funds in the cultural and social sphere via project tenders administered by collaborating organisations as of 2018. After evaluating the experience, administrative capacity, scope of operations, publicity, reputation and status of public benefit organisations, the foundation *Ziedot.lv* and the State Culture Capital Foundation was selected for collaboration in July 2017. At the end of 2017, project tenders for support of social assistance advancement and national culture events were announced in collaboration with the selected organisations.

CSR activities of Latvenergo Group in 2017 by the duration of Group's involvement



Areas of the CSR activities

- Science and education
- Raising public awareness of electrical safety
- Environmental protection
- Culture, sports and energy industry heritage
- Social support and responsibility towards employees

Science and education

Latvenergo Group implements science and education CSR projects with a view to:

- promoting young people's interest in science-related subjects and engineering professions;
- supporting young people's excellence in the exact sciences;
- supplementing teaching materials for teachers;
- supporting researchers' and teachers' scientific work in the field of energy that promotes the education of youth;
- raising public awareness of energy efficiency.

In cooperation with the Latvian Academy of Sciences, for more than 20 years Latvenergo Group has awarded its Annual Award for outstanding and significant contributions to the energy industry and achievements of young researchers in the field. Each year, the Group announces competitions for students of higher educational institutions, awarding the best graduation papers on topical issues in the energy sector, and organises a scholarship competition for students. The Group also provides students from various educational institutions with internship opportunities. Latvenergo Group employees participate in the bachelor's and master's thesis defence committees of Riga Technical University (RTU) and Latvia University of Agriculture (LUA) and also participate annually in publishing books related to the energy industry. In 2017, Latvenergo Group continued support for the Engineering High School of RTU and for improvement of the students' laboratory of the Faculty of Energy and Power Engineering of RTU.

For 22 years, Latvenergo Group has organised the knowledge contest "Experiment" for 8th and 9th-graders. It is aimed at encouraging young people's interest in learning physics and choosing engineering professions. Also, in order to teach physics to young people in an interesting and comprehensive way, provide teachers with an idea base and auxiliary materials and raise the prestige of mastering physics, Latvenergo AS has maintained the FIZMIX physics portal since 2013 (www.fizmix.lv). The FIZMIX team also presents physics experiments at workshops at schools in Latvia and at other events. In 2017, the knowledge contest "Experiment" was merged with the FIZMIX portal and is now referred to as "Fixmix Experiment".

To encourage young people's knowledgeability, as of 2016, Latvenergo Group participates in the production of the game show "Smart, Even Smarter" on Latvian national television (LTV1). In 2017, the Group also supported the participation of the Latvian team in the 48th International Physics Olympics and continued donating computer hardware to educational institutions in Latvia.

For 20 years, the *Elektrum* Energy Efficiency Centre has provided the opportunity for anyone to attend the events and educational workshops it organises, to participate in field trips free of charge and also to receive different recommendations for purchase and use of electrical appliances and smarter use of energy resources.

Raising public awareness of electrical safety

Raising public awareness of electrical safety is one of the CSR priorities of the Group's subsidiary Sadales tīkls AS. To reduce the number of electrical injuries due to insufficient knowledge, a number of projects aimed at electrical safety among children and young people are implemented each year in cooperation with educational institutions and experts. Particular attention is paid to ensuring that the information complies with the level of knowledge of each age group.

Since 2013, classes on electrical safety have been held at almost 700 educational institutions all over Latvia, educating more than 110 thousand children and young people on electrical safety matters. The main projects of 2017:

- continuing the electrical safety campaign "Don't take risks with electricity! Survive!" and improvement of the website www.arelektribuneriske.lv;
- the education and safety projects "One day for safety", cooperation with the music project "Brīnumskapis" ("Cabinet of Wonders"), and participation in various events, summer camps for children and regional safety days.

In 2017, Sadales tīkls AS continued to educate people engaged in economic activities, logging and agricultural work, encouraging them to take care of their own safety and the safety of those around them and to follow electrical safety rules while working near electricity lines.

Environmental protection

Latvenergo Group's care in preserving biodiversity and minimising the environmental impact of its operations is among the core principles of the Group's Environmental Policy. Protection of birds and replenishment of fish stock are important areas of action in this regard. The Group cooperates with the Latvian Ornithological Society in matters related to the protection and study of birds and with *Mēs zivīm*, a fish conservation society, to promote the replenishment of stock of fish breeds characteristic of the Daugava River basin. For more information on environmental protection activities implemented by the Group, see the section "Environmental Protection".

Culture, sports and energy industry heritage

By participating in nationwide cultural and sports events, Latvenergo Group promotes the development of Latvia's cultural traditions and the strengthening of its national identity and encourages an active lifestyle.

In 2017, Latvenergo AS started providing support to the XXVI Song and XVI Dance Celebration, which is among the central events of the celebration of the 100th Anniversary of the Latvian state. Latvenergo Group employees regularly participate in Lattelecom Riga Marathon and the Latvian Cycling Union Race in Sigulda. For several years, Latvenergo Group has taken part in the "Riga Carnival" event of the Riga Light Festival.

Latvenergo Group's Museum of Energy ensures research of the history of energy in Latvia and of Latvenergo Group and the collection and preservation of energy industry heritage and its availability. The museum offers exploratory tours and thematic educational classes for a variety of museum visitors and the possibility to watch the film "How the Kegums Power Plant Was Built. The Memoirs of Kārlis Dumbrājs".

In 2017, the museum restored the exhibition "Electricity does everything" by displaying the household appliances used in Latvia in the 20th century. The travelling exhibition of E. Kraucs's collection of glass plate photonegatives entitled "Construction of the Kegums Hydropower Plant (1936–1940)", which was created at the museum, is presented at educational establishments and at the National Library of Latvia. At the end of 2017, the cooperation agreement between Latvenergo AS and the UNESCO Latvian National Commission was signed again for the purpose of ensuring preservation of the documentary heritage included in the Latvian National Register of the UNESCO Memory of the World Programme.

Every year, the museum continues its participation in international and local events, including the Museum Night and the Researchers' Night. In cooperation with Pasažieru vilciens AS, the project "By Train to the Museum of Energy in Kegums and the Energy Efficiency Exhibition in Jūrmala!" was continued in 2017.

Social support and responsibility towards employees

Latvenergo Group regularly participates in charity activities. For the eighth year in a row, the Group supported the "Come Along at Christmas!" charity concert, promoting the artistic talents of children and young people with special needs. At this concert, children give performances together with the best Latvian artists.

Every year, the Group's employees donate a variety of useful everyday items to those in need.

On its own initiative, the Group provides additional social protection to its employees which is not stipulated by legislation. Information about the social protection of employees is available in the section "Employees and the Work Environment".

1.6. AWARDS

Most Attractive Employer

For the sixth time, Latvenergo AS was ranked as the most attractive employer in Latvia by *cvmarket.lv* and, for the fifth time, as the top employer in the production sector and the third most popular employer in Latvia by CV-Online Latvia.

Leader in the electricity, gas and water supply sector

For the sixth year in a row, Latvenergo AS was the electricity, gas and water supply sector leader in the Latvian Corporate Reputation Ranking.

Most Beloved Employer and Most Beloved Brand

In the Latvian Ranking of Most Beloved Brands, Latvenergo AS was ranked as the fifth most beloved employer, while the Elektrum brand was ranked as the sixth most beloved brand in Latvia.

The most valuable company in Latvia

For the tenth time, Latvenergo AS was acknowledged as the most valuable company in the Top 101 Most Valuable Companies of Latvia.

The highest ranking in the Latvian Sustainability Index

For the fifth time, Latvenergo AS received the Platinum (highest) ranking in the Latvian Sustainability Index as well as a Family-Friendly Company Certificate from the Ministry of Welfare.

TOP 500 State-Owned Company, TOP 500 Most Valuable Company, TOP 500 Profitability, TOP 500 EBITDA

These awards were received by Latvenergo AS at an event honouring the largest, most profitable, most stable and most viable Latvian companies.

CORPORATE GOVERNANCE

2.1. CORPORATE GOVERNANCE MODEL

Corporate governance – for successful achievement of goals

102-16
102-18

The corporate governance model of Latvenergo Group has been developed in compliance with good governance practice on the basis of the regulatory framework and corporate governance guidelines. The model reflects the core elements that apply to the governance institutions of the capital companies of the Group. These elements serve as a precondition for successful achievement of the goals specified by the strategy and for increasing the value of the Group. A significant role in the maintenance of the elements of the Group's corporate governance system is assigned to the values of the Group and active communication, both within the Group and in cooperation with stakeholders.

Ethics and Compliance

Latvenergo Group follows high standards of professional ethics and ensures the compliance of its operation with legislative requirements. Regular information events to improve employee awareness of ethics and compliance standards are organised. The Group also continuously improves its internal regulations and takes other measures to prevent the possibility of corruptive or fraudulent activities.

Latvenergo Group supports fair business practices, follows fair competition rules, and does not engage in transactions that restrict competition or are corruptive or discriminatory. The Group also urges its contractual partners to adhere to similar ethical principles and to act in such a manner as to avoid conflict of interest situations in cooperation with the Group's companies, including honouring restrictions on acceptance of gifts defined by the Group and not offering the Group's employees any material valuables as an incentive or reward. Upon signing agreements, Latvenergo asks for confirmation that mutual cooperation will be based on the principles of fair business cooperation. Latvenergo Group's fundamental ethical principles are published on the Group's website.

Roles, Responsibilities and Accountability

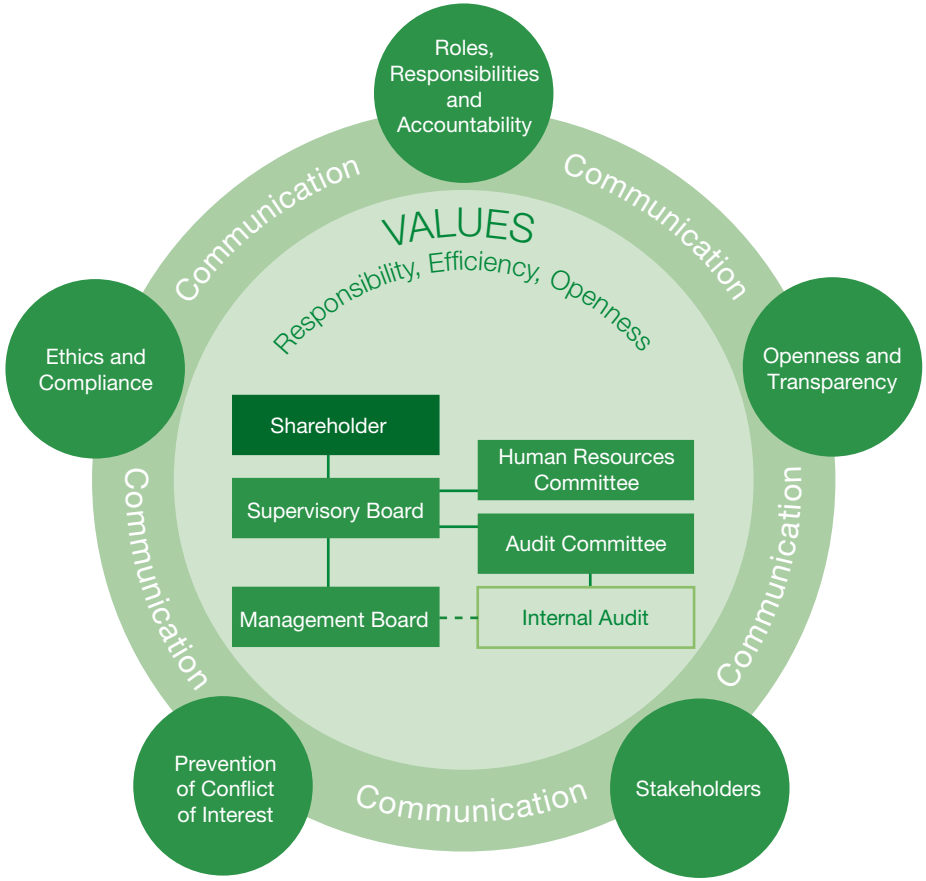
The roles, responsibilities and accountability of governance bodies are clearly defined by external laws and regulations and by the Group's internal documents. The most important of these are the companies' Articles of Association and regulations of the governance bodies. The Articles of Association of Latvenergo AS and the Regulations of the Management Board, the Supervisory Board, and the Audit and Human Resources Committees are published on the Group's website.

Openness and Transparency

Transparency of operation is ensured by Latvenergo Group through the publication of various financial and non-financial information on both the Latvenergo website and external sites, such as Nasdaq Baltic website.

- The Sustainability and Annual Report is published on a yearly basis. The Annual Report is prepared according to the International Financial Reporting Standards (IFRS) approved by the EU and the Sustainability Report is prepared according to the GRI guidelines.
- The Group's Interim Financial Reports are prepared on a quarterly basis in accordance with the information disclosure requirements for bond issuers stipulated by the Law on the Financial

Corporate Governance Model



Instruments Market. The Interim Financial Reports of Latvenergo AS and its subsidiaries are also published.

- The Latvenergo AS Corporate Governance Report is prepared on a yearly basis in compliance with the corporate governance principles of Nasdaq Riga AS.
- Regular virtual conferences on the Group's financial results and operational topicalities are also held.

The Group has been awarded for the openness and transparency of its operations. Latvenergo AS is the first company in the Baltics that has received a Nasdaq exchange award for the best investor relations in the Baltics among bond issuers.

Prevention of Conflicts of Interest

In accordance with the Law on the Prevention of Conflicts of Interest in the Activities of Public Officials, members of supervisory boards and management boards of state capital companies have the status of public officials. To prevent the influence of a personal or financial interest, the law restricts the activities of members of supervisory boards and management boards that fall outside the framework of their official powers. Members of supervisory boards and management boards are obliged to submit annual declarations of public officials, specifying income received, positions held, transactions performed, participation in commercial activities, and other information.

The Group's governance bodies ensure that principles for prevention of conflicts of interest are adhered to in the performance of official duties. Latvenergo Group's Code of Ethics defines the types of conflict of interest and the measures to prevent conflict of interest situations. Upon entering employment and signing the declaration, new employees must confirm their understanding of conflict of interest situations and their commitment to preventing their occurrence within their activities. In order to raise awareness of conflict of interest situations, training and informative events are organised by the Group.

For timely prevention of conflict of interest situations, the Group has introduced conflict of interest declarations, which are evaluated and controlled. In compliance with the Code of Ethics of Latvenergo Group, this declaration is annually submitted by managers and leading specialists of all levels, experts and other employees who, in the course of performing their official duties, participate in decision-making and have been or could find themselves in conflict of interest situations.

Stakeholders

Cooperation and communication with stakeholders is an important element of Latvenergo Group's corporate governance system. The Group is aware of its impact on stakeholders and vice versa and handles issues of material importance to its stakeholders with a sense of responsibility. More information on Latvenergo Group's cooperation with stakeholders is provided in the section "Stakeholder Engagement".

2.2. GOVERNANCE BODIES

The Supervisory Board has established the Human Resources Committee

Shareholder

100% of the shares of Latvenergo AS are owned by the state and held by the Ministry of Economics of the Republic of Latvia. The interests of the shareholder are represented at the Shareholder Meeting by the State Secretary of the Ministry of Economics or his/her authorised delegate. Shareholder Meetings are convened in accordance with the requirements and timelines stipulated by the Law on Governance of Capital Shares of a Public Person and Capital Companies.

According to the Energy Law, Latvenergo AS is designated as a national economy object of state importance, and its shares may not be privatised or alienated.

The principal duties of the Latvenergo AS Shareholder Meeting include:

- approval of the Annual Report and decision-making on distribution of the company's profit from the preceding year;
- electing and dismissing members of the Supervisory Board and the Audit Committee, approval of their remuneration;
- appointment of the auditor, determining his/her remuneration.

Four Shareholder Meetings took place in 2017. The most important decisions passed in 2017 were the approval of the Annual Report 2016, distribution of dividends in the amount of EUR 90.1 million, appointment of the auditor, election of the members of the Audit Committee and the capital release of Latvenergo AS of EUR 454.4 million in relation to receipt of the compensation of CHPP support payments.

Supervisory Board

The Supervisory Board of Latvenergo AS was elected at the Shareholder Meeting on 16 December 2016 and its term of office is five years. The Supervisory Board is composed of five members: Andris Ozoliņš (Chairman of the Supervisory Board), Andris Liepiņš (Deputy Chairman), Baiba Anda Rubesa, Mārtiņš Bičevskis and Martin Sedlacky. All members of the Supervisory Board are independent experts who are not engaged in the operational activities of the Group.

The principal duties of the Latvenergo AS Supervisory Board include:

- approval of the medium-term operational strategy;
- continuous supervision of the Management Board's activities;
- election and dismissal of members of the Management Board, approval of their remuneration;
- monitoring the compliance of the company's operations with legislation, its Articles of Association and the decisions of the Shareholder Meeting.

Fourteen meetings of the Supervisory Board took place in 2017. In addition to the principal duties, the following matters were reviewed:

- the Group's Strategic Development and Efficiency Programme until the year 2022;
- application for receipt of the compensation of CHPP support payments from the state and capital release of Latvenergo AS;
- amendments to the Regulations of the Audit Committee by including two members of the Supervisory Board in the Committee;
- establishment of the Human Resources Committee;
- improvement of the internal control environment.

The Regulations of the Supervisory Board of Latvenergo AS are available on the Group's website.

Audit Committee

An independent Audit Committee operates at Latvenergo AS, which reports on its operations and performance to the Supervisory Board. Having evaluated necessary competencies, professional experience and compliance with the requirements of the Law on the Financial Instruments Market, the Shareholder Meeting elects five members to the Audit Committee for a term of office of three years. On 3 March 2017, Torben Pedersen (Chairman of the Audit Committee), Svens Dinsdorfs and Marita Salgrāve as well as Members of the Supervisory Board Andris Ozoliņš and Andris Liepiņš were elected to the Audit Committee. All members of the Audit Committee are independent experts who are not engaged in the operational activities of the Group.

The principal duties of the Audit Committee are to supervise:

- the financial reporting process;
- efficiency of the internal control and risk management systems;
- the work of the internal audit and the external auditor;
- implementation of the Fraud Risk Management Plan.

Eight meetings of the Audit Committee were held in 2017. In addition to its regular duties, the Audit Committee carried out the selection of the auditor for 2018–2020 and the selection of the Internal Audit Director.

The Regulations of the Audit Committee are available on the Latvenergo website.

Human Resources Committee

In compliance with the Regulations, the Supervisory Board of Latvenergo AS may form committees consisting of the members of the Supervisory Board for reviewing particular matters. On 8 March 2017, the Supervisory Board formed the Human Resources Committee for personnel management matters. The Committee consists of three members who are elected by the Supervisory Board from among the members of the Supervisory Board. Mārtiņš Bičevskis, Baiba Anda Rubesa and Andris Liepiņš were elected to the Committee.

The Human Resources Committee prepares proposals for the Supervisory Board regarding the selection, remuneration, performance evaluation and combining of positions of the personnel of the Management Board, Audit Committee and internal audit of Latvenergo AS. Two meetings of the Human Resources Committee were held in 2017.

The Regulations of the Human Resources Committee are available on the Latvenergo website.

Management Board

After evaluating compliance with the required competences, experience and the intended area of responsibility, the Supervisory Board elects five members to the Management Board of Latvenergo AS for a term of office of five years. The Management Board operates in compliance with the Articles of Association and the Regulations of the Management Board and reports to the Supervisory Board. All members of the Management Board are independent in their operation and hold no interest in the capital of cooperation partners or related companies.

The principal duties of the Latvenergo AS Management Board include:

- management and representation of the company;
- accountability for the business activities of the company and the legal compliance of accounting;
- management of the company's property;
- implementing the strategic direction of the Group, its development plans, goals and policies.

The Management Board of Latvenergo AS performs the functions of shareholder in subsidiaries where it is the only shareholder.

The members of the Management Board are jointly liable for compliance with all binding laws and regulations, execution of the decisions of the Shareholder Meeting and the Supervisory Board, and the financial performance of the Group.

In 2017, 67 meetings of the Management Board were held. Number of meetings attended: Ā. Žīgurs (Chairman of the Management Board) – 67; G. Baļčūns – 62; U. Bariss – 63; M. Kuņickis – 61; G. Stafeckis – 52. The overall attendance rate was 91%.

After the end of the reporting period, as of 1 March 2018, Guntis Stafeckis, Member of the Management Board, has decided to retire from this position. As of report publication, the Management Board consists of four board members.

The Regulations of the Management Board of Latvenergo AS are available on the Latvenergo website.

Remuneration Policy for the Supervisory Board, the Audit Committee and the Management Board

Remuneration of the Supervisory Board and the Management Board is regulated by the legislation of the Republic of Latvia – the Law on Governance of Capital Shares of a Public Person and Capital Companies as well as the Cabinet of Ministers Regulations based on that law. Legal acts provide for uniform regulation regarding remuneration of members of supervisory and management boards of the companies of a public person.

The monthly salary of the Chairman of the Supervisory Board and the Chairman of the Management Board is linked to the average monthly salary of employees in Latvia during the preceding year, as published in the Official Statistical Bulletin of the Central Statistical Bureau of the Republic of Latvia, multiplied by a ratio specified according to the capital company's reference criteria (turnover, assets, number of employees). The maximum ratio applicable to the monthly salary of the chairman of a supervisory board is 3, and in 2017 this was applied to the monthly salary of the Chairman of the Supervisory Board of Latvenergo AS. The ratio applied to the monthly salary of the Chairman of the Management Board in 2017 was 10 based on the capital company's reference criteria.

The remuneration of supervisory board and management board members may not exceed 90% of the monthly salary of the chairman of a supervisory or management board respectively. Management board members are entitled to compensation for the performance of additional duties at the company. 20% of the uniform monthly salary of the Chairman and members of the Management Board comprises remuneration for performing the duties of Chief Executive Officer and Chief Officers.

Once a year, following the approval of the Annual Report and the performance evaluation, the Shareholder Meeting may decide on payment of bonuses to members of the Supervisory Board. The amount of the bonus may not exceed the amount of their monthly salary. The Supervisory Board, in turn, may decide on payment of bonuses to members of the Management Board once a year following the approval of the Annual Report. The bonuses are based on the company performance, the execution of the strategy and the achievement of the set targets. For members of the Management Board bonuses may not exceed double their monthly salary. The terms and conditions of the authorisation agreements signed with the members of the Management Board provide for the possibility to receive a severance payment in the amount of three months' salary if they are recalled from their duties before the expiration of their term of office, including in the event of reorganisation or liquidation of the company. The remuneration policy does not provide for an option to pay remuneration in the form of shares or share options.

The remuneration of the Audit Committee is stipulated by the Regulations of the Audit Committee. The remuneration of the members of the Audit Committee is determined by the Shareholder Meeting, and its amount corresponds to the average monthly salary of employees in Latvia during the preceding year, as published in the Official Statistical Bulletin of the Central Statistical Bureau of the Republic of Latvia. The monthly salaries of the Audit Committee members are determined for the entire term of their office, with the right to review them once per year. Members of the Audit Committee who are simultaneously members of the Supervisory Board of Latvenergo AS are not compensated for duties performed in the Audit Committee.

Authorisation agreements are signed with the members of the Management Board, the Supervisory Board and the Audit Committee, and the provisions of the Collective Bargaining Agreement do not apply to them.

The remuneration paid for the year 2017 to A. Ozoliņš, Chairman of the Supervisory Board of Latvenergo AS, was EUR 29,905 and EUR 26,914 for the other members of the Supervisory Board. The remuneration paid to each member of the Audit Committee of Latvenergo AS for the year 2017 was EUR 10,222, except for the members who are simultaneously members of the Supervisory Board. Members of the Human Resources Committee do not receive remuneration for their work in the Committee.

The aggregate remuneration for the year 2017 for Ā. Žīgurs, Chairman of the Management Board and Chief Executive Officer of Latvenergo AS, was EUR 151,136; for G. Baļčūns, Member of the Management Board and Chief Financial Officer, it was EUR 135,068; for U. Bariss, Member of the Management Board and Chief Commercial Officer, it was EUR 134,637; for M. Kuņickis, Member of the Management Board and Chief Operating Officer, it was EUR 135,457; for G. Stafeckis, Member of the Management Board and Chief Technology and Support Officer, it was EUR 130,610.

Internal Audit

The Internal Audit is an independent unit of Latvenergo AS and its objective is to help the Group to achieve its goals by evaluating and improving the effectiveness of internal control, risk management and corporate governance processes. Internal audits are performed in compliance with the International Standards for the Professional Practice of Internal Auditing. The activities of the Internal Audit are supervised by the Audit Committee.

The annual internal audit plan is approved by the Audit Committee. Once a year, based on the audit results, the Internal Audit submits a comprehensive opinion on the effectiveness of the Group's internal control system and recommendations for its improvement to the management of Latvenergo Group. The Internal Audit prepares its activity report and submits it to the Management Board and the Audit Committee. It comprises information on compliance of the activities with standards, self-assessment and measures for assuring and improving the quality of its services.

Dividend Policy

The distribution of Latvenergo AS dividends over the coming years is regulated by the Republic of Latvia Law on the State Budget for 2018 and the Law on the Medium-Term Budgetary Framework for 2018, 2019 and 2020. In compliance with these laws, the anticipated amount payable by Latvenergo AS in dividends for the use of state capital is EUR 94.2 million in 2018, EUR 132.9 million in 2019 (including corporate income tax) and EUR 127.1 million in 2020 (including corporate income tax). The actual amount payable by Latvenergo AS in dividends is determined by the Shareholder Meeting of Latvenergo AS after the approval of the Annual Report, upon evaluation of the results for the previous year.

Governance of Subsidiaries

Latvenergo Group subsidiaries are governed through key governance instruments such as strategy, organisational structure organised around functional units, and policies.

The activities of the Management Boards of Latvenergo AS subsidiaries Sadales tīkls AS, Latvijas elektriskie tīkli AS and Enerģijas publiskais tirgotājs AS are supervised by the Shareholder Meetings; the interests of Latvenergo AS are represented by the Management Board of Latvenergo AS. The supervisory body of the subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB, which operate outside the territory of Latvia, is their Supervisory Board. Latvenergo AS employees are appointed to the Supervisory Boards of the abovementioned subsidiaries for the supervision of the relevant areas of operation. Supervisory functions at Liepājas enerģija SIA, where the equity share of Latvenergo AS is 51%, are carried out by a Supervisory Board of six individuals, half of whom are representatives of Latvenergo AS.

Latvenergo AS Supervisory Board

Andris Ozoliņš
Chairman of the Supervisory Board

TERM OF OFFICE

16.12.2016–15.12.2021

COMMITTEE MEMBERSHIP

Audit Committee

EXPERIENCE

2016–2018: Baltic International Bank AS, Member of the Supervisory Board

2013–2014: Reverta AS, Member of the Supervisory Board

2013–2014: Kredītinformācijas birojs AS, Member of the Supervisory Board

2010–2011: DNB Bank ASA, Member of the Management Board

1999–2012: DNB banka AS (NORD/LB Latvija AS), President and Chairman of the Management Board, Member of the Management Board

1997–1999: Irvin & Co Baltics SIA, Chief Executive Officer, Senior Consultant

EDUCATION

RTU Riga Business School, Master of Business Administration (2002)

University of Latvia, Diploma in Philosophy (1991

Andris Liepiņš
Deputy Chairman of the Supervisory Board

TERM OF OFFICE

16.12.2016–15.12.2021

COMMITTEE MEMBERSHIP

Audit Committee
Human Resources Committee

EXPERIENCE

2014–2016: Riga International Airport SJSC, Chairman of the Management Board

2011–2014: Air Baltic Corporation AS, Chairman of the Supervisory Board

2001–2014: Ministry of Economics, Deputy State Secretary

2002–2006: Latvenergo AS, Member of the Supervisory Board

1995–2001: Development Agency of Latvia, Member of the Management Board, Director of the Investment Department

1994–1995: Saeima, Member of Parliament, Ministry of Economics, Parliamentary Secretary

1994: Development Agency of Latvia, Member of the Management Board, Director of the Investment Department

1991–1994: Ministry of Economics, Department of External Economic Relations, Senior Specialist

EDUCATION

RTU Riga Business School, Master of Business Administration (2010)

Columbia University in the City of New York, Master of International Relations (1997)

University of Latvia, Master of Public Administration (1996)

University of Latvia, Diploma in Economics (1993)

Baiba Anda Rubesa
Member of the Supervisory Board

TERM OF OFFICE

16.12.2016–15.12.2021

COMMITTEE MEMBERSHIP

Human Resources Committee

EXPERIENCE

(2015–present: RB Rail AS, Chairperson of the Management Board, Chief Executive Officer

2014–present: RFactor SIA, Owner and Chairperson of the Management Board

2012–2015: Citadele Banka AS, Member of the Supervisory Board

2010–2013: Statoil ASA, Vice President, Corporate Social Responsibility

2008–2010: Statoil Azerbaijan, Director, Government & Public Affairs

2002–2009: DnB NORD Banka AS, Member of the Supervisory Board

2001–2008: Latvija Statoil SIA, Managing Director

1996–2000: Statoil Baltic States, Director, Marketing & Public Affairs

1994–1996: Es un partneri SIA, Owner

1993–1993: Bell Sygma Inc., Assistant Vice President

1985–1992: Volkswagen Group, Manager of Corporate Image and Coordinator of International Public Relations

EDUCATION

Shaw College, Degree in Business Administration (1975)

York University, Bachelor of Arts (1974)

Mārtiņš Bičevskis
Member of the Supervisory Board

TERM OF OFFICE

16.12.2016–15.12.2021

COMMITTEE MEMBERSHIP

Human Resources Committee (Chairman)

EXPERIENCE

2016–present: State Real Estate SJSC, Chairman of the Supervisory Board

2012–2017: Employers' Confederation of Latvia, Vice President, Member of the Supervisory Council

2011–2016: Association of Latvian Commercial Banks, President, Member of the Board

2008–2011: Ministry of Finance, State Secretary

2004–2008: Ministry of Justice, State Secretary

2003–2004: Ministry of the Interior, Deputy State Secretary

2000–2003: Office of Citizenship and Migration Affairs, Head

1999–2000: Ministry of the Interior, Parliamentary Secretary

1999: Saeima, Member of Parliament

1999: Privatisation Agency, Member of the Supervisory Board

EDUCATION

University of Latvia, Faculty of Law, Lawyer (1998)

Martin Sedlacky
Member of the Supervisory Board

TERM OF OFFICE

16.12.2016–15.12.2021

EXPERIENCE

2012–present: Air Baltic Corporation AS, Member of the Management Board, Chief Operating Officer

2006–2013: The Boston Consulting Group (Czech Republic), Project Manager

EDUCATION

University of Economics in Prague, CEMS Master in International Management (2006)

University of Economics in Prague, Engineer Degree in Economics (2006)

Latvenergo AS Management Board

Āris Žīgurs

Chairman of the Management Board and Chief Executive Officer

TERM OF OFFICE

16.11.2015–15.11.2020

EXPERIENCE

2016–present: Member of the Council of Higher Education

2015–present: Employers' Confederation of Latvia, Member of the Board

2013–present: Latvenergo AS, Chief Executive Officer

2011–present: RTU, Chairman of the Counsellor Convent

2011–present: LUA, Member of the Counsellor Convent

2011–present: Latvian National Committee of the World Energy Council, Vice President

2010–present: Latvenergo AS, Chairman of the Management Board

2010–present: EURELECTRIC, Member of the Board of Directors

1996–2010: Rīgas Siltums AS, President and Chairman of the Management Board

EDUCATION

RTU, Doctor of Sciences in Engineering, energy sector (2009)

RTU Riga Business School, Master of Business Administration (2004)

LUA, Faculty of Engineering, engineer-mechanic (1988)

Guntars Baļčūns

Member of the Management Board and Chief Financial Officer

16.11.2015–15.11.2020

2016–present: Elektrum Eesti OÜ, Member of the Supervisory Board

2016–present: Elektrum Lietuva UAB, Member of the Supervisory Board

2016–present: Baltic Institute of Corporate Governance, Member of the Supervisory Board

2015–present: Latvenergo AS, Chief Financial Officer

2015–present: Latvenergo AS, Member of the Management Board

2014–2015: Enerģijas publiskais tirgotājs AS, Member of the Management Board

2005–2015: Latvenergo AS, Business Planning and Control Director, Corporate Strategy Project Manager

RTU Riga Business School, Master of Business Administration (2016)

University of Latvia, Master of Economics (2005)

SSE Riga, Bachelor of Economics and Business Administration (2003)

Uldis Bariss

Member of the Management Board and Chief Commercial Officer

16.11.2015–15.11.2020

2013–present: Latvenergo AS, Chief Commercial Officer

2010–present: Elektrum Lietuva UAB, Chairman of the Supervisory Board

2010–present: Elektrum Eesti OÜ, Chairman of the Supervisory Board

2005–present: Latvenergo AS, Member of the Management Board

2005: Latvenergo AS, Project Director of Distribution Network Restructuring

2002–2004: Latvenergo AS, Economics Department Director

1996–2002: Lattelekom SIA, Head of the Financial Planning and Control Division, Head of the Management Accounting Sector

RTU, Doctor of Science in Engineering, Environmental Science (2017)

SSE Riga, Executive Master of Business Administration (2008)

University of Latvia, Master of Economics (2004)

Māris Kuņickis

Member of the Management Board and Chief Operating Officer

16.11.2015–15.11.2020

2013–present: Latvenergo AS, Chief Operating Officer

2012–present: EURELECTRIC, Deputy Member of the Board of Directors

2011–present: Latvian Association of Power Engineers and Energy Constructors (LAPEEC), Member of the Board

2010–present: Latvenergo AS, Member of the Management Board

2006–2010: Rīgas gaisma LGA, Director, Executive Officer

University of Latvia, Master's Degree, Faculty of Physics and Mathematics (2005)

RTU, Bachelor of Engineering, Faculty of Power and Electrical Engineering (2002)

Guntis Stafeckis

Member of the Management Board and Chief Technology and Support Officer (until 01.03.2018)

16.11.2015–01.03.2018

2016–2018: Latvenergo AS, Chief Technology and Support Officer

2015–2018: Latvenergo AS, Member of the Management Board

2011–2015: Latvijas elektriskie tīkli AS, Chief Executive Officer

2010–2011: Siltumelektroprojekts AS, Chief Executive Officer

1995–2009: Siemens SIA, Chief Executive Officer, Manager of the Energy Department, Manager of the Energy and Transport Systems Department

1995: Latvenergo AS, Deputy Head of the Technical and Production Department of the Daugava HPPs

RTU, Professional Master's Degree in Electrical Engineering (1986)

Latvenergo AS Audit Committee

Torben Pedersen
Chairman of the Audit Committee

TERM OF OFFICE

03.03.2017–02.03.2020

EXPERIENCE

2015–present: Electronic House UAB, Member of the Supervisory Board

2013–present: Vilnius International School, Shareholder Representative

2012–present: Latvenergo AS, Chairman of the Audit Committee

2013–2014: Rus-Agro Team AS, Member of the Management Board

2012–present: Baltic Engineers UAB, Chairman of the Management Board

2011–2016: Danish Chamber of Commerce in Lithuania, Member of the Supervisory Board

2001–2010: Deloitte, Partner

1994–2001: Arthur Andersen, Partner

EDUCATION

Aarhus School of Business, Master of Economics and Auditing (1974)

Chartered Accountant qualification (Denmark)

Marita Salgrāve
Member of the Audit Committee

TERM OF OFFICE

03.03.2017–02.03.2020

EXPERIENCE

2017–present: International Organization of Supreme Audit Institutions, FIPP member

2015–present: Latvenergo AS, Member of the Audit Committee

2015–present: State Audit Office of the Republic of Latvia, Advisor to the Auditor General in strategic matters

2007–2015: State Audit Office of the Republic of Latvia, Member of the Council, Director of the Fourth Audit Department

1998–2007: Central Finance and Contracting Agency, Deputy Director, Director of the Programme Management Department, Senior Procurement Specialist

1993–1998: Ramboll AS, Project Manager

EDUCATION

Sint-Aloysius School of Economics (EHSAL) (Belgium), Master of Business Administration (1998)

University of Latvia, Faculty of Economics and Management, postgraduate qualification of an economist (accountant) (1997)

Oxford College of Petroleum and Energy Studies, postgraduate qualification in energy and the environment (1995)

University of Latvia, Faculty of Chemistry, Master of Analytical Chemistry (1988)

Svens Dinsdorfs
Member of the Audit Committee

TERM OF OFFICE

03.03.2017–02.03.2020

EXPERIENCE

2017–present: INDEXO IPAS, Member of the Supervisory Board

2015–present: Elko Grupa AS, Director, Member of the Management Board

2012–present: Latvenergo AS, Member of the Audit Committee

2006–2014: Elko Grupa AS, Finance Director, Member of the Management Board

2004–2006: Sirowa Riga AS, Finance Director

1998–2004: Air Baltic Corporation AS, Vice President of Strategic Development, Business Control Director

EDUCATION

SSE Riga, Master of Finance and Economics (2003)

SSE Riga, Bachelor of Economics and Business Administration (1998)

2.3. GROUP MANAGEMENT

The Group's management is implemented according to the strategic directions

102-18 Latvenergo Group's management model is based on best corporate governance practice. In order to ensure effective governance of the Group, decision-making and achievement of goals, strategic and operational management are separated.

The Group's strategic management is ensured by the Management Board, whose accountability is joint according to the Commercial Law, and the operational management is ensured by Chief Officers, whose accountability is individual. The main duty of the Management Board is to lead the Group in order to reach the objectives stated in the strategy. At minimum, the Management Board reports to the Supervisory Board on a quarterly basis and to the shareholder on an annual basis. Chief Officers ensure the operational management of Latvenergo AS, including the achievement of set goals, implementation of strategy and developed policies, and other everyday duties according to delegation.

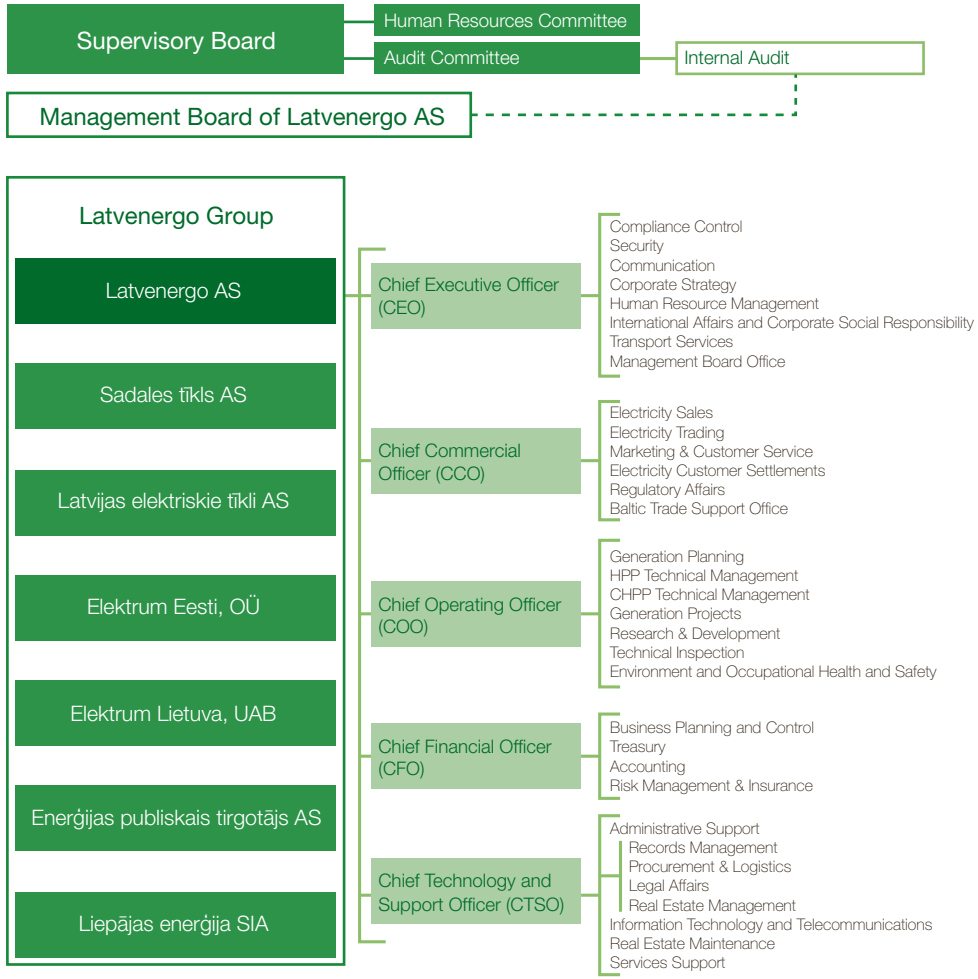
Considering their previous experience and knowledge of the Group's operations, the duties of Chief Officers are performed by the Members of the Management Board of Latvenergo AS. The division of duties of Chief Officers at the end of the reporting year was as follows:

- **Āris Žīgurs –** Chief Executive Officer;
- **Guntars Baļčūns –** Chief Financial Officer;
- **Uldis Bariss –** Chief Commercial Officer;
- **Māris Kuņickis –** Chief Operating Officer;
- **Guntis Stafeckis –** Chief Technology and Support Officer.

The Chief Officers' areas of accountability and subordinated functions are clearly defined. Chief Officers are individually accountable to the Chief Executive Officer for the operational activity of subordinated functions, ensuring their division's cooperation with the functions of other divisions and adoption of decisions in compliance with the Group's strategy. The Chief Executive Officer is accountable to the Management Board for the operational activity of subordinated functions. The areas are defined and accountability of the Chief Officers is set in accordance with the strategic goals of the Group.

In 2017, for the purpose of optimising the organisational structure required for performing the business operations of Latvenergo AS and the decision-making process, changes were implemented in the structure of the Generation Division. The past functions of Generation Projects and Maintenance Projects are now merged into the single function of Generation Projects. Also, the location of the Compliance Control function within the organisational structure was changed; it is now directly subordinated to the Chief Executive Officer.

Latvenergo Group Organisational Structure



2.4. INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT

The Group continuously improves its internal control system

Internal Control System

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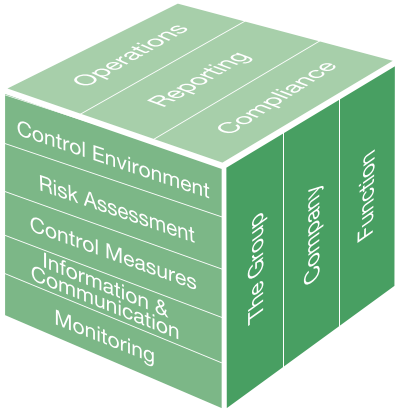
To ensure the achievement of Latvenergo Group's strategic goals, successful supervision and efficiency of operations, an internal control system has been introduced and is continuously improved at the Group. It has been developed taking into account the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework, which is among the internationally recognised internal control approach frameworks. Three key objectives of the internal control system:

- efficiency of the Group's operations;
- credibility of the disclosed information;
- compliance of operations with regulatory enactments.

COSO cube



Efficiency of the work processes

The goal of the work process of Latvenergo Group is operational efficiency and effectiveness. In order to continue improving the competitiveness of Latvenergo Group and to strengthen the position of the power utility on the dynamically changing regional market, during the strategy period until 2022 an efficiency programme is planned to provide for review, centralisation and digitalisation of the Group's processes.

Reporting

Reporting includes both internal and external reports on financial and non-financial operations. The credibility of the information delivered provides accurate and complete information to the management of Latvenergo Group for decision-making and supervision of company operations. External reports ensure that investors and other stakeholders are kept informed of the financial position of the company and its performance.

Compliance

Latvenergo Group operates in compliance with regulatory enactments. In order to ensure compliance with regulatory enactments, internal regulatory enactments and their compliance with external regulation is reviewed regularly, potential risks are identified and evaluated, and additional controls are developed.

In order to achieve the above goals on the level of Latvenergo Group, its subsidiaries and departments, the following internal control system's elements are continuously improved:

- control environment;
- risk assessment;
- control measures;
- information and communication;
- monitoring.

Control environment

The management of the Group promotes business activities that are in line with the principles of good faith and compliance with ethical standards and implements actions necessary to prevent the risk of corruption and fraudulent conduct and to promote the improvement of the control environment. Responsible persons for establishment and performance of controls are appointed on all organisational levels. In order to promote employee understanding of the internal control environment and processes, the Group holds regular employee trainings. On an annual basis, the Internal Audit provides a comprehensive opinion on the effectiveness of the internal control environment and develops recommendations for its improvement.

Risk assessment

Latvenergo Group continuously improves its risk management process in order to adapt to the changing business environment and market development trends. Risk assessment is increasingly integrated into all the company's governance processes. For more information on the Group's risk management process and major risks, see the section "Risk Management".

Control measures

Latvenergo Group has introduced and continuously improves integrated control measures, in particular the Group's governance policies, the regulations of structural units, the division of employee duties and responsibilities, etc. These are aimed at promoting implementation of the Group strategy and achievement of goals by ensuring economical, productive and efficient operations compliant with ethical standards.

Information and communication

Latvenergo Group's internal information and control systems ensure verified, accurate and reliable information for communicating both internally within the Group and to external stakeholders.

The management of Latvenergo Group provides regular information to employees on both long-term and short-term plans. The key information exchange and communication channels are the Intranet, the employee newsletter Latvenergo Vēstis, internal record-keeping systems, electronic communication, internal databases, employee forums and workshops. In order to ensure feedback, internal opinion surveys, employee development interviews and competence assessments are performed. Working groups are also established where representatives with various skills, know-how and competencies are delegated to ensure the exchange of employees' opinions and knowledge and raise their motivation and engagement in decision-making. In order to promote employee understanding of the internal control system, the Group organises employee trainings.

Monitoring

The Group's management is responsible for regular assessment and improvement of controls. The management's performance is monitored by the Supervisory Board (the Shareholder Meeting until formation of the Supervisory Board in December 2016), the Audit Committee and the Internal Audit. The external auditor issues an opinion on compliance of the financial reports. All the aforementioned institutions are independent in their operations.

Supervisory bodies

Institution	Objective	Monitoring scope and tasks	Reporting
Auditor	To provide an opinion on compliance of the Group's financial reports with the IFRS	▪ Auditing financial reports and checking the sustainability report; ▪ Evaluating accounting principles and justification of major management accounting estimates.	Once a year, following the finalization of the consolidated financial statements, the Auditor reports at the Shareholder Meeting.
Supervisory Board	To represent the interests of the Shareholder in between the Shareholder Meetings and supervise the operation of the Management Board	▪ Supervising the Management Board's operations; ▪ Approval of the medium-term operational strategy of the company; ▪ Evaluation of the work of the Audit Committee; ▪ Supervising the compliance of the company's operations with legislation, the Articles of Association and decisions adopted at the Shareholder Meeting.	At least once a year, the Supervisory Board reports at the Shareholder Meeting.
Audit Committee	To oversee the preparation of the Group's financial reports and the operation of internal control systems, thus stimulating transparency of company operations	▪ Supervising the preparation of financial reports; ▪ Supervising the effectiveness of the internal control and risk management system; ▪ Supervising the activities of the Internal Audit and the auditor as well as implementation of the Fraud Risk Management Plan; ▪ Ensuring the process of selection of the sworn auditor.	At least once a year, the Audit Committee reports on its activities and performance of tasks to the Supervisory Board.
Human Resources Committee	To ensure the supervisory functions of the Supervisory Board in the area of human resources management	▪ Ensuring the selection of the employees of the Management Board, the Audit Committee and the Internal Audit; ▪ Evaluation of the remuneration, performance and combining of positions of the Management Board, the Audit Committee and the Internal Audit employees.	The Human Resources Committee reports on its activities and performance of tasks to the Supervisory Board.
Internal Audit	To evaluate and assist governance bodies and structural units in improving the effectiveness of risk management, internal control and corporate governance processes	▪ Evaluating the effectiveness of internal control, risk management and corporate governance processes, preparing recommendations for their improvement and supervising their implementation.	Every quarter the Internal Audit reports to the Audit Committee on the audits performed and the status of implementation of audit recommendations.

Risk Management

The objective of Latvenergo Group risk management is to identify significant risks for the Group in a timely manner and manage them to ensure achievement of the Group's strategic goals and minimise potential losses or harm to its reputation.

Risk management at Latvenergo Group is integrated both in the processes of development and implementation of the strategy and in operational activities. The core principles of the Group's risk management are defined by the Risk Management Policy. The risk management process provides for continuous risk identification, assessment and management.

Significant risks for the Group are divided into four categories:

- *Strategic risks* involve matters of strategic importance for the Group, such as the industry development, new competitors entering the market, and implementation of projects of strategic importance. The main risk management instruments for this category are monitoring change and development trends in the energy sector and the political environment, participating in developments that affect the Group's operational aspects, and evaluating and implementing necessary changes in the Group;
- *Operational risks* include risks arising from the Group's operational specifics: energy generation, maintaining power plants and ensuring their functionality, and energy supply and distribution. Operational risks are associated with loss of assets, human health and safety, information technologies, environmental impact and other issues. Operational risks arise from imperfect or insufficiently effective processes and systems, employee error or insufficient competence, damage to equipment, or external events. The main risk management instruments for this category are continuous improvement of the internal control system, development and use of maintenance and development plans, and use of insurance services.
- *Financial risks* are risks associated with funding of the Group's operations. The Group is subject to various financial risks: market risks, credit risk, and liquidity and cash flow risks. In its financial risk management Latvenergo Group applies financial risk controls and performs various risk restriction measures. The Group uses long-term fixed price supply contracts with customers, electricity derivatives, natural gas supplies at fixed prices, and balanced placement of financial assets and instruments. Cash flow risk is restricted by using the credit facilities granted by banks allowing to meet existing and expected commitments and compensate for fluctuations in cash flows. Within the framework of financial risk restriction, tax, financial statement and reporting risks are also evaluated and monitored;
- *Legal and compliance risks* are risks arising from rules and regulations issued by the EU and Latvian institutions. The main risk management instruments for this risk category are monitoring changes and development trends in the legal environment that affect the Group's operational area, participation in the development process of new regulatory documents, and implementation of required changes in the Group. In order to minimise any kind of abuse or incorrect or unlawful action for personal gain, the Compliance and Control Department has been established at the Group. It organises and manages the compliance control process by ensuring effective fraud and corruption risk management at the companies of Latvenergo. Continuous employee training and monitoring is an important instrument for managing this type of risk.

The major risks identified by the Group are analysed in internal working groups and in the Risk Management Committee, which is a specially established risk management supervision institution on the level of the Management Board of Latvenergo AS. Within the analysis, the probability and impact of a risk is evaluated, critical controls are identified, risk mitigation measures are developed, and the implementation of critical controls and risk mitigation measures is supervised. Any risks identified are conveyed to the internal audit system, thus allowing the risk assessment to be used for planning the activities of the Internal Audit as well.

2.5. GROUP PROCUREMENT

The Group complies with and encourages its contractors to follow ethical and good faith principles of cooperation

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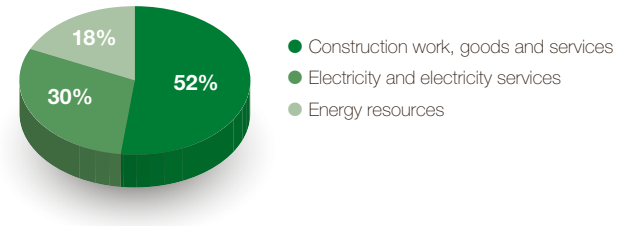
To ensure its operations, Latvenergo Group procures electricity, energy resources (natural gas, woodchips and diesel fuel) and fuel as well as various types of construction work, goods and services. In 2017, the total cost of Latvenergo Group's procurement was around EUR 670 million, approximately 50% of which constituted construction work, goods and services, while electricity and electricity services constituted approximately 30% and the cost of energy resources constituted approximately 20%.

Most of the Group's procurement was from suppliers and service providers in the Baltics and the Nordic countries. The total number of suppliers exceeds 3.5 thousand.

Types of procurement in 2017



The Group's procurement complies with EU legislation and the legal acts of the Republic of Latvia and those countries in whose territory the Group carries out its commercial activity. The key principles of the Group's procurement are based on the requirements of Directives 2014/24/EU and 2014/25/EU of the European Parliament and the Council and those of the Law on Procurement of Public Service Providers of the Republic of Latvia. The Group is committed to ensuring the most efficient use of funds and, in selecting suppliers, ensures competition and fair and equal treatment and follows the principle of transparency of procurement.

Latvenergo Group encourages its contractors to comply with comparable principles of ethics and, upon signing agreements, asks its partners to provide declarations of adherence to good faith principles of cooperation. The ethical principles for cooperation with contractual partners are published on the Group's website.

To ensure efficient procurement, Latvenergo Group has established a qualification system for suppliers of construction work and services, aimed at selecting and maintaining a list of qualified suppliers. The qualification system contains 24 types of construction work and engineering with 96 qualified contractors and planning engineers.

Procurement of construction work, goods and services

In 2017, Latvenergo Group's procurement of construction work, goods and services amounted to approximately EUR 350 million, constituting about 50% of its overall procurement expense. Investment in both reconstruction of existing assets and construction of new ones accounts for the largest share of procurement of construction work, goods and services. In 2017, the Group made investments amounting to EUR 243.8 million. In order to secure high quality power network service, technical indices and security of operations, a considerable amount of investment was made in network modernisation. Investment in network assets accounted for 65% of the total investment in the reporting year. The Group is also continuing reconstruction of the hydropower units of the Daugava HPPs, where EUR 41.8 million were invested in the reporting year.

The other major expense within the procurement of construction work, goods and services consists of procuring materials, repair work and various services. The expenses of Latvenergo AS and Sadales tīkls AS account for more than 90% thereof.

Electricity procurement

Purchased electricity (2013–2017)

	Unit	2013	2014	2015	2016	2017
Purchased electricity	GWh	3,656	5,590	4,701	4,081	3,544

In 2017, Latvenergo Group's procurement of electricity and electricity services amounted to approximately EUR 200 million, constituting about 30% of its overall procurement expense. Electricity and electricity service procurement expenses include ancillary electricity services and electricity future transactions performed to reduce price risks. The total amount of electricity and ancillary electricity services purchased wholesale was 3,544 GWh, which is 13% less than in the previous year. This was mainly due to higher electricity output at the Daugava HPPs. The Group sells all the electricity generated by its plants and at the same time procures electricity for its customers on the Nord Pool, the leading international power exchange in Europe, thus ensuring full transparency of procurement.

Latvenergo Group's electricity procurement process is targeted at cost optimisation and provides economic benefits to both the Group and its customers. Generation volumes of the Riga CHPPs and Daugava HPPs are linked to economically equivalent volumes of customer portfolios, thus achieving cost-effectiveness while excluding internal price risks between sale and purchase transactions. The Group's customer portfolio can be made larger than its generation volumes by including additional electricity financial instruments in the price risk management and making use of the flexibility of the Group's generation assets, switching strategically between electricity supply sources: the power exchange and the Group's own power plants. In this way, Latvenergo Group realises the profit potential of sales of electricity generated, utilises possibilities to reduce the cost of procuring electricity necessary for customers, and reduces its exposure to market price fluctuation risks. Moreover, the Riga CHPPs provide for the possibility to stabilise electricity prices in the region.

Energy resource procurement

Amounts of fuel consumed (2013–2017)

	Unit	2013	2014	2015	2016	2017
Natural gas*	thsd. nm^3	597,846	517,119	569,004	598,425	465,741
Wood chips	loose m^3	169,801	233,786	216,645	232,792	255,352
Diesel fuel	m^3	5	111	120	18	12

*as of 2017, also includes the volume of natural gas sold

The energy resource procurement of Latvenergo Group comprises natural gas, woodchips and diesel fuel. In 2017, its expense amounted to EUR 120 million or 20% of the overall procurement expense. The Riga CHPPs accounted for more than 90% of fuel expenses, the rest coming from the Liepaja plants and Kegums Boiler House.

Natural gas accounts for the largest share of Latvenergo Group's overall fuel expenses. It is used as the primary fuel by the Riga CHPPs and as one of the fuel sources by the Liepāja plants.

Until 3 April 2017 Latvijas Gāze AS held the monopoly right to natural gas sales and utilisation of the natural gas system. Since the opening of the market, any consumer is free to choose their natural gas merchant and any user of the system has the right to access the system at the tariffs approved by the PUC. Since 1 June 2017, Latvenergo Group has organised natural gas supplies to the Riga CHPPs through wholesale purchases of natural gas. Liepājas enerģija SIA buys natural gas from Latvijas Gāze AS.

In 2017 Latvenergo Group consumed 466 million nm^3 or 4,907 GWh of natural gas, which is 22% below the level of the previous year. Annual natural gas consumption at Latvenergo Group plants ranged from 500 to 600 million nm^3 during preceding years depending on thermal energy demand and market conditions. Moreover, three new heat producers started operating in the vicinity of Riga CHPP-2 in 2017, thus increasing competition on the thermal energy market.

To ensure the reliability of thermal energy supply for emergency situations when the supply of natural gas is interrupted, the Riga CHPPs store backup fuel reserves of diesel. The boiler house of Liepājas enerģija SIA also uses diesel. Procurement of diesel fuel accounts for an insubstantial share of the overall expense of energy resource procurement at the Group.

At the Liepaja plants and Ķegums Boiler House a renewable energy source, woodchips, is used, which accounted for approximately 2% of the total fuel procurement expense in 2017.

Like all other goods and services, woodchips and diesel fuel are procured under the conditions of free competition.

2.6. STAKEHOLDER ENGAGEMENT

We provide for various forms of stakeholder engagement in our activities

102-40 The operation of Latvenergo Group affects a broad range of stakeholders. By assessing the social, environmental and economic impact of its operations, the Group ensures varied engagement of
102-42 stakeholders therein.

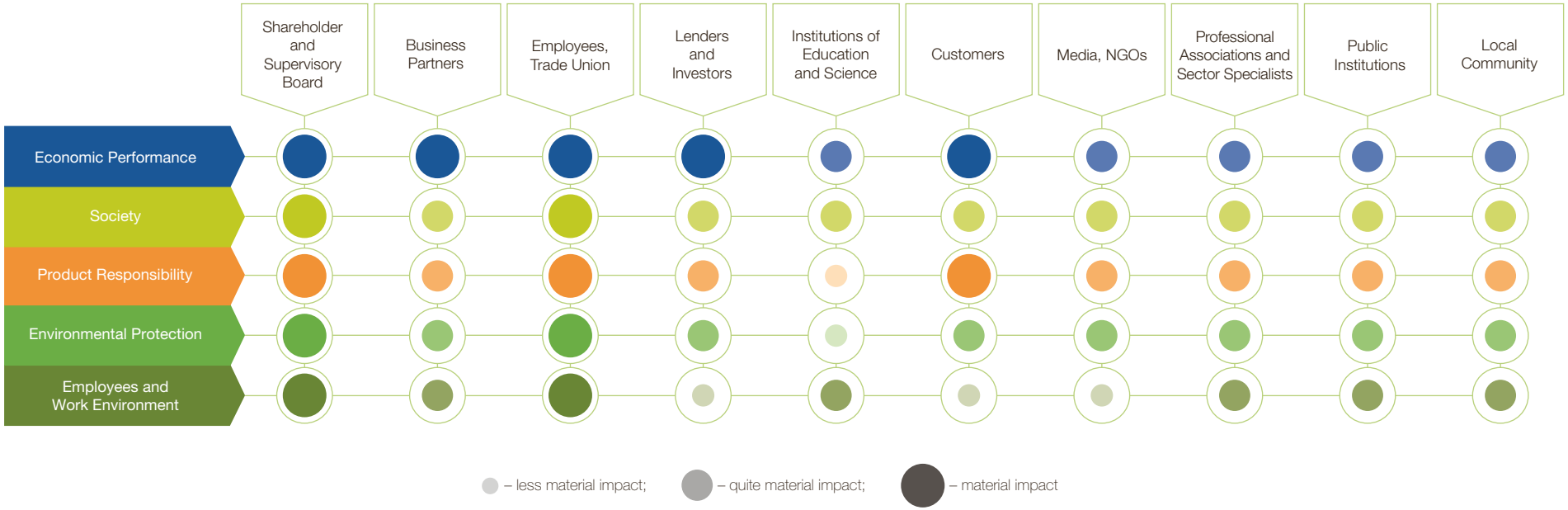
102-43 Through internal and external discussions, Latvenergo Group has identified stakeholders who have been
102-44 grouped into a stakeholder map. Stakeholders are evaluated according to their impact on Latvenergo Group's operations and vice versa. The evaluation is carried out in the areas of economic performance, society, product responsibility, environmental protection and employment and work environment. Identification and grouping is carried out taking into account the GRI guidelines and the AA1000 Stakeholder Engagement Standard, which sets an example for best practice in quality stakeholder engagement at both a strategic and an operational level.

Latvenergo Group engages with stakeholders on several levels:
- consultation – identification of current issues;
- negotiation – participatory discussions;
- involvement – exchange of opinion without joint decision-making and cooperation;
- collaboration – joint decision-making and cooperation.

In 2017, Latvenergo Group continued to promote best practice in sustainability, social responsibility and corporate governance. The Group shared its experience at conferences organised by the Cross-Sectoral Coordination Centre, the Institute for Corporate Sustainability and Responsibility, the Free Trade Union Confederation of Latvia and the ECL.

For more information on the sustainability aspects jointly defined by stakeholders and the Group, see the section "Materiality Assessment".

Stakeholders of Latvenergo Group



Stakeholders

Stakeholder	Representatives	Material issues / Sustainability aspects	Engagement description	Level of engagement
Shareholder and Supervisory Board	Ministry of Economics of the Republic of Latvia, Members of the Supervisory Board	▪ Group strategy, governance, investments and performance; ▪ Compliance with the requirements of regulatory acts and fair competition; ▪ Involvement in the development of energy sector policy; ▪ The Group's contribution to the national economy; ▪ Efficiency of energy generation facilities; ▪ Electricity and thermal energy generation from renewable energy resources, increasing its share; ▪ Contribution to the promotion of public welfare and CSR activities; ▪ Contingency management plans.	Information on the shareholder and the Supervisory Board is available in the section "Governance Bodies".	Collaboration
Business Partners	Construction companies and equipment suppliers, service providers, energy resource suppliers, energy generators and traders, transmission system operators, etc.	▪ Clear and transparent procurement tenders; ▪ Electricity transmission and distribution, natural gas transmission; ▪ Mandatory procurement (MP) of electricity and subsidised electricity tax (SET); ▪ Development of electricity interconnections; ▪ Efficiency of energy generation facilities.	The Group regularly informs its business partners about ethical principles, maintains and regularly updates its Register of Qualified Bidders, and encourages partners to apply for inclusion in its qualification system. The Group regularly surveys its current and potential business partners, defining areas where improvement is required. Sadales tīkls AS regularly informs business partners about planned investment projects.	Involvement
Employees, Trade Union	Existing and potential employees, trade union "Enerģija"	▪ Collective Bargaining Agreement, healthy and safe working environment, rights and responsibilities of the employer and employees; ▪ Productivity and motivation, competencies, remuneration and welfare of employees; ▪ Data safety; ▪ Availability and efficiency of distribution services; ▪ The Group's contribution to the national economy.	Latvenergo Group conducts annual employee opinion polls to investigate employees' attitudes towards various factors that impact the work environment. Employee performance is assessed on a quarterly basis. During the annual career development interviews, employees and their managers discuss achievement of annual targets of the structural unit and individual targets and further activities for improving their competencies. The annual employee opinion polls also contain questions about the use and the content of the Sustainability Report. The Management Board of Sadales tīkls AS organises an annual meeting with all the company's employees and representatives of the trade union where it reviews the performance of the year and elucidates on the company's goals for the following years. In 2017 representatives of the Group had 24 meetings with the trade union to look for solutions to issues of mutual importance.	Negotiation and involvement
Funders and Investors	Banks, European Commission (EC), bondholders	▪ The Group's financial results, significant events, compliance with the terms of agreements; ▪ Involvement in the development of energy sector policy; ▪ Compliance with the requirements of regulatory acts and fair competition; ▪ Transparent, fair and ethical marketing and communication practice; ▪ Customer satisfaction with the company, its services, service level, availability of information and its content; ▪ The Group's contribution to the national economy.	On Latvenergo Group's website, information is provided on the Group's financial results and performance indicators, including quarterly publication of interim financial reports. All relevant information is also published on the Nasdaq Riga exchange website and submitted to the Official System for Central Storage of the Regulated Information of the Financial and Capital Market Commission. Since 2015 Latvenergo Group has been organising regular webinars on financial results and business developments where stakeholders can post questions online. In August 2017 representatives of Latvenergo AS rang the traditional trading session opening bell at Nasdaq MarketSite in New York's Times Square. Latvenergo AS is the first company in the Baltics to receive the Nasdaq Baltics exchange award for the Best Investor Relations among Bond Issuers.	Consultation and collaboration
Institutions of Education and Science	Academic institutions, institutions of higher, secondary and vocational education	▪ Educational programmes meeting the requirements of the labour market; ▪ Content of educational materials for children and youth; ▪ Contribution to the promotion of public welfare and CSR activities; ▪ Involvement in the development of energy sector policy; ▪ Transparent, fair and ethical marketing and communication practice; ▪ Availability of information.	The Group's experts participate in theoretical and practical training of specialists in cooperation with LUA and RTU. In cooperation with the Latvian Academy of Sciences, the Group awards scientists for their achievements in the energy sector, organises graduation paper and scholarship competitions, and provides students with internship opportunities. For more information on cooperation with institutions of education and science, see the section "Corporate Social Responsibility".	Collaboration

Stakeholders

Stakeholder	Representatives	Material issues / Sustainability aspects	Engagement description	Level of engagement
Customers	Current and potential customers (households and legal entities)	▪ Electricity products, tariffs, pricing of related services; ▪ Quality of services provided; ▪ Customer satisfaction with the company, its services, service level, availability of information and its content; ▪ Payment options and services; ▪ Availability and efficiency of distribution services; ▪ Reducing the frequency and duration of unscheduled power outages; ▪ Transparent, fair and ethical marketing and communication practice; ▪ Compliance with the requirements of regulatory acts and fair competition; ▪ Contingency management plans.	Latvenergo Group's assortment of electricity products is adjusted to customer needs by introducing new products and improving existing ones. Information the customers are interested in is available on Elektrum customer portals in the Baltic countries, on the customer portal of Sadales tīkls AS, on social networks, at customer service centres and via other information channels. For corporate customers, the Group regularly prepares the Electricity Market Overview. The Energy Efficiency Centre in Jūrmala organises regular free seminars on possibilities to improve electricity usage habits. Latvenergo Group conducts annual customer satisfaction surveys and undertakes activities to increase customer satisfaction. For more information, see the section "Product Responsibility".	Involvement
Media, Non-Governmental Organisations (NGOs)	Journalists, NGOs	▪ The Group's core operations and corporate governance; ▪ Current issues in energy sector policy in Latvia and the EU; ▪ MP and the MP component; ▪ The Group's CSR activities; ▪ Efficiency of energy generation facilities; ▪ Contingency management plans; ▪ Electricity and thermal energy generation from renewable resources; ▪ Occupational health and safety; ▪ Availability and efficiency of distribution services.	Latvenergo Group cooperates with national and regional media. About 270 press releases were prepared in 2017 and several media events and press conferences were organised. The main topics were the MPC and the impact of the solutions developed for its reduction on the MPC payments to Latvenergo AS, replenishment of fish stocks and cleaning of the Vedze River. The Group regularly provides up-to-date information on its activities and answers questions from journalists on its website and in social media. Latvenergo Group also provides information related to its core business to NGOs whose activities are focused on the development of civic society and protection of individual rights.	Consultation and involvement
Professional Associations and Sector Specialists	See the section "Representation at Associations, Organisations and Unions"	▪ The energy sector's policies and the regulatory environment in the EU and Latvia; ▪ Development trends and innovations in the energy sector; ▪ Optimisation of electricity consumption for one's own use; ▪ Electricity and thermal energy generation from renewable resources; ▪ The amount of air pollution from generation of electricity and thermal energy; ▪ Expenditure on environmental protection; ▪ Compliance with environmental protection requirements; ▪ Compliance with the requirements of regulatory acts and fair competition; ▪ Contingency management plans; ▪ Transparent, fair and ethical marketing and communication practice; ▪ Contribution to the national economy.	Representatives of Latvenergo Group regularly discuss development issues of the energy sector and related sectors with industry experts at various forums, conferences, workshops and working groups. In 2017, the Group's representatives participated in the energy forum "Towards sustainable energy supply in Latvia", in the conference "Energy 2017" and in the Baltic Energy Forum 2017, as well as in other events. For more information, see the section "Representation at Associations, Organisations and Unions".	Consultation and involvement
Public Institutions	Ministry of Economics of the Republic of Latvia, Public Utilities Commission (PUC), Competition Council, Ministry of Environmental Protection and Regional Development, Procurement Monitoring Bureau, etc.	▪ Development of Latvian and EU energy policies and regulatory provisions; ▪ Improvement of the regulatory environment; ▪ Energy tariffs and their components; ▪ Electricity and thermal energy generation from renewable resources; ▪ Contingency management plans; ▪ Compliance with the requirements of regulatory acts and fair competition; ▪ Efficiency of energy generation facilities.	Latvenergo Group experts participate in the development of energy sector policy documents and legislative acts and regularly provide opinions for the preparation of national position statements on energy and environmental matters on the current agenda of the EU Council. Information on position statements prepared in 2017 is available in the section "Society". In compliance with the procedure provided for by the legal acts, Latvenergo Group cooperates with the Competition Council and also provides regular information on its operations, financial results and calculation of the MP components to the PUC.	Consultation and involvement
Local Community	Residents of Latvia, municipalities, residents in the vicinity of the Group's facilities	▪ The Group's CSR activities; ▪ Environmental protection, modernisation of generation facilities, and electricity network infrastructure projects; ▪ Provision of Latvenergo Group services and problem solving; ▪ MP component.	The local community is regularly involved in the discussion of the modernisation projects at the Group's facilities. The opinion of Latvian society is regularly surveyed through various opinion polls, including a survey on residents' awareness of the Latvian electricity market. The Group also organises a wide range of social responsibility activities, which are described in the section "Corporate Social Responsibility". The Group cooperates with local governments regarding provision of energy supply, environmental impact assessment for modernisation projects at the Group's facilities, and the development of the regulatory environment for the energy sector by municipalities and public institutions. In spring there are regular interinstitutional meetings to secure the preparedness of responsible services, institutions and local governments and their action during the spring flood period in the Daugava River basin. Sadales tīkls AS regularly organises meetings with all the local governments of Latvia and informs them about the work performed to improve the energy supply and the power network renovation and reconstruction projects planned in the territories of municipalities.	Consultation, involvement and negotiation

Representation at Associations, Organisations and Unions

102-13 Participation in national associations and professional organisations as well as international organisations and unions provides information to Latvenergo Group on current developments in the energy sector and related sectors and ensures representation of its interests in the development of national and international policy documents, legal acts and standards.

National Associations and Professional Organisations

	Association, Professional Organisation	Engagement description
	Latvian Association of Power Engineers and Energy Constructors (LAPEEC)	Membership in the Association provides an opportunity to participate in the evaluation and development of legal acts, policy documents and standards for the electrical power engineering and energy construction sector; the organisation of staff certification and training programmes; performance of scientific research and organisation of scientific and technical events related to electrical power engineering; and cooperation with educational institutions in the electrical power engineering sector. Latvenergo Group representatives regularly participate in LAPEEC meetings to ensure exchange of opinions on topical issues for the energy sector, including the energy security and development of the Daugava infrastructure and the development of the Latvian national standardisation system for improving the competitiveness of the national economy and innovation.
	Latvian Association of Large Dams	Membership in the Association ensures exchange of information on technical, economic, environmental and social aspects of dams and related innovations and safety issues. The Association is represented at the International Commission on Large Dams (ICOLD). In 2017, representatives of the Association participated in the 85th ICOLD Annual Meeting in the Czech Republic and continued work on the ICOLD Dam Safety Committee.
	Latvian Association of Heat Supply Companies (LAHC)	The LAHC provides Latvenergo Group with current information on district heating, tariffs and cogeneration, use of renewable resources in generation of thermal energy and other topical issues in energy sector development. The LAHC also organises meetings of experts and supports the interests of the Group at state and local government institutions in matters related to heat supply. Group experts participate in developing the LAHC's positions on drafts of policy documents and legal acts important for the sector.
	Latvian Chamber of Commerce and Industry (LCCI)	The LCCI is a member of the Association of European Chambers of Commerce and Industry and of the International Chamber of Commerce. The LCCI represents the interests of its members in drafting policy documents and legislation specific to business activity in general and the energy sector by state and local government institutions. Group experts share their experience in the energy sector at seminars held by the LCCI. In 2017, Group representatives provided information on possibilities of improving companies' energy efficiency and the practical aspects of opening the gas market.
	Employers' Confederation of Latvia (ECL)	Participation in the ECL ensures representation of the Group's interests in the drafting of policy documents and legislation on labour law and labour protection and fosters the development of economic, educational and social policies favourable to business development. Latvenergo Group representatives are involved in the ECL Platform for Energy and the Environment and in the drafting of position statements, and they participated in ECL working groups, competitions, conferences and workshops.
	Institute for Corporate Sustainability and Responsibility	Since 2010, the Group has participated in the Sustainability Index of Latvia, conducted by the Institute for Corporate Sustainability and Responsibility based on an internationally recognised methodology for evaluating corporate sustainability and responsibility. Latvenergo AS became a corporate member of the Institute in July 2017. This will secure the possibility for the Group to receive information on the latest CSR trends and to participate in development of the planning documents of responsible business operations policy. In 2017, the Group participated in Sustainability Week organised by the Institute, including the conference "Market of Responsible Ideas" and the creation of the Responsible Ideas Catalogue by providing information on the Group's activities to stimulate young people's interest in physics.
	World Energy Council, Latvian National Committee (WEC LNC)	Participation in the WEC LNC provides information about the research, extraction, transport, transformation and efficient use of energy resources on both a national and international scale. Latvenergo Group experts participate in the activities of the WEC LNC, including analysis of energy policy documents and legal acts and organisation of forums. In 2017 WEC LNC representatives participated in the WEC Baltic Sea Region national committee's discussion and presented reports on energy policy in Latvia, the operations of the WEC LNC and the Latvian natural gas market.

International Organisations and Unions		
	International Organisation, Union	Justification of Membership
BALTIC INSTITUTE OF CORPORATE GOVERNANCE	The Baltic Institute of Corporate Governance (BICG)	Latvenergo Group has been an active BICG member since the very outset of the operations of the Institute. The Group engages in activities and training and assists with the development of corporate governance guidelines for Baltic companies and the development of good corporate governance practice in Latvia. Latvenergo Group's management has completed the BICG education programmes on good corporate governance practice and has confirmed the Group's preparedness to comply therewith.
eurelectric ELECTRICITY FOR EUROPE	Union of the Electricity Industry EURELECTRIC	EURELECTRIC represents the interests of the electricity industry on an international level. Participation of Latvenergo Group representatives in the Union is ensured by the LAPEEC, a member of EURELECTRIC. Participation in EURELECTRIC's Board of Directors, committees and working groups gives Latvenergo Group access to information on the latest EU developments in the energy sector and provides an opportunity to participate in the drafting of EU policy documents, legislation, and EURELECTRIC research papers and position statements. In September 2017, Kristian Ruby, the Secretary General of EURELECTRIC, visited Riga and presented the EURELECTRIC development vision until the year 2020 to representatives of Latvenergo Group and LAPEEC. The meeting's participants also discussed the positions of the Association regarding EU energy policy. For more information on the involvement of Latvenergo Group in drafting EURELECTRIC position statements in 2017, see the section "Society".
OECD BETTER POLICIES FOR BETTER LIVES BIAC	Organization for Economic Cooperation and Development (OECD), Business and Industry Advisory Committee (BIAC)	The BIAC is involved in the shaping of OECD policies and provides members with up-to-date information on the OECD's business development initiatives. BIAC membership enables Latvenergo Group to participate in discussions and decision-making on business development matters of international importance. In 2017, Latvenergo Group participated in the fifth Global OECD Forum on Responsible Business Conduct as well as in the business session and consultations of stakeholders on improvement of the operation of the national contact points organised by the OECD.
Member of VGB POWERTECH www.vgb.org	Technical Association for Power and Heat Generation VGB PowerTech e.V.	Representation in the Association ensures that Latvenergo Group receives information on the best practice of power plants in the areas of exploitation, development and environmental protection, including the availability and safety of similar power plant equipment and solutions for increasing operational flexibility and efficiency. In 2017 new working groups and committees were established at VGB providing technical consultations and exchange of experience on technologies using renewable resources. The experience of VGB members has been used for optimisation of the operation and maintenance of the Group's production facilities.
EDSO for smart grids	European Distribution System Operators' Association for Smart Grids	Representation in the Association ensures that the Group's subsidiary Sadales tīkls AS receives up-to-date information on European distribution system operators' plans and on smart grid technologies. It also enables participation in drafting position statements in the area of smart grids.
ENCS	European Network for Cyber Security, ENCS	The ENCS is a non-profit organisation founded in 2012 which unites critical infrastructure companies (including distribution system operators) and security experts in order to facilitate the exchange of information and support competence development needed for cyber security and secure infrastructure of smart grids. To ensure information exchange and experience as well as sustainable development as regards protection of information and improvement of processes, Sadales tīkls AS became a member of the ENCS in 2017.

Other commitments and initiatives

102-12 The environment, energy efficiency and social responsibility are important aspects for the sustainability of Latvenergo Group. Therefore, in addition to the requirements stipulated by regulatory enactments, the Group follows the requirements of international standards in its operations.

By complying with the requirements of the European Union's regulatory enactments on energy efficiency, Latvenergo AS has implemented and certified an energy management system in compliance with ISO 50001. In 2017, Liepājas enerģija SIA also received a certificate for its energy management system's compliance with this standard. In order to implement the requirements of energy efficiency at Sadales tīkls AS, the energy management principles are integrated in its certified environmental management system.

Integrated management systems comprising environmental management, quality management and occupational health and safety are implemented and certified in the Generation Division of Latvenergo AS and at Sadales tīkls AS. In the Generation Division, project management has also been implemented and certified within the scope of the quality management system. An accredited certification company audits and certifies the compliance of the abovementioned systems with the requirements of ISO 14001, ISO 9001, and OHSAS 18001. In 2017, the environmental management system was expanded and implemented in all the areas of operation of Latvenergo AS.

The subsidiaries Latvijas elektriskie tīkli AS and Liepājas enerģija SIA have certified and maintain quality management systems in compliance with ISO 9001 requirements.

In cooperation with stakeholders, Latvenergo Group voluntarily integrates activities into its operations to improve public welfare and the environmental situation, following the principles of the ISO 26000 standard on social responsibility and the AA1000 standard on stakeholder engagement.

2.7. CORPORATE GOVERNANCE REPORT

The Management Board of Latvenergo AS has evaluated the company's compliance with the Law on the Financial Instruments Market, Article 56.2, and the Principles of Corporate Governance and Recommendations on Their Implementation approved by Nasdaq Riga AS on 1 June 2010. The principles have been prepared taking into account the recommendations of the EU and the OECD on the governance of capital companies. They set requirements with respect to shareholder meetings, management and supervisory boards, disclosure of information, internal control and risk management, and the remuneration policies of governing bodies.

Upon evaluating the company's governance system and compliance with these principles in 2017, the Management Board of Latvenergo AS confirms that the company has complied with all applicable principles of corporate governance in all key material aspects.

The full text of the Latvenergo AS Corporate Governance Report 2017 is publicly available on the Latvenergo website (www.latvenergo.lv) and the Nasdaq Baltic website (www.nasdaqbaltic.com). Detailed information on compliance with the corporate governance principles is presented in the Corporate Governance section of the Sustainability Report 2017. Of the 83 Nasdaq Riga corporate governance principles, Latvenergo AS complies with 77 fully, while 6 are not applicable to company operations.

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Māris Kuņickis
Member of the Management Board

2.8. AUDIT COMMITTEE REPORT

The Audit Committee of Latvenergo AS operates under the Commercial Law and Financial Instruments Market Law of the Republic of Latvia and the Rules of the Audit Committee approved by the Shareholder.

No restrictions have been imposed on our actions, and representatives of Latvenergo AS have ensured the availability of necessary information. We have informed the members of the Management Board of our conclusions and recommendations based on the work of the Audit Committee.

In 2017, the activities of the Audit Committee focused on reviewing the following issues, which impact the Group's operations:

- the Group's risk management processes, including integration of the Group's risk assessments into the planning and execution of the internal audit plan;
- supervision of the Fraud Risk Management plan's execution;
- monitoring of the operations of the Internal Audit and the external auditor.

The Audit Committee has also carried out the selection process of the external auditor for the period 2018-2022 and of the Internal Audit Director.

Having assessed the information and processes reviewed during the 2017 financial year, nothing has come to our attention that would lead us to believe that the internal controls of Latvenergo AS do not provide a reliable basis for the preparation of the 2017 Annual Report.

We submit our activity report and assessments to the Supervisory Board of Latvenergo AS in April 2018.

Torben Pedersen
Chairman of the Audit Committee

Marita Salgrāve
Member of the Audit Committee

Svens Dinsdorfs
Member of the Audit Committee

Andris Ozoliņš
Member of the Audit Committee

Andris Liepiņš
Member of the Audit Committee

OPERATING SEGMENTS

102-2
102-10

Latvenergo Group's activity is organised along three operating segments: generation and trade, distribution, and lease of transmission system assets.

The generation and trade segment comprises generation of electricity and thermal energy, ensured by Latvenergo AS and Liepājas enerģija SIA, as well as electricity and natural gas trade (retail and wholesale) operations in the Baltic States carried out by Latvenergo AS and subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

The functions of public trader, i.e. administration of electricity mandatory procurement, are performed by the subsidiary Enerģijas publiskais tirgotājs AS.

The distribution segment provides electricity distribution services in Latvia through Sadales tīkls AS – the largest distribution system operator in Latvia.

The segment handling lease of transmission system assets is ensured by Latvijas elektriskie tīkli AS, the owner of the transmission system assets, which leases them to the transmission system operator Augstsprieguma tīkls AS.

3.1. GENERATION AND TRADE

We produce 83% of the electricity sold to customers

Generation and trade is the Group's largest operating segment in terms of both revenue and EBITDA value. Activities within this segment include trade of generated and procured electricity both to retail customers in the Baltics and wholesale on the Nord Pool power market. The Group also generates and trades thermal energy in Riga and Liepaja. Since 1 June 2017, Latvenergo AS has organised natural gas supplies to its generating facilities independently through wholesale purchases of natural gas. The Group has also launched natural gas trade to customers in Latvia and Estonia.

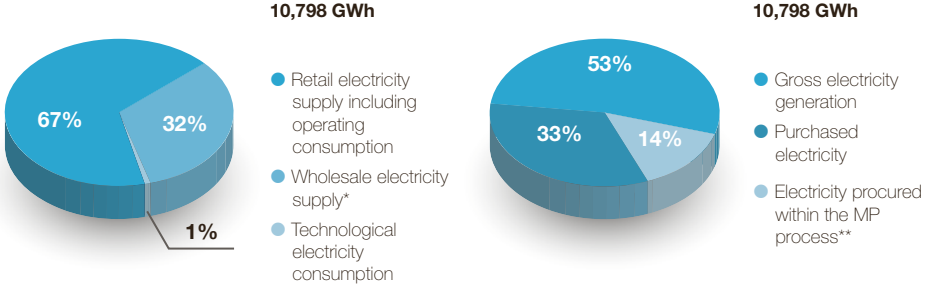
The majority of generation and trade segment revenue is unregulated, while tariff-regulated operational revenue comprises revenue from:

- capacity payments for the installed electrical capacity and generation of thermal energy at Riga combined heat and power plants (CHPPs);
- generation of electricity and thermal energy at Liepaja generation facilities and small plants (Aiviekste Hydropower Plant (HPP) and Kegums Boiler House).

Latvenergo is among the biggest electricity traders in the Baltics. In 2017, its market share in the Baltic countries amounted to approximately 27%. The total amount of electricity supplied in retail and wholesale (including auxiliary consumption) constituted 10,798 GWh, of which 64% was supplied to retail customers.

In 2017, Latvenergo Group power plants generated 5,734 GWh or 53% of the total electricity trade. Compared to 2016, the electricity generated increased by 22%. 75% of the electricity was generated from renewable energy sources. The generation capacities of Latvenergo Group also ensure electricity trade support services, such as provision of emergency back-up capacity and supply of regulating electricity to transmission system operators.

Latvenergo Group electricity balance sheet in 2017



Latvenergo Group electricity balance sheet (2013–2017)*

	Unit	2013	2014	2015	2016	2017
Retail electricity supply including operating consumption	GWh	8,065	8,800	7,961	7,666	7,259
incl. retail electricity supply	GWh	8,065	8,800	7,961	7,666	6,923
Wholesale electricity supply*	GWh	1,588	1,562	1,907	2,474	3,448
Technological electricity consumption	GWh	104	89	95	105	91
TOTAL	**GWh**	**9,757**	**10,451**	**9,963**	**10,245**	**10,798**
Gross electricity generation	GWh	4,854	3,625	3,882	4,707	5,734
Electricity procured within the MP process**	GWh	1,247	1,235	1,380	1,457	1,520
Purchased electricity	GWh	3,656	5,590	4,701	4,081	3,544
TOTAL	**GWh**	**9,757**	**10,451**	**9,963**	**10,245**	**10,798**

* the amount of electricity generated at Latvenergo Group facilities, which has been traded and procured on the electricity exchange for auxiliary consumption purposes, was not included in Latvenergo Group electricity balance
** excluding electricity generated by Latvenergo Group

3.1.1. Generation

75% of the total electricity output is produced from renewable energy sources

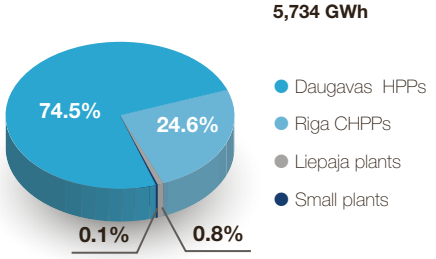
EU1 EU2

Latvenergo Group has a balanced and environmentally friendly energy generation portfolio, consisting mostly of hydropower plants and highly efficient combined heat and power plants. Most of the electricity and thermal energy is generated by the three Daugava HPPs and two Riga CHPPs. Energy is also generated by generation facilities in Liepaja, Aiviekste HPP, Ainazi Wind Power Plant (WPP) and Kegums Boiler House.

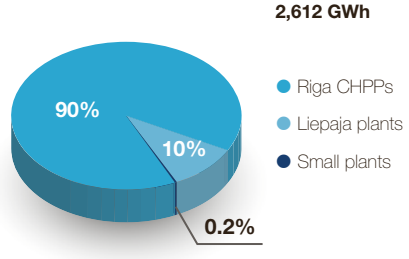
The total installed electrical capacity at Latvenergo Group generation facilities is 2,569 MW, exceeding 85% of the total installed capacity at power plants in Latvia. The installed thermal capacity of Latvenergo Group thermal energy generation facilities is 1,842 MW.

In 2017, the facilities of Latvenergo Group generated 5,734 GWh of electricity and 2,612 GWh of thermal energy. The total electricity generation accounted for 79% of the total electricity consumption in Latvia. The electricity sales outside Latvia accounted for 1/3 of the total retail sales of electricity and amounted to 2.3 TWh.

Electricity generation in 2017



Thermal energy generation in 2017



Installed electrical capacity of generation facilities (2013-2017)

	Unit	2013	2014	2015	2016	2017
Daugava HPPs	MW_{el}	1,536	1,536	1,536	1,536	1,536
Riga CHPPs*	MW_{el}	1,025	1,025	1,025	1,025	1,025
Liepaja plants	MW_{el}	6	6	6	6	6
Small plants	MW_{el}	2	2	2	2	2
TOTAL	**MW_{el}**	**2,569**	**2,569**	**2,569**	**2,569**	**2,569**

* installed capacity when Riga CHPP-2 is in condensation mode

Installed thermal energy capacity of generation facilities (2013-2017)

	Unit	2013	2014	2015	2016	2017
Riga CHPPs	MW_{th}	1,617	1,617	1,617	1,617	1,617
Liepaja plants	MW_{th}	236	223	223	221	221
Small plants	MW_{th}	4	4	4	4	4
TOTAL	**MW_{th}**	**1,857**	**1,844**	**1,844**	**1,842**	**1,842**

Electricity generation (2013-2017)

	Unit	2013	2014	2015	2016	2017
Daugava HPPs	GWh	2,852	1,925	1,805	2,449	4,270
Riga CHPPs	GWh	1,957	1,648	2,025	2 206	1,411
Liepaja plants	GWh	43	48	48	47	48
Small plants	GWh	3	4	3	5	5
TOTAL	**GWh**	**4,854**	**3,625**	**3,882**	**4,707**	**5,734**

Thermal energy generation (2013-2017)

	Unit	2013	2014	2015	2016	2017
Riga CHPPs	GWh	2,305	2,308	2,175	2,417	2,349
Liepaja plants	GWh	257	248	229	253	258
Small plants	GWh	5	5	4	5	5
TOTAL	**GWh**	**2,566**	**2,560**	**2,408**	**2,675**	**2,612**

Daugava HPPs

The Daugava HPPs are the biggest hydropower plants in the country providing for an environmentally friendly mode of electricity generation. They operate on water – a renewable energy source.

Although the installed capacity of the Daugava HPPs is high, their ability to generate electricity depends on the water inflow in the Daugava River. In years with normal inflow levels, the Daugava HPPs operate at full capacity during the spring flooding season, which lasts for about one to two months annually. During the flooding period, the water volume may exceed water inflow during low water periods more than 10 times. During the spring flooding, Latvenergo Group is able to cover the entire customer demand for electricity and trade the excess on the electricity exchange.

Outside the flooding season, the Daugava HPPs provide for the possibility to accumulate water and generate electricity when the demand and prices on the Nord Pool exchange increase.

In 2017, the Daugava HPPs generated 4,270 GWh of electricity, which is 74% above the level of the previous year. The water inflow to the Daugava was exceptionally high in 2017. According to data from the Latvian Environment, Geology and Meteorology Centre, it was 849 m^3/s on average, which is 140% of the Daugava's mean annual (1992-2017) inflow. Thus, the output of the Daugava HPPs in 2017 was the highest since 1998 and the third highest since monitoring began in 1966. The amount of electricity generated by the Daugava HPPs in 2017 accounted for 74% of the Group's total electricity output.

Daugava HPPs: construction chronology

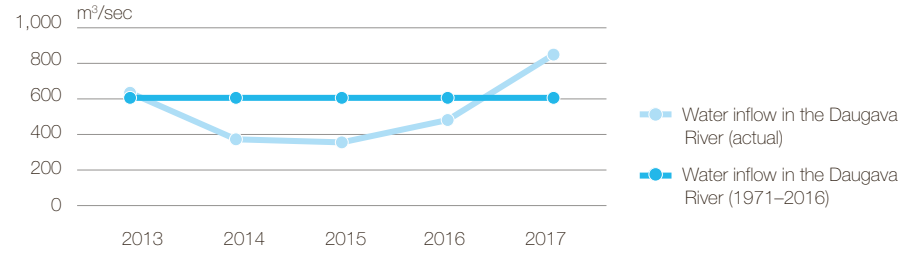
Kegums HPP, built in 1936–1939, is the oldest of the Daugava HPPs, with an initial installed capacity of 72 MW. The plant was renovated after the war, rebuilt in 1979 and reconstructed within the framework of the hydropower unit reconstruction programme. At present seven hydropower units with an aggregate capacity of 240 MW are operated at Kegums HPP.

Plavinas HPP is the largest hydropower plant in the Baltics and one of the largest in the EU in terms of installed capacity. The power plant started operating in 1968 with ten hydropower units; capacity amounted to 825 MW at the time. Reconstruction of hydropower units has been carried out at the plant several times. Also, reconstruction within the framework of the hydropower unit reconstruction programme started in 2011 and continues at Plavinas HPP. The reconstruction of hydropower units has improved the efficiency of Plavinas HPP. At the end of 2017, nine hydropower units were in operation at the plant. The total installed capacity at Plavinas HPP is 894 MW.

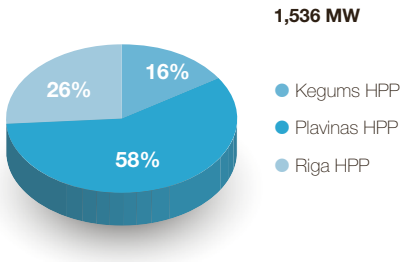
Riga HPP, with 6 hydropower units and a total capacity of 402 MW, was commissioned in 1974. Due to the hydropower unit reconstruction programme at the Daugava HPPs, four hydropower units were in operation at Riga HPP at the end of 2017. The total installed capacity at Riga HPP is 402 MW.

Plavinas HPP and Riga HPP can also operate in synchronous compensator mode (adjusting the voltage in high-voltage electric networks), allowing the transmission system operator to ensure a certain voltage quality.

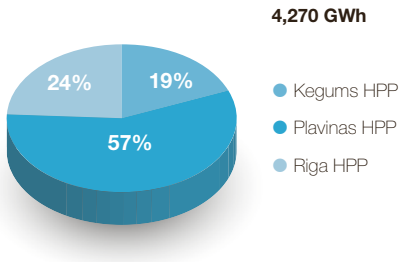
Water inflow in the Daugava River (2013–2017) – *Source: Latvian Environment, Geology and Meteorology Centre*



Installed electrical capacity of generation facilities at Daugava HPPs in 2017



Electricity generation at Daugava HPPs in 2017



Electricity generation at Daugava HPPs (2013-2017)

	Unit	2013	2014	2015	2016	2017
Kegums HPP	GWh	532	376	350	475	825
Plavinas HPP	GWh	1,640	1,089	1,022	1,386	2,429
Riga HPP	GWh	679	460	433	588	1,016
TOTAL	**GWh**	**2,852**	**1,925**	**1,805**	**2,449**	**4,270**

Investments

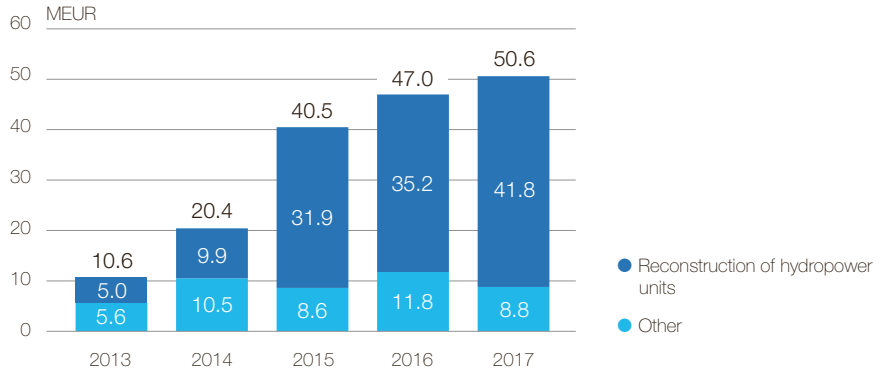
In 2017, total investments in Daugava HPP assets amounted to EUR 50.6 million, including EUR 41.8 million for the Daugava HPP hydropower unit reconstruction programme. At the end of 2017, one reconstructed hydropower unit of the Plavinas HPP was put into operation.

Latvenergo Group is continuing with the gradual overhaul of the unreconstructed hydropower units at the Daugava HPPs. The main purpose of the reconstruction project is to replace outdated hydro turbines and increase the installed capacity, efficiency rate and electricity output. This promotes reliable, efficient, sustainable and competitive operations of the Daugava HPPs within the overall energy system and liberalised electricity market.

Thirteen of the 23 Daugava HPPs hydropower units have already been modernised. The hydropower unit reconstruction process is scheduled for completion in 2022. The total cost for reconstructing the hydropower units is expected to exceed EUR 200 million. The investments made by the end of the reporting year amounted to EUR 128.4 million. The reconstruction will provide for operation of the hydropower units for the next 40 years.

An increase in the installed capacity and efficiency ratios of the hydropower units ensures more efficient use of water, which is a renewable energy source; thus, the Group is mitigating the negative impact on climate change. Each additional megawatt hour of electricity generated by the Daugava HPPs reduces CO_2 emissions by 0.345 t/MWh, assuming that this energy would otherwise be generated in condensation mode at combined heat and power plants by using natural gas.

Investments in Daugavas HPPs (2013-2017)



Riga CHPPs

Latvenergo Group's upgraded Riga CHPPs are operated mostly in the highly efficient cogeneration mode to cover thermal energy demand. Consequently, generation of electricity at the combined heat and power plants depends largely on thermal energy consumption, which in turn depends on weather conditions, the duration of the heating season, and the situation on the electricity market.

The Riga CHPPs guarantee a significant base-load electricity capacity that can cover Latvian electricity consumption almost completely in circumstances where, due to certain factors, electricity imports from foreign countries are limited. In such cases, the plants can operate as stable base-load capacities that will promptly offset the shortage of cross-border supply.

The Riga CHPPs use natural gas as their primary fuel, which is the environmentally friendliest type of fossil fuel available for power generation. To ensure the reliability of thermal energy supply in emergency situations (emergency cut-offs of gas supply), the Riga CHPPs store back-up fuel reserves of diesel.

The amount of electricity generated by the Riga CHPPs in 2017 was 1,411 GWh, a 36% decrease compared to the previous year. This was mainly due to the untypically high electricity output at the Daugava HPPs. The Riga CHPPs operate efficiently and flexibly, adapting their operational modes to the electricity market's conditions. The amount of electricity generated by the Riga CHPPs in 2017 was 25% of Latvenergo Group's total electricity output.

In 2017, the amount of thermal energy generated by the Riga CHPPs was 2,349 GWh or 3% less compared to the previous year. Thermal energy generated by the Riga CHPPs is supplied to Rīgas siltums AS at regulated tariffs.

At the end of 2017, within the framework of reduction of the costs of the mandatory procurement supported by the Cabinet of Ministers, Latvenergo AS applied for the receipt of a one-off compensation from the state, at the same time opting out of the receipt of 75% of the annual electricity capacity payment to cogeneration plants Riga CHPP-1 and Riga CHPP-2 in future. The remaining support in the amount of 25% ensures the operation of the CHPPs and both CHPPs will continue guaranteeing the electricity base capacities needed for Latvia. More information can be found in the Section "Mandatory Procurement".

Riga CHPPs: construction chronology

The first combined heat and power plant in Riga (Riga CHPP-1) was built from 1954 to 1958 and fully reconstructed in 2005. Two gas turbines, one steam turbine and three water boilers for district heating are operated at the plant. The installed electrical capacity of CHPP-1 equals 144 MW and the thermal capacity is 493 MW.

The second combined heat and power plant in Riga (Riga CHPP-2) is the largest in Latvia. It was launched in 1973. Reconstruction of two power units was performed from 2006 to 2013. Currently Riga CHPP-2 is the most efficient and up-to-date combined cycle power plant in the Baltics.

Two combined-cycle gas turbine (CCGT) units and five water boilers are currently operated at Riga CHPP-2. The electrical capacity of Riga CHPP-2 in cogeneration mode reaches 832 MW, while the thermal energy capacity of the two power units is 544 MW in cogeneration mode. The total thermal energy capacity of Riga CHPP-2, including water boilers, is 1,124 MW.

The total installed electrical capacity of the Riga CHPPs in cogeneration mode is 976 MW (1,025 MW in condensation mode).

In 2017, total investment in Riga CHPP assets was EUR 22.5 million.

Electricity generation at Riga CHPPs (2013–2017)

	Unit	2013	2014	2015	2016	2017
Riga TEC-1	GWh	406	487	464	613	595
Riga TEC-2	GWh	1,550	1,161	1,561	1,593	816
TOTAL	**GWh**	**1,957**	**1,648**	**2,025**	**2,206**	**1,411**

Thermal energy generation at Riga CHPPs (2013–2017)

	Unit	2013	2014	2015	2016	2017
Riga TEC-1	GWh	772	966	978	1,110	1,195
Riga TEC-2	GWh	1,533	1,342	1,197	1,307	1,154
TOTAL	**GWh**	**2,305**	**2,308**	**2,175**	**2,417**	**2,349**

Investments in Riga CHPPs (2013-2017)

	Unit	2013	2014	2015	2016	2017
Investments	MEUR	34.0	11.0	15.0	11.3	22.5

Liepaja plants

Latvenergo AS holds a 51% share in Liepājas enerģija SIA. Liepājas enerģija SIA ensures generation, transmission, distribution and supply of thermal energy in the city of Liepaja as well as generation of electricity in cogeneration mode.

The total installed thermal energy capacity of the Liepaja plants is 221 MW, including 40 MW from a renewable source: woodchips. Installed electrical capacity totals 6 MW. In 2017, the Liepaja plants generated 258 GWh of thermal energy and 48 GWh of electricity.

New generation capacities have been built at Liepaja plants with co-financing from the EU Cohesion Fund, increasing the share of biomass consumption in the fuel balance at the Liepaja plants from 0% before 2010 to 62% in 2017.

Due to the reconstruction of thermal energy transmission and distribution networks in Liepaja, thermal energy losses have also been reduced considerably over the past few years. The loss ratio decreased from 15.4% in 2013 to 12.7% in 2017. Encouraging responsible use of thermal energy and urging users to take care of environmental sustainability, Liepājas enerģija SIA now provides a possibility for customers to obtain and analyse thermal energy consumption data for their homes online.

Liepaja plants (2013–2017)

	Unit	2013	2014	2015	2016	2017
Installed electrical capacity of generation facilities	MW_{el}	6	6	6	6	6
Installed thermal energy capacity of generation facilities	MW_{th}	236	223	223	221	221
Electricity generation	GWh	43	48	48	47	48
Thermal energy generation	GWh	257	248	229	253	258
Thermal energy losses	GWh	38	36	32	32	31
Proportion of losses	%	15.4%	15.2%	14.3%	13.0%	12.7%

Small plants

The generation facilities within Latvenergo Group's energy system also include two small power plants: Ainazi WPP, with a capacity of 1.0 MW, and Aiviekste HPP, with a capacity of 0.8 MW. In 2017, total electricity output at the small plants was 5 GWh, which is approximately 0.1% of Latvenergo Group's total electricity output.

Kegums Boiler House, with an installed thermal capacity of 4 MW, generates only thermal energy. It is fuelled by woodchips. Total thermal energy output at Kegums Boiler House in 2017 was 5 GWh.

3.1.2. Trade

Latvenergo Group commences natural gas sales in Latvia and Estonia

EU3 Latvenergo Group trades electricity and natural gas in the Baltic States under the *Elektrum* brand. The product range is designed for different consumption and usage patterns so that each customer can choose what is most suitable.

In 2017, Latvenergo Group was among the leaders in electricity trade in the Baltics. The market share of the Group accounts for approximately 27% of the total Baltic retail electricity market, where the total consumption amounts to approximately 26 TWh. Latvenergo Group's retail electricity supply in the Baltics in 2017 was 6.9 TWh, or 10% less compared to the previous year. The decrease is related primarily to increasing competition in the large business customer segment. The electricity sales outside Latvia amounted to 2.3 TWh and accounted for approximately 1/3 of the total retail sales of electricity. In 2017, Latvenergo Group commenced sale of natural gas to business customers in Latvia and Estonia and approximately 100 contracts were signed by the end of the year.

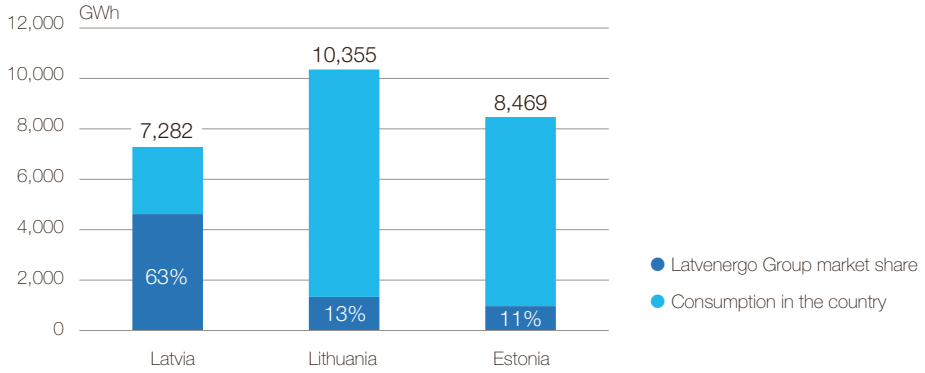
In the customer breakdown according to segments, households constituted 96% of the total number of customers and business customers constituted 4%. At the end of 2017, Latvenergo Group had approximately 799.6 thousand customers in the household segment and 34.1 thousand business customers:

- 773.4 households and 34.1 thousand business customers in Latvia;
- 7.1 thousand business customers in Lithuania;
- 26.2 households and 2.1 thousand business customers in Estonia.

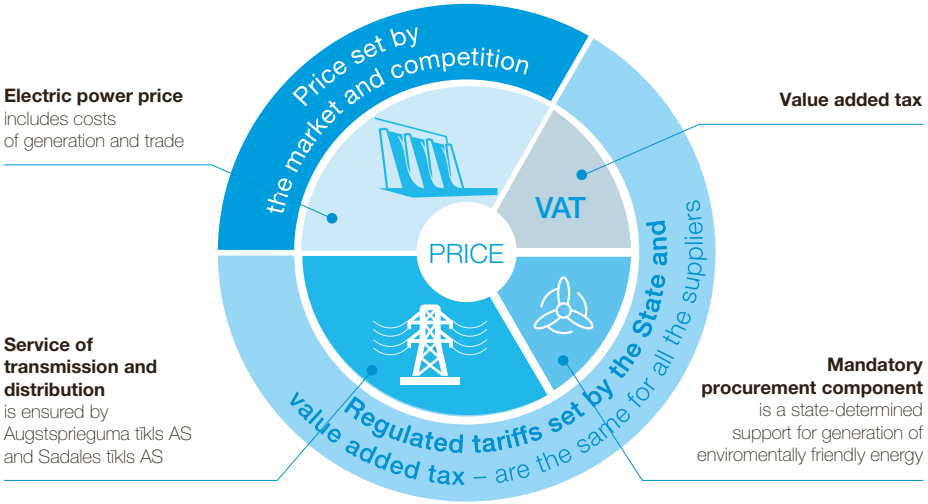
In comparison to 2016, the number of corporate customers in the Baltics increased by 1% and the number of household customers decreased by 3%.

In 2017, the Group introduced two new electricity products for the household segment. One of them is *Elektrum Smart House*, which provides remote control of space heating and electrical devices at home. *Elektrum Solar* is the other new product; it provides for the possibility to use independently generated electricity from solar light.

Market share in the Baltics in 2017



The price of electricity is comprised of several components (example of Latvia)



3.1.3. Mandatory Procurement

The decision on changes in support to the Riga CHPPs lowers the average amount of mandatory procurement component

Mandatory procurement (MP) is a state-regulated support mechanism for electricity generators in Latvia. This mechanism is implemented in the form of electricity procurement or guaranteed payments for installed capacity.

In accordance with the Electricity Market Law, the right to sell electricity generated within MP or receive guaranteed payment for the installed capacity at power plants is granted to generators who generate electricity in efficient cogeneration or from renewable energy sources. The support in the form of a payment for the guaranteed capacity is received by cogeneration plants with installed capacity above 4 MW. These rights to generators are granted by the Ministry of Economics of the Republic of Latvia.

The provisions for electricity generation, electricity MP pricing and the amount of guaranteed capacity payments are governed by regulations of the Cabinet of Ministers of the Republic of Latvia. The amount of MP support depends on the type of energy resource used (wind, water, biomass, biogas, natural gas), the installed capacity, and, for some plants, the cost of natural gas. Measures for prevention of the risk of overcompensation of MP power plants were introduced in 2017.

On 13 June 2017, Cabinet Regulations regarding support to energy-intensive processing industry companies entered into force. The Regulations stipulate that eligible companies complying with the criteria can apply for a reduction of the Mandatory Procurement Component (MPC). Payments to companies to which the Ministry of Economics has granted the right to receive a reduction of the MPC are made by the public trader.

In compliance with the Electricity Market Law, the functions of the public trader in Latvia are performed by Enerģijas publiskais tirgotājs AS. Expenditures associated with the MPC and the support paid to energy-intensive processing industry companies are compensated to the public trader from the MPC payments by electricity end-users and a state budget grant.

On 1 September 2017, amendments to the Electricity Market Law entered into force providing for a new procedure for covering the MP costs to be compensated to the public trader. As of 1 January 2018, consumers pay an MPC comprising a variable part and a fixed part. The variable part is calculated in proportion to the electricity consumption and the fixed part (the capacity component) depends on the type of system service used. The amount of the MPC is set on the basis of the MP costs of the preceding year and is approved by the PUC.

Enerģijas publiskais tirgotājs AS receives an annual state grant. During the preceding years this has allowed the MPC to remain static irrespective of the increase in MP costs. The state grant is funded mainly from the dividends paid by Latvenergo AS, and until the end of 2017, from the SET (subsidised electricity tax) revenue as well. This tax was applied to the state support provided for MP generators, i.e. revenue from the electricity sold within the MP, as well as the guaranteed payment for installed capacity to cogeneration plants. The tax was differentiated depending on the type of energy source used. In the coming years, according to the provisions of the Law on the Medium-Term Budget Framework 2018, 2019 and 2020, the dividends of Latvenergo AS for the use of state capital are intended to form the main source of financing for compensation of the MP costs.

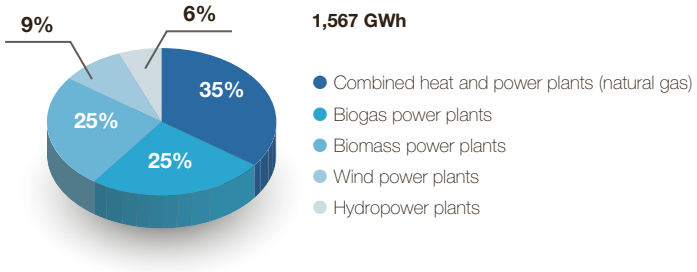
Amendments to Cabinet Regulation No. 221, which entered into force on 14 October 2017, stipulate that cogeneration plants with installed capacity above 100 MW may opt out of the guaranteed annual capacity payments of the remaining aid period by receiving a one-off compensation corresponding to the discounted value of the unreceived future support payments. In October 2017, Latvenergo AS applied for the receipt of such a one-off compensation from the state, at the same time opting out of the receipt of 75% of the annual electricity capacity payment to cogeneration plants Riga CHPP-1 and Riga CHPP-2 in future. This allows for reducing the long-term state liabilities by EUR 262 million. As of 1 January 2018, the mean MPC has decreased by 0.1 cent/kWh.

Mandatory procurement: key indicators

In 2017, 1,567 GWh of electricity were procured within the MP process, which is 4% more than in the previous year. Though in 2017 the support period ended for 24 power plants, the increase was mainly affected by the commissioning of new power plants and an increase in the capacity of the existing power plants. In 2017, the biggest support per generated kWh within the MP (following the SET) was received by biogas plants (12.6 cents/kWh) and small-scale hydropower plants (12.1 cents/kWh), and the lowest support was received by cogeneration plants with installed capacity up to 4 MW (5.8 cents/kWh) and the Riga CHPPs (5.9 cents/kWh). Following the reduction of the intensity of support payments in 2018, the planned support payment to the Riga CHPPs will decrease to 1.4 cents/kWh.

The total MPC did not change in 2017. It has been 2.679 cents/kWh since 2014. The total amount of state subsidies received in 2017 was EUR 69.9 million. As of 1 January 2018, the mean MPC amounts to 2.579 cents/kWh. In order to secure reduction of the MPC in 2018, a state budget subsidy in the amount of EUR 88.6 million is also provided.

Electricity purchased within the mandatory procurement



Mandatory procurement key indicators (2013–2017)

	Unit	2013	2014	2015	2016	2017
Power plants	number	368	386	400	402	408
MP paid-up capacity	MW	1,310	1,354	1,364	1,379	1,394
Electricity purchased within the MP	GWh	2,610	1,284	1,427	1,503	1,567
MP costs above the market price (after SET)	MEUR	209.9	215.3	224.3	207.9	235.3

For more information on MP, see the website of Enerģijas publiskais tirgotājs AS.

3.2. DISTRIBUTION

Increase in the efficiency of distribution grid use

EU3
EU4

Among the operational segments of Latvenergo Group, the distribution segment is the biggest in terms of assets and second biggest in terms of the value of the turnover. Sadales tīkls AS, a subsidiary of the Group, is the biggest distribution system operator in Latvia, providing electricity distribution system service to approximately 819 thousand customers. The distribution system operator ensures equal access to electricity distribution networks, which is one of the prerequisites for ensuring competition in the Latvian electricity market.

The electricity distribution network ensures the flow of electricity from the transmission network and electricity generators connected to the distribution networks to electricity consumers. At the end of 2017, the total length of electricity lines was 93,560 km. The number of distribution network transformers was 29,967, while the number of transformer substations was 27,085, with a total installed capacity of 5,913 MVA.

Due to significant investment in distribution networks, the length of low-voltage lines to distribution system users has been decreasing every year, thus developing a more efficient structure for the power grid and improving the quality and reliability of power supply. Reconstruction of the medium voltage overhead line network increases the share of cable lines in the overall length of power lines year by year, i.e. from 28% in 2013 to 34% in 2017. This has allowed for reducing the negative impact of weather conditions on power networks and the number of failures on lines. The volume of electricity not supplied to customers as a result of failures has decreased by 63% during the last five years, from 2,559 MWh in 2013 to 950 MWh in 2017.

In 2017, the volume of distributed electricity has remained on the level of 2016 and amounts to 6,463 GWh. Electricity distribution losses constitute a significant performance indicator of the distribution segment (see also the EU12 indicator). Compared to 2016, electricity losses did not change and constituted 4.6% of the total electricity received by the network. Total losses during the last five years decreased by 7% or 24 GWh.

In 2017, the amount of electricity received by distribution networks from small electricity generators continued to increase. This volume reached 1,575 GWh, which is 1.4 times more compared to 2013. The increase is mainly due to the commissioning of new electricity generation capacities.

Sadales tīkls AS provides the distribution system service in compliance with the tariffs approved by the PUC. Since 2016, balanced distribution system service tariffs have been in force, allowing customers to evaluate the existing connection capacities and increasing the efficiency of their use. Efficient use of connection capacities also means a considerable gain for Sadales tīkls AS, allowing for faster and less expensive construction of network connections to new customers in future.

Electricity received in distribution network (2013–2017)

	Unit	2013	2014	2015	2016	2017
From transmission network	GWh	5,670	5,470	5,236	5,304	5,225
From small generators	GWh	1,139	1,297	1,448	1,495	1,575
TOTAL	**GWh**	**6,808**	**6,767**	**6,684**	**6,799**	**6,800**

Distributed electricity and losses (2013–2017)

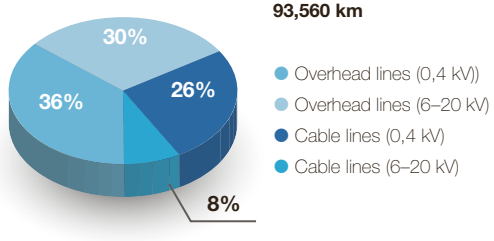
	Unit	2013	2014	2015	2016	2017
Distributed electricity	GWh	6,447	6,421	6,263*	6,465	6,463
Electricity distribution losses, technological and operating consumption	GWh	361	346	328**	334	337
TOTAL	**GWh**	**6,808**	**6,767**	**6,591**	**6,799**	**6,800**
Electricity losses	%	5.0%	4.8%	4.6%	4.6%	4.6%

* The volume of electricity distributed excludes 123 GWh; that amount corresponds to the regulated electricity tariff revenues received at the beginning of 2015 that were recognized in 2014
** The amount of losses is increased by 30, which is related to the recalculation of actual consumption of customers and the actual amount paid for electric energy

Reconstruction and construction (2013–2017)

	Unit	2013	2014	2015	2016	2017
Overhead lines constructed (0,4 kV)	km	17	19	37	22	18
Cable lines constructed (0,4 kV)	km	995	1,089	934	651	781
TOTAL low-voltage power lines	**km**	**1,012**	**1,107**	**972**	**673**	**799**
Overhead lines constructed (6–20 kV)	km	305	300	556	628	522
Cable lines constructed (6–20 KV)	km	126	104	189	140	115
Cable lines constructed (6–20 KV) (Cable programme)	km	162	207	210	208	211
TOTAL medium-voltage power lines	**km**	**593**	**611**	**955**	**976**	**848**
Transformer substations reconstructed	number	577	649	877	773	726
Connections constructed	number	7,335	8,510	7,588	9,353	8,907

Length of electricity distribution lines in 2017



Efficiency programme

Improvement of the operational efficiency of the distribution segment of Latvenergo Group is an important precondition for its balanced development and reduction of operational costs. In order to identify opportunities for improving operational efficiency, Sadales tīkls AS has been performing in-depth analysis of operational processes and management of assets and personnel since 2016. Both employees in charge of daily planning, management and oversight of work and an independent international management consulting company were involved in the evaluation. The evaluation of the distribution segment's operation included also benchmarking with other European distribution system operators.

With the purpose of improving the operational efficiency of Sadales tīkls AS, a plan for improving the network management process and cost reduction was approved in 2017. Within this plan, the company's organisational structure and operational processes were improved and the management of assets and personnel was reviewed. As a result of implementing the plan in 2017, the number of jobs was reduced by 122. In addition, the core operation processes related to customer service were reviewed, and within the framework of the efficiency programme the number of jobs was reduced by 16.

The changes implemented represent a part of the operational efficiency improvement activities that will be implemented until 2022. During this period, the amount of resources required for operations will be reduced at Sadales tīkls AS, including the number of geographic locations of employees and specialised machinery.

Introduction of smart electricity meters also contributes to the operational efficiency of the distribution segment. Implementation of this project has allowed for a reduction of the costs of meter service and maintenance. The number of work assignments related to meter inspection and meter reading has decreased considerably. Thus, in 2017, within the project the number of jobs was reduced by 56. In total, in 2017, the number of jobs was reduced by 194.

Investment and maintenance

Each year, maintenance and development of distribution networks include large-scale repairs and investment. This is aimed at increasing the quality and reliability of the energy supply, reducing the frequency and duration of scheduled and unscheduled power supply outages due to damage, and ensuring adequate voltage quality. Increased cleaning of electricity transmission lines as well as implementation of the investment programme in 2017 reduced the number of failures on power grids and the duration of unscheduled disconnections by 9.6% and 3% respectively in comparison to 2016 (for additional information, see indicators EU28 and EU29).

Investment in reconstruction and modernisation of distribution networks is made in line with the Sadales tīkls AS Development Plan 2014–2023. The objective of the plan is to ensure a sustainable and economically viable electricity distribution service by effectively managing the power network and enhancing the reliability and quality of the electricity supply, which is important for the competitiveness and growth of the national economy. The plan details the actions to be taken to achieve the goals set in the medium-term operational strategy of Sadales tīkls AS.

Sadales tīkls AS has done an analysis of electricity network development and usage perspectives and set criteria to be considered when planning reconstruction and renovation work. In compliance with the criteria, 2% of the total electricity network needs to be renovated every year. During the last four years, the volume of investment in distribution assets has stabilised at the level strategically required for distribution assets. The amount of investment in 2017 was close to EUR 108 million.

The following investment projects and programmes for improving the power supply's quality and reliability and for developing the smart grid were continued in the distribution segment in 2017:

- *Cable Programme* – replacing medium-voltage non-isolated overhead lines with cable lines (mostly in forested areas). This helps to reduce the number of electricity supply disruptions due to unfavourable weather conditions. A total of 211 km of medium-voltage cable lines were built in 2017. The low voltage network is reconstructed into cable lines at locations where the existing poles of overhead power lines can be used;
- *Restoration of lines and reconstruction of transformer substations* – 8,907 new connections were built. In the historical centre of Riga reconstruction of the 0.23 kW power network was continued, resulting in provision of power supply compliant with modern needs and requirements;
- *Automation programme* – construction of remote-controlled circuit breakers and installation of fault location detectors which promptly provide information about power supply failures on power grids and contribute to more efficient elimination thereof;
- *Introduction of smart electricity meters* improves customer awareness of electricity consumption, promoting the efficiency of electricity consumption and cost reduction for the distribution system operator, customers and electricity traders. More than 405 thousand smart meters have been installed at the end of 2017, accounting for 36% of the total fleet of meters and metering 78% of the total volume of electricity consumed by customers.

Investments (2013–2017)

	Unit	2013	2014	2015	2016	2017
Investments	MEUR	92.0	103.2	102.0	106.4	107.7

3.3. LEASE OF TRANSMISSION SYSTEM ASSETS

We provide for investments in transmission system projects in Latvia

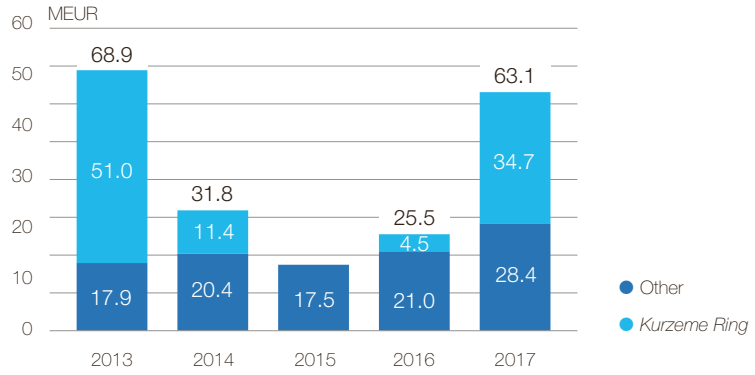
EU4 The operation of this segment is ensured by Latvijas elektriskie tīkli AS, which is the holder of the distribution system assets (330 kV and 110 kV power transmission lines, substations and distribution points) and leases the assets to Augstsprieguma tīkls AS, the transmission system operator. Lease of the transmission system assets is a regulated segment. The lease payment for the transmission assets is calculated in compliance with the methodology approved by the PUC.

At the end of 2017, the total length of power transmission lines was 5,240 km, of which 74% was 110 kV lines and 26% was 330 kV lines. To ensure the operation of the transmission network, sixteen 330 kV substations with a total autotransformer capacity of 3,825 MVA and one hundred and twenty-three 110 kV substations with a total installed transformer capacity of 5,196 MVA are used.

Investment

Total investment in transmission system assets in 2017 amounted to EUR 63.1 million. The most important transmission network investment projects include the *Kurzeme Ring* project and the third Latvia–Estonia transmission network interconnection.

Investments in transmission system assets (2013–2017)



The *Kurzeme Ring* project

The most important investment project of the transmission system of the last few years, *Kurzeme Ring*, was started in 2009. Implementation of the project improves the reliability of power supply considerably in Kurzeme and Latvia as a whole and allows for more efficient use of the Lithuania-Sweden sea cable NordBalt through even greater integration of the Baltic countries on the Nordic electricity market.

The project is being implemented in three stages, and the total planned length of the 330 kV transmission ring is approximately 330 km. The first stage was completed in 2012 through construction of the *Riga Ring*. By commissioning the new 330 kV power transmission line *Grobiņa–Ventspils* in August 2014, the second stage of the *Kurzeme Ring* project was completed. For the concluding part of the project *Ventspils–Tume–Rīga*, the design work for the 330 kV line was performed and construction work was started in 2017 on three stages:

- *Dundaga–Valdemārpils–Talsi;*
- *Kandava–Tume;*
- *Priedaine–Imanta.*

As at the end of 2017, within the third stage, in total 66 kilometres of 330/110 kV power transmission lines were built. Reconstruction at the 110 kV substations *Priedaine* and *Valdemārpils* was performed and reconstruction was started at the substations *Kandava* and *Dundaga*. The amount of investment in 2017 equalled EUR 34.7 million.

The *Kurzeme Ring* project is scheduled for completion in 2019. The total estimated construction costs of the project amount to approximately EUR 220 million, including the costs of implementing the first and second stages of the project in the amount of EUR 95 million. An agreement was concluded with the EC Innovation and Networks Executive Agency for financing the construction of the concluding stage of the project *Ventspils–Tume–Riga*, providing for co-financing in the amount of 45%.

The third Estonia–Latvia power transmission network interconnection

An important future electricity transmission infrastructure project for the entire Baltic region is a new, third electricity transmission network interconnection between Estonia and Latvia. The new 330 kV interconnection will increase the available throughput between the Latvian and Estonian energy systems, reducing the price differences between the Latvian/Lithuanian and Estonian bidding areas.

The planned length of the new 330 kV interconnection line in Latvia is about 190 km. It is scheduled for completion by the end of 2020. The overall construction costs of the project in Latvia are estimated to be EUR 100 million. In 2015, an agreement was concluded with the EC Innovation and Networks Executive Agency that provides 65% co-financing for the total eligible project costs. The procurement procedure for performance of the design and construction work of the 330 kV power transmission line was completed in 2017.

Other projects

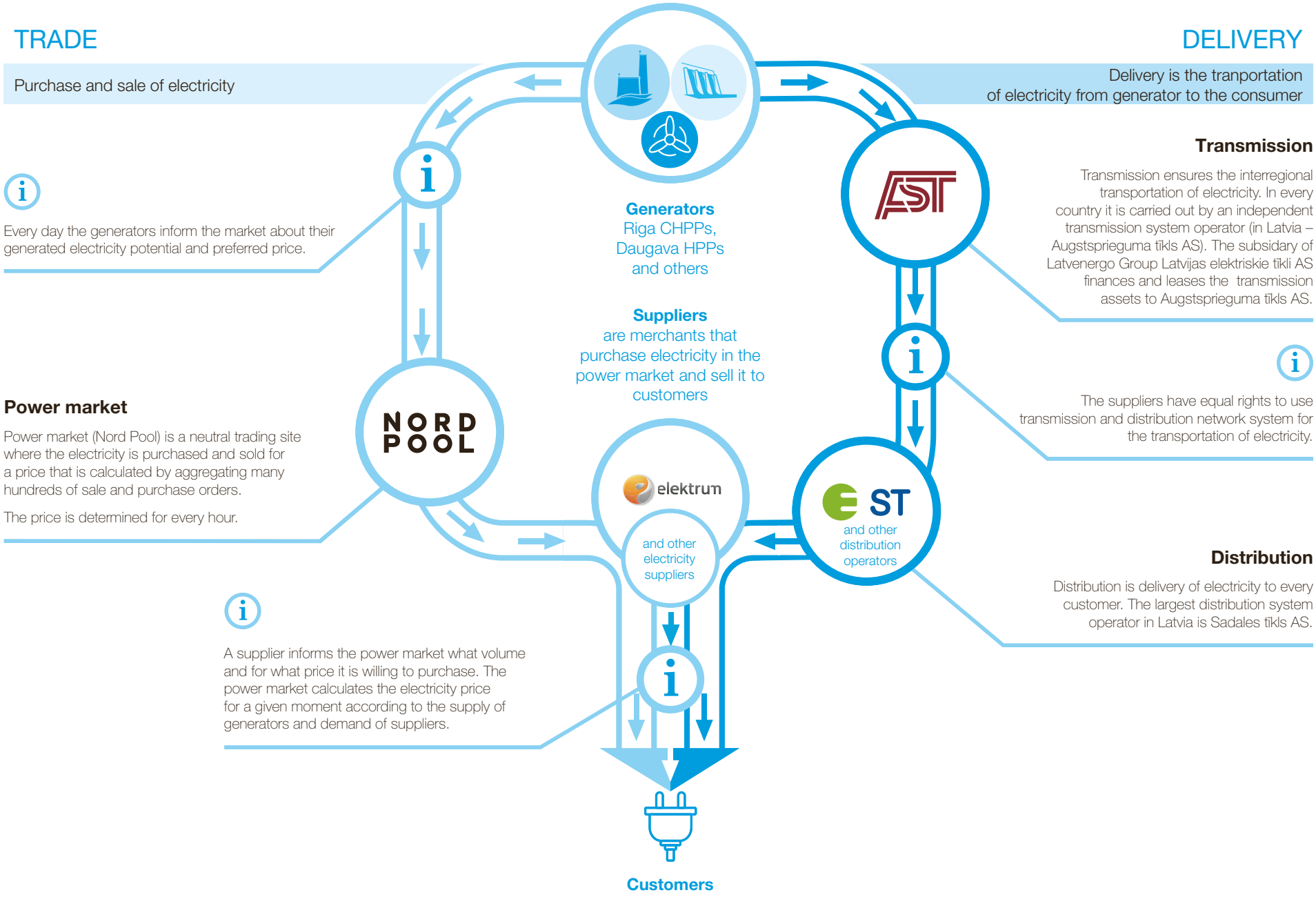
To increase the stability of electricity supply to consumers and meet capacity demand at transmission network points, other important projects were implemented in 2017, such as reconstruction of the 110 kV distribution switchgear of the 330/110 kV substation *Ventspils* and reconstruction of the 110 kV substation *Aloja*. Reconstruction of the 110 kV switchgear of the substation *Viskaļi* was continued and reconstruction was started at the 330 kV substations *Daugavpils* and *Aizkraukle* and at the 110 kV substation *Bolderāja.* In order to ensure an increase in the capacity of the distribution system connections, two 110 kV substations, *Skanste* and *Koknese,* were built and construction of the substation *Stīpnieki* was started. Also, reconstruction projects for 330 kV and 110 kV power transmission lines were continued by reconstructing the line elements.

TRADE

Purchase and sale of electricity

DELIVERY

Delivery is the tranportation of electricity from generator to the consumer



Every day the generators inform the market about their generated electricity potential and preferred price.

Power market

Power market (Nord Pool) is a neutral trading site where the electricity is purchased and sold for a price that is calculated by aggregating many hundreds of sale and purchase orders.

The price is determined for every hour.

A supplier informs the power market what volume and for what price it is willing to purchase. The power market calculates the electricity price for a given moment according to the supply of generators and demand of suppliers.

Transmission

Transmission ensures the interregional transportation of electricity. In every country it is carried out by an independent transmission system operator (in Latvia – Augstsprieguma tīkls AS). The subsidary of Latvenergo Group Latvijas elektriskie tīkli AS finances and leases the transmission assets to Augstsprieguma tīkls AS.

The suppliers have equal rights to use transmission and distribution network system for the transportation of electricity.

Distribution

Distribution is delivery of electricity to every customer. The largest distribution system operator in Latvia is Sadales tīkls AS.

PERFORMANCE INDICATORS

4.1. MATERIALITY ASSESSMENT

Material topics for the Group and its stakeholders are defined according to the international GRI guidelines

102-46 The content of the Latvenergo Group Sustainability Report is based on economic, social and environmental
102-47 topics important for the Group and its stakeholders. These material topics were defined in compliance with the GRI Guidelines and the materiality assessment methodology developed by Latvenergo Group.
102-49 The process of defining the material topics and the relevant disclosures can be divided into four steps.

Step 1

In order to determine the sustainability topics a list of potentially relevant topics was compiled. It contains topics potentially relevant for both the Group and its stakeholders. The list was based on the following sources of information:

- GRI Guidelines;
- GRI Electric Utilities Sector Disclosures;
- information disclosed by similar companies in the energy sector;
- Latvenergo Group strategy and policies;
- stakeholder opinion;
- a study of the Group's communications;
- information disclosed in previous Sustainability Reports, etc.

During this step a total of 27 topics were identified as relevant to Latvenergo Group operations. In order to facilitate the evaluation of their significance, these topics were grouped into five areas: economic performance, society, product responsibility, environmental protection, and employment and work environment. Latvenergo Group's priority stakeholders in each sustainability area were identified through Group management surveys and assessed by the responsible managers of the respective areas.

Step 2

In order to determine the most relevant sustainability topics, in-depth involvement of the Group management and stakeholders was implemented in 2015. The opinions of the Group's managers were identified through opinion surveys and in working groups. The opinions of the Group's employees were determined through the annual survey, which comprised questions about material topics of the Group's sustainability.

A workshop was organised to find out the opinions of priority stakeholders on the material topics of the Group's sustainability. About 70 stakeholder representatives were invited to the workshop, representing all the priority stakeholder groups of Latvenergo Group.

During the workshop, the stakeholders were invited to evaluate the materiality of each pre-selected topic on a scale of not material to very material. In the following stage of the workshop, participants were asked to work in groups and express their ideas and suggestions regarding ways to improve the Group's sustainability on its most material topics. The results of the working groups were revealed in a panel discussion.

Step 3

Within this step, the results of the stakeholder workshop and Latvenergo Group management survey were compiled and a materiality matrix of sustainability topics was drawn up. The results of the employee opinion survey and the management working groups were also taken into account in developing the matrix. The matrix was assessed and approved by the top management of the Group.

The matrix comprises 27 sustainability topics identified as relevant to Latvenergo Group. The vertical axis of the matrix reflects the importance of the sustainability topics to the Group's stakeholders, and the horizontal axis reflects the importance of these topics from the Group's point of view. The materiality matrix is divided into three parts: most, moderately and least material topics. Nine topics were evaluated as being the most material, rated as such by both stakeholders and Latvenergo Group. Twelve topics were recognised as being of moderate materiality and six as being least material.

The Sustainability Report covers most and moderately material topics. The least material topic "Biodiversity" is also included as this is one of the fundamental principles of the Group's Environmental Policy. Latvenergo Group has obtained assurances that certain stakeholders would appreciate more

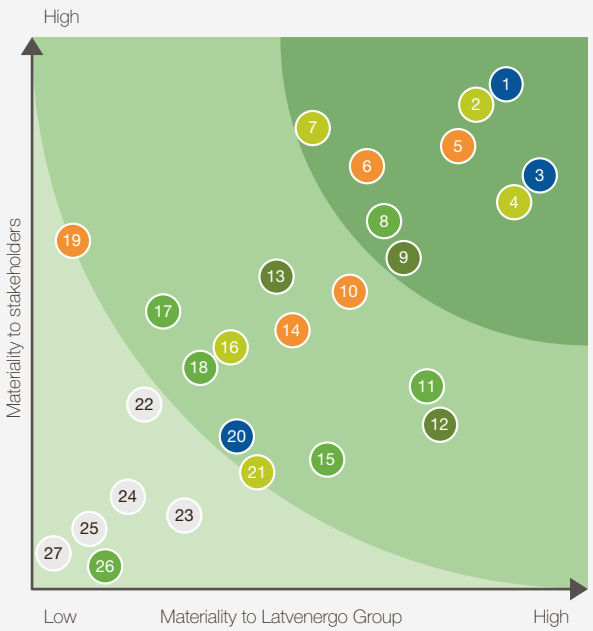
information on the Group's impact and contribution to the protection of biodiversity, especially regarding such issues as the protection of white storks and the replenishment of fish stocks in the Daugava River basin.

According to the GRI Guidelines, in cooperation with the responsible managers of the respective areas, disclosures corresponding to these topics were identified. In preparing information to be disclosed in the report, the materiality of each topic to Latvenergo Group companies and stakeholders was taken into account. Overall, the report discloses information on 22 material sustainability topics for the Group and 33 specific standard disclosures (see the GRI Index).

Step 4

Every year the preparation of the report includes re-evaluation of stakeholders' opinions, the topics identified and the relevant disclosures. This is done by the responsible persons for the relevant areas, considering changes in the operational environment and the Group's operations and the feedback received from stakeholders. During this process the Group concluded that in 2017 there was no need to change the sustainability topics identified. The Sustainability Report 2017 is prepared according to the GRI Standards; therefore, some disclosures were merged, moved and/or updated in comparison to the previous report, which was prepared in accordance with the GRI G4 Guidelines.

As the availability of the electricity distribution services is among the most material topics according to both the stakeholders and the Group, an additional disclosure, EU27, is included in the Sustainability Report 2017. This disclosure reveals information on the number and duration of power supply disconnections in the household segment due to non-payment and reconnection once payment is arranged.



Economic Performance

- 1 Efficiency of generation plants
- 3 Contribution to the economy
- 20 Support received from state

Society

- 2 Emergency planning
- 4 Public policy making
- 7 Compliance and fair business
- 16 Community contribution
- 21 Impact on local communities

Product Responsibility

- 5 Availability and efficiency of distribution system
- 6 Customer satisfaction
- 10 Data security
- 14 Information availability
- 19 Fair marketing communication

Environmental Protection

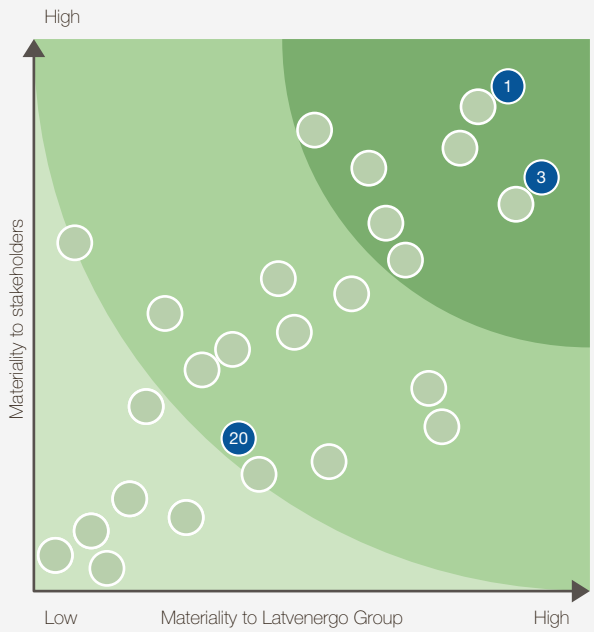
- 8 Resource consumption in production
- 11 Environmental compliance
- 15 Air pollution
- 17 Energy consumption
- 18 Renewable energy
- 22 Waste and waste water
- 24 Environmental protection expenditure
- 26 Biodiversity

Employment and the Work Environment

- 9 Health and safety
- 12 Workplace compliance
- 13 Employee development
- 23 Human rights and workplace diversity
- 25 Work-life balance
- 27 Employee involvement and freedom of association

4.2. ECONOMIC PERFORMANCE

Economic Performance topics



1 Efficiency of generation plants
3 Contribution to the economy
20 Support received from state

Management Approach

Latvenergo Group is the largest provider of power supply services and the most valuable power utility in the Baltic countries. The economic performance of the Group includes the commitment to encourage sustainable use of resources and long-term economic growth. The Group implements this commitment by offering modern and competitive products and services and by investing wisely in energy production and power network development. Efficiency plays an important role across the whole energy production and supply process, thus improving the competitiveness and quality of services.

Contribution to the national economy

The energy industry is an important economic driver since energy is an indispensable raw material in all the industries of the national economy. It provides a direct contribution to economic growth by creating added value in the economy through sustainable and sizeable investment and direct and indirect creation of jobs. Latvenergo Group has a major impact on the overall public welfare in the form of taxes and dividends paid to the state budget, job creation, investment and procurement.

Latvenergo Group's operations have a major impact on the economic growth of both Latvia and the Baltics. In 2017, Latvenergo Group made investments in the amount of EUR 244 million, with total investment over the past five years exceeding EUR 1 billion. Significant amounts have been invested in environmentally friendly energy generation and power network development projects. During the last five years, the biggest investment projects have been the Daugava HPP hydropower unit reconstruction programme and the energy infrastructure project "Kurzeme Ring" (see the annex "Green Bond Report").

Latvenergo Group is among the biggest taxpayers in Latvia. In 2017, the Group paid 238 million EUR to the state budget of Latvia, including more than 90 million EUR as dividends for the use of state capital. The amount of taxes paid in Lithuania and Estonia is EUR 12 and 6 million accordingly. The Group is also one of the biggest employers in Latvia, with a total of 3,908 employees as of the end of 2017. Through competitive wages, contributions to the pension fund, training for improvement of professional skills, and termination benefits upon retirement, Latvenergo Group takes good care of its employees.

Latvenergo Group's financial results have improved considerably over the last five years. Considerate and sustainable investment and efficiency improvements within both energy production and distribution and sales processes are the preconditions for the Group's growth. The value of the Group's assets exceeds EUR 4 billion and equity amounts to EUR 2.8 billion as of 31 December 2017. Detailed information on the performance of the Group is available in the Latvenergo Consolidated Annual Report 2017.

Efficiency of energy generation facilities

The Daugava HPPs and Riga CHPPs, the Group's largest energy generation facilities, operate in conditions of free competition, trading all the electricity they generate on the Nord Pool power exchange. The efficiency of the energy generation facilities is very important for maintaining the competitiveness of the power plants in a changing market situation.

In 2017, the reconstruction of hydro power units was continued at the Daugava HPPs. Until 2022, Latvenergo Group plans to gradually overhaul the remaining 10 hydropower units at the Daugava HPPs. Thus, hydropower turbine efficiency ratios and installed capacity will be improved, increasing annual electricity output.

The Riga CHPPs flexibly adjust their operating modes to the changing electricity market situation and are operated mostly in the highly efficient cogeneration mode. In unfavourable market conditions, the generation of Riga CHPPs is reduced by utilising the opportunity to purchase cheaper electricity from the Nordic countries. The output of the Daugava HPPs is planned considering the water inflow in the Daugava River and the possibility to accumulate water and generate electricity during periods when the demand and the exchange price is higher. Through an optimal combination of Riga CHPP and Daugava HPP output with import opportunities in the region, customers in the Baltics benefit from both price approximation to the Nordic level and long-term price stability.

A certified integrated management system in compliance with the requirements of ISO 9001, ISO 14001 and OHSAS 18001 and an energy management system in compliance with the requirements of ISO 50001 for electricity and thermal energy generation have been implemented and are maintained, thus confirming operational efficiency. The aim of the quality policy is to improve and develop the thermal energy and electricity generation processes, ensuring their quality and stable performance in line with the requirements of legal acts and customer demand.

Distribution efficiency

Along with the improvement of electricity supply quality, Latvenergo Group implements programmes and activities to reduce electricity losses in distribution networks. By 2023, the Group plans to reduce losses to 4.47% of the electricity received in the power grid.

Transformers are among the installations causing the biggest technical losses in the distribution network; therefore, they are being replaced by more energy-efficient transformers according to the plan. Power losses are also reduced by improving the monitoring of electricity consumption and by using the possibilities provided by smart meters. At the end of 2017, smart and electronic meters accounted for 36% of the fleet of electricity meters.

For more information, see the subsection "Distribution".

Performance Indicators

201-1

Direct economic value generated and distributed

In 2017, the economic value generated by Latvenergo Group was EUR 1,076.8 million, which is 4% of the GDP of Latvia. The economic value generated increased by 14% in comparison to the previous year. The increase was positively affected by the output of the Daugava HPPs, which was 74% higher, and also the one-off compensation for the Riga CHPPs' capacity payments in the amount of EUR 454.4 million, of which EUR 140 million were recognised as 2017 revenue.

The distributed economic value was EUR 686.4 million and amounted to 64% of the economic value generated. The majority or 57% of the distributed value is comprised of operating costs, including electricity procurement, electricity services, fuel and other operational costs.

The added value generated by Latvenergo Group in 2017 was distributed among the following stakeholders:

- business partners – remuneration for resources and services delivered to ensure the Group's operations;
- employees – direct and indirect remuneration for work;
- state authorities – taxes and duties paid, remuneration for the use of state capital (dividends);
- providers of debt capital and investors – remuneration for the use of borrowed capital;
- the local community – donations and aid.

Latvenergo Group is a significant payer of dividends for the use of state capital in Latvia. In 2017, dividends paid for 2016 comprised EUR 90.1 million. Over the last five years, more than EUR 250 million have been paid into the state budget. Latvenergo AS dividends are also used as a source of funding for the state budget programme "Electricity user support", ensuring the reduction of the MPC.

In 2017, the undistributed economic value of Latvenergo Group represented 36% of the economic value generated, reaching EUR 390.4 million. 62% or EUR 243.8 million of this amount has been earmarked for investment.

Economic value generated and distributed (2016–2017)

	Unit	2016	2017
Economic value generated	**MEUR**	**941.9**	**1,076.8**
Revenue and other income	MEUR	939.6	1,075.6
Income from financial activities	MEUR	2.3	1.2
Economic value distributed	**MEUR**	**660.9**	**686.4**
Raw materials, consumables and other operational expenses	MEUR	428.3	390.8
Remuneration of employees	MEUR	96.0	113.3
Payments for the use of state capital	MEUR	77.4	90.1
Payments to providers of debt capital	MEUR	14.2	11.2
State imposed payments	MEUR	44.5	80.3
Charity and sponsorships	MEUR	0.5	0.7
Retained economic value	**MEUR**	**280.9**	**390.4**
Depreciation and amortisation	MEUR	186.8	189.1
Savings and reserves	MEUR	94.1	201.3

201-3

Defined benefit plan obligations and other retirement plans

Taking care of its employees and respecting the terms stated in the Collective Bargaining Agreement, Latvenergo Group makes contributions to a pension fund and pays termination benefits to employees upon their retirement (for more information on the Collective Bargaining Agreement, see the section "Employees and the Work Environment"). These benefits apply to 97% of the Group's employees.

In compliance with the Collective Bargaining Agreement, Latvenergo Group makes monthly contributions to the current account of Pirmais Slēgtais Pensiju fonds AS (the pension fund) on behalf of employees until they reach the pensionable age for statutory pensions. The contributions amount to 5% of each pension fund member's monthly remuneration. In 2017, Latvenergo Group contributed EUR 2.2 million to the pension fund on behalf of its employees (EUR 2.3 million in 2016). The lower amount of contributions compared to 2016 is attributable to the decrease in the number of employees during 2017.

The accumulated private pensions become available to employees after they reach the age of 55 or in case of Group 1 disability. If the employee draws on the accumulated pension after reaching the age of 55, the employer suspends contributions. The operations of Pirmais Slēgtais Pensiju fonds AS are supervised by the Financial and Capital Market Commission.

Termination benefits upon retirement apply to employees who terminate employment and are eligible for a state old-age pension or disability pension. The amount of the benefits depends on the duration of service at Latvenergo Group. Latvenergo Group grants a benefit in the amount of an average weekly salary for each year of employment. The amount of Latvenergo Group's obligation for the benefit plan is disclosed in Note 22 of the Notes to the Financial Statements.

201-4

Funding received from the state

Latvenergo Group did not receive foreign financial assistance in 2017. During the preceding years, for the implementation of major investment projects, Latvenergo Group attracted co-financing from the EU. One of the key projects co-financed by the EU is the *Kurzeme Ring* transmission network project. The construction of the initial stages, *Riga Ring* and *Grobiņa–Ventspils*, received 50% co-financing within the framework of the European Energy Programme for Recovery. An agreement on 45% co-financing for the final project stage, *Ventspils–Tume–Riga*, has been signed with the EC Innovation and Networks Executive Agency. EU funds have also been attracted in the amount of 65% co-financing for the third Estonia–Latvia power transmission 330 kV network interconnection. As of 1 January 2015, transmission projects are implemented by Augstsprieguma tīkls AS (for more information on the projects, see the section "Operating Segments").

In compliance with the Electricity Market Law, the functions of the public trader in Latvia are performed by Enerģijas publiskais tirgotājs AS, a subsidiary of the Group. Within the state budget programme "Electricity user support", Enerģijas publiskais tirgotājs AS receives a targeted grant from the state budget that has allowed for maintaining an unchanged MPC value and allows for reducing it as of 2018. The revenue from Latvenergo AS dividends is used as the main source of funding for this budget programme. In 2017, Enerģijas publiskais tirgotājs AS received a EUR 69.9 million targeted grant from the state budget. This also includes payments of state budget funds to energy-intensive processing industry companies in the amount of EUR 2.9 million, which are paid out by Enerģijas publiskais tirgotājs AS.

Funding received from the state and the EU (2013–2017)

	Unit	2013	2014	2015	2016	2017
Project *Kurzeme Ring*	MEUR	7.6	0	18.0	0.2	0
Liepaja plants	MEUR	2.4	2.2	0	0	0
Smart technology	MEUR	0.2	0	0	0	0
Grant for limiting MPC*	MEUR	0	29.3	20.3	59.2	69.9
TOTAL	**MEUR**	**10.1**	**31.4**	**38.3**	**59.4**	**69.9**

* as of 2017, includes payments to energy-intensive processing industry companies

EU11

Average generation efficiency of thermal plants by energy source and by regulatory regime

Generation efficiency indicators are calculated as the ratio of electricity and thermal energy generated and the energy necessary for their generation. Generation efficiency indicators are affected by the generation facility's chosen operation modes, which are adjustable according to electricity market conditions.

In 2017, the generation efficiency at the Daugava HPPs has not changed significantly – 18.6 m^3 of water were used for generation of one kWh. In order to improve generation efficiency and return on resources, the Daugava HPPs use the possibility of accumulating water and generating electricity when the demand for electricity and the exchange price is higher (during the peak hours).

The generation efficiency indicator of the Riga CHPPs increased by 5% in comparison to the preceding year. The upgrading of equipment and its operation in the highly efficient cogeneration mode has contributed to this increase.

Compared to other power generation companies in the Baltics, the efficiency indicators of Latvenergo Group generation facilities are considered high.

Generation facility efficiency indicators (2013–2017)

	Unit	2013	2014	2015	2016	2017
Daugava HPPs	m^3/kWh	19.5	18.7	18.8	18.9	18.6
Riga CHPPs	%	79%	80%	79%	83%	88%
Liepaja plants	%	91%	91%	90%	90%	91%
Kegums boiler house	%	86%	86%	86%	86%	86%

EU12

Distribution losses as a percentage of total energy

One of the most important indicators describing the efficiency of the distribution segment is distribution losses as a percentage of total electricity received in the grid. This indicator has remained unchanged at 4.6% during the last three years. This is the historically lowest electricity loss rate for Latvenergo Group.

Distribution losses (2013–2017)

	Unit	2013	2014	2015	2016	2017
Distribution losses	%	5.0	4.8	4.6	4,6	4.6

EU30

Average plant availability factor by energy source and by regulatory regime

The power plant availability factor for the generation facilities of the Daugava HPPs and Riga CHPPs is calculated as the time period during which a plant provides its nominal capacity. The remaining time is intended for scheduled and unscheduled repair work.

In 2017, the plant availability factors for the Daugava HPPs were 5% lower than in the previous year. The decrease was due to the Daugava HPP hydropower unit reconstruction programme, within which reconstruction of three hydropower units took place in the reporting year.

Also, the availability factors of the Riga CHPPs were slightly lower in comparison to the previous year. This was due to the inspections of gas turbines and generators and reconstruction of individual devices.

In 2017, the Daugava HPPs were operational for an average of 3,245 hours and on back-up for an average of 3,104 hours. The average annual duration of scheduled repair work per hydropower unit was 1,917 hours. Unscheduled repairs were performed on two hydropower units amounting to 75 hours in total.

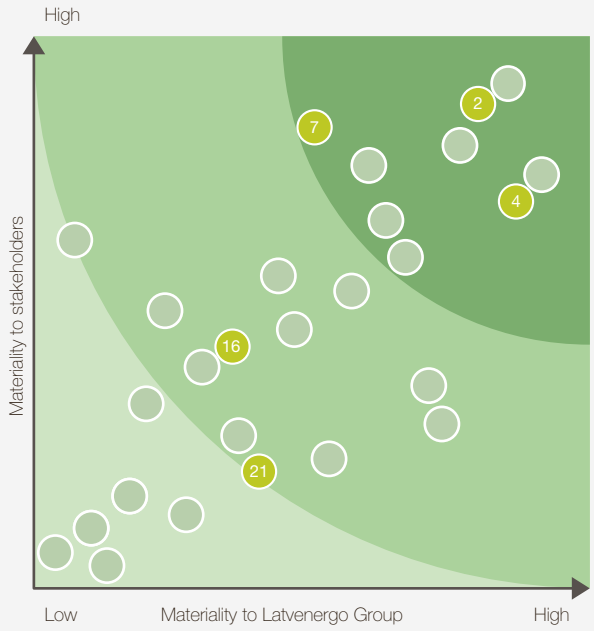
The CHPPs were operational for an average of 2,752 hours and on back-up for an average of 4,019 hours. The average annual duration of scheduled repair work per unit was 1,540 hours. Unscheduled repairs were performed on the gas and steam turbine of CHPP-1 and the gas turbine of the second power unit of CHPP-2, amounting to 448 hours in total.

Average plant availability (2013–2017)

	Unit	2013	2014	2015	2016	2017
Daugava HPPs	%	91	93	87	81	76
Riga CHPPs	%	93	86	82	82	80

4.3. SOCIETY

Society topics



2 Emergency planning
4 Public policy making
7 Compliance and fair business
16 Community contribution
21 Impact on local communities

MANAGEMENT APPROACH

Responsibility is one of Latvenergo Group's values and a fundamental principle of corporate governance. The Group's management and employees undertake responsibility for tasks performed in compliance with the requirements of applicable laws and regulations and with best practice. Latvenergo Group conducts business in a transparent, ethical, safe, reliable and fair manner, ensuring provision of information to stakeholders and engaging them in its activities.

Latvenergo Group's management approach with regard to its impact on society is based on openness and the following socially responsible activities:

- in compliance with the principles defined by its Code of Ethics, Latvenergo Group guarantees fair and equal treatment of stakeholders, preventing fraud and corruption. The Group has published ethical principles for cooperation with contractors and urges them to follow similar ethical principles in cooperation;
- the Group evaluates the impact of its activities on society and the environment in its day-to-day operations and in implementing new projects. Local communities and other stakeholders are regularly involved in public consultations regarding the modernisation projects at the Group's facilities. Emergency and crisis management and prevention plans have been developed for the Group's critical infrastructure;
- the Group actively informs stakeholders about its activities and expresses its position on subjects regarding energy and related industries which are of importance to the Group and its stakeholders.

Compliance with the requirements of regulatory acts and fair competition

One of the cornerstones of Latvenergo Group corporate governance is ethics and compliance. The Group has introduced a Code of Ethics, which defines the Group's corporate values and professional conduct principles for ensuring that employees carry out their responsibilities with the utmost integrity, are unbiased, comply with high ethical standards, and prevent fraud, corruption and illegitimate or fraudulent conduct in their activities. The Group also urges its contractors to adhere to equivalent ethical principles.

The Group has also developed and introduced a Fraud and Corruption Risk Management Policy. It defines the basic principles for the management of this risk and the main tasks and responsibilities of the managers and employees of all levels. Along with the policy, a range of measures have been introduced to mitigate the likelihood of the fraud and corruption risk:

- annual fraud and compliance risk assessment and corrective action planning and quarterly monitoring of the implementation of risk mitigation measures are carried out;
- employees who, in the performance of their duties, have found themselves or might find themselves in situations of conflict of interest submit a conflict of interest declaration on an annual basis. Upon entering employment relations and signing the declaration, new employees must confirm in writing their understanding of conflict of interest situations and commitment to prevent their occurrence;
- regular training on best practice for the prevention and mitigation of fraud and corruption risks is carried out;

In 2017, Latvenergo AS, Sadales tīkls AS and Latvijas Elektriskie tīkli AS introduced uniform software for risk assessment and conducted an annual assessment of risks, including fraud and corruption risk.

Financial and human resources are allocated to ensure the legal compliance of the Group's operations, preventing the occurrence of compliance risks. The Group regularly keeps track of changes to laws and regulations, participates in public consultations and cooperates with the responsible institutions. The Group also develops and maintains its internal procedures to ensure the compliance of its operations.

Considering that Latvenergo Group is the dominant player in the electricity market in Latvia, increased attention is being paid to the principles of equal market competition. To prevent any issues related to competition law, the Group has developed a Competition Law Manual and organises regular educational workshops for employees whose activities may impact the occurrence of such issues.

Emergency management plans

Latvenergo Group is not fully protected against natural disasters and damage caused by humans. To mitigate these risks, the Group has created a common emergency and crisis management system. The purpose of the system is a common approach for resolving issues that arise during emergency or crisis situations and to ensure continuous and reliable operations of the Group or their prompt and efficient recovery.

The principles developed for action in crisis situations provide for cooperation with the Crisis Management Council, the Energy Crisis Centre, local governments, the Department of Management and Operations of the State Fire and Rescue Service (SFRS), the National Armed Forces and Augstsprieguma tīkls AS. The Group's emergency and crisis management plan has been coordinated with the Ministry of Economics of the Republic of Latvia, which is responsible for the development of the national energy policy and for the planning and management of energy crisis recovery measures.

To raise their awareness of their duties in managing emergency and crisis situations, employees receive regular instruction. In cooperation with Augstsprieguma tīkls AS, annual emergency and crisis management training is carried out where possible emergency scenarios are simulated. These activities involve employees of various Latvenergo Group organisational units and specialists from the Department of Management and Operations of the SFRS and from the National Armed Forces. To improve recovery response and reduce material losses, the training process is subsequently analysed and preventive measures to be taken are defined.

Involvement in shaping energy sector policy

Latvenergo Group engages in shaping energy sector policy to promote sustainable development of the Group, the industry and the economy. In line with the objectives and targets set in the Group's strategy, the Group's representatives engage in drafting statements and opinions on Latvian and EU-level studies, guidelines, standards, policy documents and legislation pertaining to the energy sector and related sectors.

The Group's experts make recommendations for the development and improvement of various Latvian regulatory documents on a regular basis. The most important of these in 2017 included the regulation on the use of the natural gas infrastructure, the reform of state support principles for power plants with a capacity over 4 MW, and participation in the preparation of Latvia's national positions on the EC package of documents forming the future European Energy Union.

The Group's involvement in shaping energy sector policy is ensured through its participation in the European electricity sector professional association EURELECTRIC. In 2017, the Group's experts continued to contribute to the development of EURELECTRIC position papers on the legislative package Clean Energy for all Europeans. Latvenergo Group also joined the Declaration on Electrification published by EURELECTRIC in June 2017. It calls on European and national policymakers and stakeholders to take advantage of electricity, remove barriers to electrification and create the necessary regulatory framework for the wider use of efficient electrical technologies in various economic sectors.

By participating in various forums, Latvenergo Group's experts promote the exchange of opinions on topical issues for Latvian and EU energy policy, including the energy sector in Latvia and the forthcoming changes in the sector, market-based energy, the opening of the natural gas market in Latvia, challenges in the natural gas market in the Baltic states, and the development of a smart grid that meets customer requirements. The most significant examples in 2017 included the energy forum organised by the newspaper Dienas Bizness, the conference Energy 2017 and the Baltic Energy Forum in Lithuania.

Impact on society

Latvenergo Group is aware that its operations have an impact on stakeholders and follows all regulatory requirements regarding the assessment of the impact of its operations. The Group identifies stakeholders' views and engages society in decision-making if the Group's operations are related to potential harm or risk of harm to the environment and society. Customers and others may express their opinions in public consultations or submit a complaint or an application in the most convenient manner for them (see the section "Product Responsibility"). Latvenergo Group cooperates with the responsible services, institutions and local governments to ensure the safety of local communities affected by the Daugava HPP reservoirs during the spring flood period.

Performance Indicators

205-2 **Communication and training on anti-corruption policies and procedures**

In the reporting period, Latvenergo Group continued to organise training on fraud and corruption risk management and recommended risk mitigation measures for managers and employees. All Latvenergo AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS Management Board members, Chief Officers and managers participated in the training. In order to raise awareness among employees about anti-corruption issues, discussions were organised in the departments, during which potential risks were assessed and the necessary control measures needed to diminish the risk of fraud and corruption were identified.

In 2017, a seminar for managers was organised which was led by representatives of the Corruption Prevention and Combating Bureau (KNAB). The main topics of the seminar were prevention of ethical conflicts and conflicts of interest, raising anti-corruption awareness, and measures to be taken to reduce fraud and corruption. Around 120 employees of the Group participated in the seminar, including all Management Board members of Latvenergo AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS.

In addition, the development of an e-learning programme on the prevention of conflict of interest, fraud and corruption was completed in 2017. At the end of the year, pilot training was conducted for Latvenergo AS and Sadales tīkls AS employees. In 2018, after approval of the programme, e-learning is planned for all Latvenergo employees.

In the reporting year, a publicly available reporting channel for reporting cases of fraud and malpractice in the operations of Latvenergo Group was created on the Group's website. Reporting is anonymous. Those who want to be contacted by the responsible employees may provide contact information in the report form. An informative e-mail was sent to all employees regarding the creation of the reporting channel.

205-3 **Confirmed incidents of corruption and actions taken**

No cases of corruption were identified within Latvenergo Group in the reporting period. The risk of fraud and corruption at Latvenergo Group is properly managed in compliance with the risk assessment results. Mitigation of fraud and corruption risks is ensured through internal documents regulating employees' activities and determining the scope of their authority. Furthermore, Latvenergo Group carries out risk mitigation activities and continuously improves its preventive measures and detection.

206-1 **Legal actions for anti-competitive behaviour and monopoly practices**

In 2017, no cases of anti-competitive behaviour or misuse of the dominant position by Latvenergo Group were identified, and no court proceedings against Latvenergo Group were initiated or are ongoing.

413-1 **Operations with implemented local community engagement, impact assessments, and development programmes**

Latvenergo Group engages the community in all projects where public interests are at stake. To ensure coordinated action and provide prompt information to the community, the SFRS, in cooperation with Latvenergo AS, organises coordination meetings with the participation of the responsible institutions, services and local governments in the vicinity of water reservoirs during the spring flood. At the meetings, updated information is provided regarding cooperation, communication and actions of the institutions during the spring flood in the Daugava River basin.

In public information activities, Latvenergo Group cooperates with national and regional media. Various media events on the opening of the natural gas market in Latvia, the MP and the solution developed by the Ministry of Economics for reducing MP expenses, and the environmental and CSR projects supported by the Group were held in the reporting year.

For communication with the public and customers and their engagement, Latvenergo Group also makes active use of social media, which allows for prompt replies to questions about the Group's operations and specific practical questions from customers.

415-1 **Political contributions**

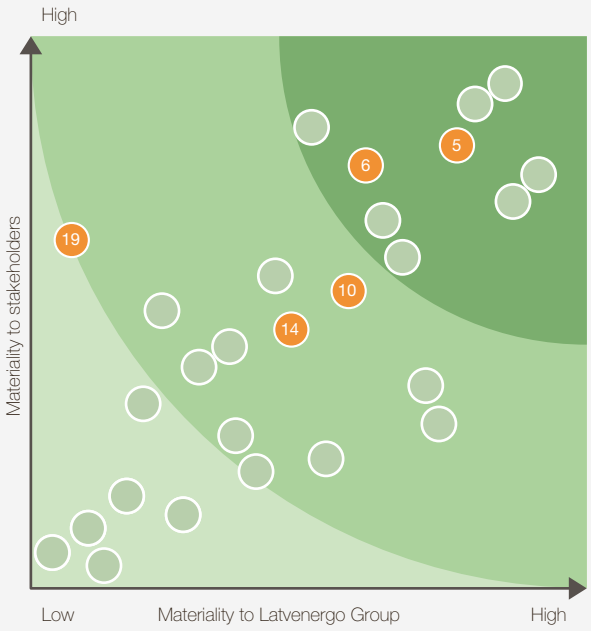
In compliance with the requirements of the laws and regulations of the Republic of Latvia, the Group Corporate Social Responsibility Policy and Latvenergo AS Donation Strategy, Latvenergo Group does not make any monetary and/or non-monetary contributions to political organisations.

419-1 **Non-compliance with laws and regulations in the social and economic area**

No significant fines or non-monetary sanctions were applied in 2017 for any failure by the Group to comply with laws and regulations in the social and economic area.

4.4. PRODUCT RESPONSIBILITY

Product Responsibility topics



- 5 Availability and efficiency of distribution system
- 6 Customer satisfaction
- 10 Data security
- 14 Information availability
- 19 Fair marketing communication

Management Approach

Latvenergo Group's operations are targeted at developing and offering competitive electricity services that meet customers' needs as well as building long-term, mutually beneficial and loyal relationships with customers. In turn, distribution services are based on the provision of high-quality and secure electricity supply in Latvia. To achieve these goals, the Group follows the principles of cost-effectiveness and operational excellence.

Customer satisfaction

Trade

Customer satisfaction is one of the main prerequisites for building loyal long-term relationships with customers. In order to ensure customer satisfaction, the Group improves existing products and services and introduces new ones, taking into account the needs of its customers. Major new developments in 2017:

- the *Elektrum Smart House* service, which allows for remote control of electricity and heating devices;
- the *Elektrum Solar* service, which makes it possible to generate green electricity using solar panels;
- the Balanced Payment Barometer, which allows customers to avoid large accumulations or overpayments;
- the opportunity to receive a notification about an increase in the exchange price at certain hours in the *Elektrum* mobile application.

Based on customer interests and needs, the Group raises the awareness of energy efficiency and safety issues among customers and society in general. Advice on these issues is regularly published in the customer newsletter "*Elektrum* tavām mājām" (*Elektrum* for Your Home) and in *Elektrum* social network accounts. The *Elektrum* Energy Efficiency Centre holds informative activities and campaigns focusing on energy efficiency issues, while Sadales tīkls AS is engaged in educating society on energy safety issues. To promote customer loyalty, the *Elektrum* Friendly Benefits programme is implemented, which was used by 34 thousand customers in 2017.

An essential factor for customer satisfaction is the quality of customer service as well as its availability and convenience. To assess the quality of customer service and identify the opportunities for its improvement in a timely manner, the following customer service key performance indicators have been defined at the Group:

- proportion of calls answered;
- calls answered within 30 seconds;
- proportion of complaints and applications answered within 15 days;
- first call resolution (for the household segment);
- proportion of e-mails answered within 24 hours;
- average waiting time at customer service centres.

Compared to previous years, virtually all the key performance indicators show improvement.

Customer service key performance indicators in Latvia (2013-2017)

	Unit	2013	2014	2015	2016	2017
Calls answered	%	92	90	90	87	89
Calls answered within 30 seconds	%	86	78	78	73	76
Emails answered within 24 hours	%	n/a	n/a	n/a	54	90
The average waiting time CSC	min	n/a	n/a	n/a	10	7
Response rate for claims answered in 15 days	%	63	75	69	71	92
First call resolution for household segment	%	n/a	n/a	n/a	91	90

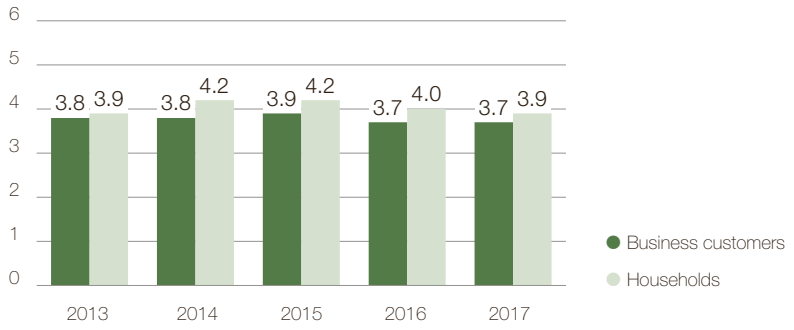
In cooperation with sociological research agencies, the Group conducts regular customer satisfaction and loyalty surveys in the household and business customer segments in Latvia. These surveys make it possible to:

- identify service aspects that need development and improvement;
- compare the Group's services and communication channels with local benchmarks;
- compare current customer satisfaction with previous periods.

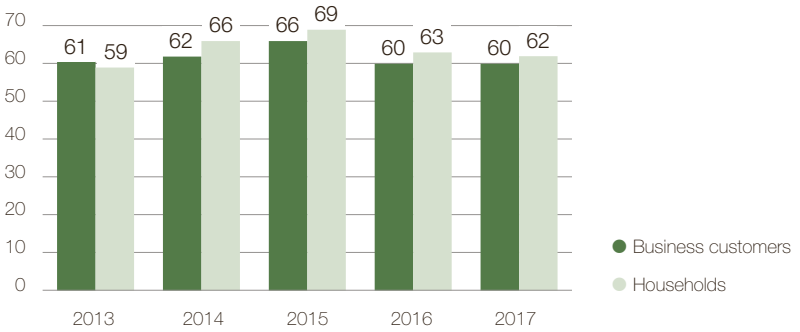
Customer satisfaction and loyalty surveys measure overall satisfaction with the Group, its services, customer service, payment options and information availability and content. Customer satisfaction is measured by the customer satisfaction index on a 6-point scale, while customer loyalty is measured by the index on a 100-point scale. In 2017, the customer satisfaction index remained unchanged in the business customer segment, and the changes in the household segment were statistically insignificant. Since the opening of the electricity market, there has been a growing customer loyalty trend with regard to those customers willing to evaluate and compare electricity traders.

A total of 190 customer complaints were received, representing less than 1% of the Group's customer contacts. 12% of complaints regarding electricity trade were substantiated and 7% were partially substantiated. Responses were given promptly: 92% of the complaints regarding electricity trade were handled within 15 days.

Latvenergo customer satisfaction index (2013–2017)



Latvenergo customer loyalty index (2013–2017)

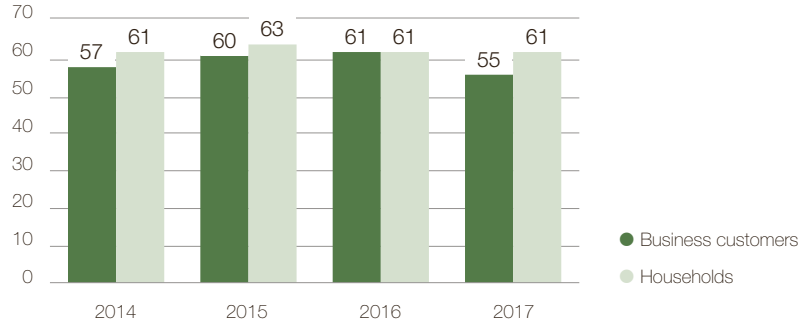


Distribution

In 2017, the Sadales tīkls AS customer satisfaction index remained unchanged for households and decreased from 61 to 55 index points for businesses. The overall index is considered medium high. The decrease in indicators in the business segment occurred in the subsegment of small enterprises, and the main reason for this was the balanced distribution system tariffs which were introduced in 2016. These encouraged customers to evaluate their capacity utilisation habits and raised the issue of efficient use of their chosen power grid connection. An increase in indicators was observed in the subsegment of medium and large enterprises compared to 2016. Maintaining the household segment index at the level of 2016 demonstrates successful communication and explanation in implementing the new tariffs.

To assess the quality of customer service, Sadales tīkls AS also introduced customer experience monitoring in 2017. The results are analysed and used to improve the service provision processes and customer service aspects. In 2017, the overall rating of all services was 3.8 on a 5-point scale.

Sadales tīkls AS customer satisfaction index (2014–2017)



Customer data security

Latvenergo Group has extensive customer databases. Data processing and maintenance complies with all regulatory requirements in terms of data security and confidentiality. Customer service processes are adapted to ensure confidentiality of data. Data security and protection are also ensured through customer authorisation on the customer portal and in direct communication activities.

On 25 May 2018, Regulation (EU) 2016/679 of the European Parliament and of the Council on the protection of personal data enters into force. In 2017, targeted and systematic work was started at the Group to ensure compliance with the data subject's rights laid down in the regulation as well as make all possible improvements to ensure the protection of personal data in accordance with the requirements of the new regulation. Since 2017, a personal data protection specialist has been employed at the Group, who takes part in revising the Group's processes, including customer service and sales processes, checking the compliance of the database management systems operation and, if necessary, initiating the development and implementation of adjustments.

Information availability

The following convenient customer service channels are offered in Latvia to maintain a high level of service quality and availability and hence customer satisfaction:

- the *elektrum.lv* customer portal, with online customer service launched in 2017;
- customer service by phone;
- customer service on site at the customer service centres;
- an option to submit questions via e-mail;
- social networks.

In Lithuania and Estonia, customer service is ensured via the customer service portals *elektrum.lt* and *elektrum.ee* as well as by phone.

The most popular customer service channel is the *elektrum.lv* portal, where the number of visits in 2017 increased by 24%. Customers make active use of the portal to submit meter readings and make payments. The popularity of the *Elektrum* mobile application grew by 67%: it is used by more than 73 thousand customers. The use of other service channels decreases every year.

Customer service is also provided in Russian and English, while informational materials at customer service centres are also available in Russian. Russian and English translations of mail messages and agreements are available upon request. Customer service centres ensure access for customers with reduced mobility. To reduce the waiting time for customers with children and pregnant women, separate queues are arranged for them.

To ensure the availability of information on electricity distribution services as well as simplify and speed up their receipt, self-service options were developed on the customer portal *e-st.lv* in 2017. The portal now provides electronic documents and automated processing of customer applications. Compared to 2016, the number of registered users of *e-st.lv* grew by 74%. The convenience of the customer portal is especially appreciated by large business customers, of whom 77% use the portal on a regular basis.

A map of outages with up-to-date information on scheduled and emergency outages in the power grid can be found on the website of Sadales tīkls AS and on the customer portal *e-st.lv.* Power grid faults may be reported free of charge 24/7 by calling 8404.

Honest marketing communication

In communicating with customers through marketing and sponsorship activities, Latvenergo Group ensures compliance of information with Latvian and EU law, the standards of fair competition, and the policies of the Group. The most important internal documents include the Group's Code of Ethics, Brand Management Policy and Corporate Social Responsibility Policy. The communication of Latvenergo Group and its brands is always based on compliance with Group and brand values.

Quality of distribution services

Sadales tīkls AS is building a sustainable power grid, paying attention to the safety of the grid at each site individually and in the grid as a whole as well as to the quality of the equipment and materials supplied and the work performed. The power grid is being rebuilt using efficient technical solutions that are economically feasible in the long term.

The key performance indicators for quality of electricity supply are System Average Interruption Frequency Index (SAIFI) and System Average Interruption Duration Index (SAIDI). Both indicators are calculated as an average indicator on a per-customer-per-year basis. Sadales tīkls AS conducts regular detailed analysis of these indicators and takes measures to improve them.

Electricity supply interruptions are divided into scheduled and unscheduled interruptions. Scheduled supply interruptions are associated with planned network maintenance repair and construction work, and customers are notified about these interruptions in a timely manner. The frequency of unscheduled supply interruptions is determined by the technical solutions of the electricity grid, damage due to adverse weather conditions (storms, snowbreaks, floods, etc.), and damage caused by third parties or theft. To reduce the duration of unscheduled power interruptions, the following measures were implemented in 2017:

- 726 transformer substations and 1,647 km of power grid were reconstructed, including the replacement of 211 km of medium-voltage overhead lines with cable lines in forested areas;
- electricity line maintenance and clearance work on line routes totalling 5,742 km was carried out and low-voltage power grid repairs using insulated wires were performed on line routes totalling 1,103 km;
- 263 remote-controlled circuit breakers were built, separating power lines in densely populated areas and forested areas, and technically obsolete equipment was replaced with newer technologies;
- maintenance repairs were carried out in 1,289 transformer substations.

Compared to 2016, the total number of power grid faults was reduced by 9.6%. Preventive measures to reduce the frequency and duration of power outages are also planned for the coming years. To this end, the Group plans to continue the construction of new cable lines, carry out clearance work on electricity line routes on a regular basis, introduce new technical solutions and improve existing processes. The maximum duration of power outages for scheduled work during winter months is set to 5 hours.

Seeking to ensure high quality services, Sadales tīkls AS continuously improves its customer service-related processes. If provision of electricity supply services is found to be inconsistent with quality requirements, customers are compensated for any losses incurred.

Safety of distribution services

Safe electricity supply is a priority for Sadales tīkls AS. Accidents at the company's electrical installations are most frequently associated with third party negligence in the vicinity of the electrical infrastructure: disregarding the requirements of the Protection Zone Law in business operations and touching 20 kV electricity line wires with machinery.

Sadales tīkls AS carries out a variety of educational activities to reduce the number of electrical injuries and accidents, including lectures at schools, other educational institutions and summer camps for children and youth as well as educational work at electrical safety events organised by institutions supervising tractor machinery and agricultural work. Within the scope of these activities, Sadales tīkls AS employees explain the nature of electrical hazards and what to do in the event of an accident.

To address electrical safety issues in the virtual environment, the website *arelektribuneriske.lv* has been created where children and young people are educated about the dangers of electricity in an interactive and attractive way. Electrical safety issues are also discussed on the Sadales tīkls AS website and on the electrical safety site (Elektrodrošība) on the *draugiem.lv* portal.

Performance Indicators

417-3 **Incidents of non-compliance concerning marketing communications**

No cases of non-compliance of Latvenergo Group marketing activities with legal or voluntary provisions were identified in 2017.

418-1 **Substantiated complaints regarding breaches of customer privacy and losses of customer data**

In 2017, two substantiated (2016: two), one partially substantiated (2016: zero) and six unsubstantiated (2016: two) complaints were registered concerning possible customer data privacy violations. The errors in customer data processing were eliminated immediately upon receipt of the complaints. Six complaints submitted were from customers, one was from a third party and two were anonymous.

419-1 **Non-compliance with laws and regulations in the social and economic area**

In 2017, compensations for damage to electrical equipment due to distribution network disruptions were paid in 46 cases for a total amount of EUR 16.2 thousand. A reduced electricity distribution tariff for inadequate voltage quality was applied to 137 customer sites.

Compensations for damage associated with disruptions in distribution system power grids (2013-2017)

	Unit	2013	2014	2015	2016	2017
Compensation cases	number	97	71	66	48	46
Amount paid	thsd. EUR	43.3	31.3	23.0	24,1	16.2

Customer sites of reduced electricity distribution tariff for inadequate voltage quality (2013-2017)

	Unit	2013	2014	2015	2016	2017
Sites	number	72	156	163	131	137

EU25 **Number of injuries and fatalities to the public involving company assets, including legal judgements, settlements and pending legal cases of diseases**

Six accidents involving third parties occurred at Sadales tīkls AS electrical installations. The accidents were due to touching electricity lines when operating machinery; fishing; carrying out construction work; carrying out work uncoordinated with Sadales tīkls AS on a pole; and attempting to steal electrical installations. One of the cases where a power line was touched by machinery was fatal. There were no court cases in the reporting period.

Number of accidents to third parties (2013-2017)

	Unit	2013	2014	2015	2016	2017
Fatal	number	2	0	2	0	1
Serious	number	1	1	0	1	0
Not serious	number	6	2	5	2	5
TOTAL	**number**	**9**	**3**	**7**	**3**	**6**
Number of legal cases	number	0	0	0	0	0

EU26 **Percentage of the population unserved in licensed distribution or service areas**

The service area specified in the electricity distribution licence covers 99% of the territory of the Republic of Latvia. Electricity distribution is ensured to approximately 819 thousand electricity distribution service customers. Electricity distribution services are provided to all households that have concluded agreements on electricity supply within the service area specified in the licence.

EU27

Number of residential disconnections for non-payment, broken down by duration of disconnection

In 2017, electricity supply was disconnected for 8,261 households due to failure to pay in a timely manner. 38% of disconnections lasted up to 48 hours. Cases where disconnections were longer than 1 month (29%) can be explained by changes of household users.

In accordance with laws and regulations, the distribution system operator is obliged to restore electricity supply within five days after it has received a full payment for the system services or upon receipt of a relevant notification from the trader. After the payment, 98% of households had their electricity connection restored within 24 hours and for the rest of households the connection was restored the following day.

Number of residential disconnections for non-payment (2017)

	Unit	2017
Up to 48 hours	number	3,164
From 48 hours to 1 week	number	1,219
From 1 week to 1 month	number	1,460
From 1 month to 1 year	number	2,415
Vairāk nekā 1 gads	number	3
TOTAL	**number**	**8,261**

Length of time between arrangement of payment and reconnection

	Unit	2017
Up to 24 hours	number	8,069
From 24 hours to 1 week	number	192
More than 1 week	number	0
TOTAL	**number**	**8,261**

EU28

Power outage frequency (SAIFI) and average power outage duration (SAIDI)

EU29

Well-targeted investment by Latvenergo Group in the distribution segment has contributed to substantially reduced power interruption frequency (SAIFI) and duration (SAIDI) over the last five years. Other contributing factors were the renovation of electricity networks with a high impact on power outages and clearance work on electricity distribution line routes.

In 2017, Sadales tīkls AS continued to increase the share of the power line maintenance and repair work performed without cutting voltage for consumers.

System Average Interruption Frequency Index (SAIFI) (2013-2017)

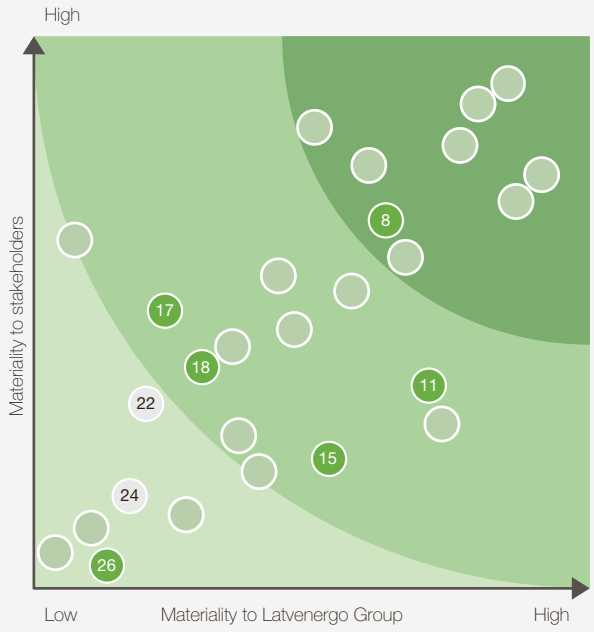
	Unit	2013	2014	2015	2016	2017
Unscheduled: natural phenomena (massive damage)	number	0,6	0,4	0,2	0,2	0,2
Unscheduled: damage (incl. if caused by third parties)	number	2.9	2.4	2.1	2.2	2.0
Scheduled: network maintenance and overhaul	number	1.0	1.0	0.8	0.7	0.6
TOTAL SAIFI	**number**	**4.5**	**3.8**	**3.2**	**3.1**	**2.8**

System Average Interruption Duration Index (SAIDI) (2013-2017)

	Unit	2013	2014	2015	2016	2017
Unscheduled: natural phenomena (massive damage)	minutes	149	57	18	26	18
Unscheduled: damage (incl. if caused by third parties)	minutes	192	153	126	104	100
Scheduled: network maintenance and overhaul	minutes	280	256	206	156	143
TOTAL SAIDI	**minutes**	**620**	**466**	**350**	**286**	**261**

4.5. ENVIRONMENTAL PROTECTION

Environmental Protection topics



- 8 Resource consumption in production
- 11 Environmental compliance
- 15 Air pollution
- 17 Energy consumption
- 18 Renewable energy
- 22 Waste and waste water
- 24 Environmental protection expenditure
- 26 Biodiversity

Management Approach

Latvenergo Group is aware of the role of environmental protection in sustainable development and implements its key principles in all its operations. The Latvenergo Group Strategy 2017–2022 has set environmental protection as one of its priorities in energy generation and supply processes.

Environmental Policy and governance

The key principles of Latvenergo Group in relation to environmental issues are established in its Environmental Policy. The following main principles characterise the Group's environmental philosophy and attitude towards the environment:

- effective management of environmental risks in all business areas of the Group;
- ensuring governance of industrial accident risks;
- reducing pollutant emissions and the Group's impact on climate change;
- efficient use of natural resources;
- promoting the implementation of balanced and economically sound technologies and measures that mitigate or prevent effects leading to climate change or ensure adaptation to it;
- fostering preservation of biodiversity;
- assessment of the environmental impact of investment projects and minimising the harm caused to the environment;
- providing regular and open information to society and stakeholders about environmental activities;
- acting in an environmentally friendly manner and urging society and partners to do the same;
- integrating the key principles of green procurement into procurement procedures.

The ability of Latvenergo Group to develop and enhance its environmental performance is evidenced by its environmental management system, implemented and certified in compliance with ISO 14001. This means that the Group focuses on minimising its environmental impact in all areas of operation and processes. In 2017, in continuing to improve management processes, the environmental management system was expanded and implemented in all areas of operation of Latvenergo AS.

Resource and energy consumption

Sustainable use of resources has become increasingly important at both a national and European level. This is promoted in particular by the implementation of the requirements of the EU Energy Efficiency Directive and the EU-level commitment to reducing the consumption of primary energy sources by 20% by 2020, which constitutes a serious challenge for the energy sector as well.

Using modern and efficient technologies is one of the main ways for the Group to save resources and reduce emissions. Latvenergo Group makes targeted investment in technological improvements that increase the efficiency of plants, reduce resource consumption and mitigate the environmental impact both directly and indirectly.

At its plants, Latvenergo Group uses a combination of optimal and diversified energy sources available to Latvia, which ensures a high proportion of renewable energy. The Group has a balanced and environmentally friendly generation portfolio, consisting mostly of hydropower plants and highly efficient combined heat and power plants.

The Riga CHPPs mainly generate electricity in cogeneration using the most environmentally friendly fossil fuel: natural gas. Cogeneration or combined heat and power generation is a highly efficient energy generation process that ensures more efficient use of fuel and, consequently, less emissions, including the amount of CO_2 per unit of energy generated. One of the CHPP performance indicators is the fuel utilisation factor, which varies according to the operating modes. For Latvenergo Group's CHPPs, this indicator in 2017 was between 84% and 92% in cogeneration mode and between 40% and 53% in condensation mode. When generating energy in cogeneration mode, the savings of primary energy sources are obtained in relation to the figures from the operation of the plant in condensation mode. In 2017, the savings of primary energy sources achieved this way amounted to 26.7% at Riga CHPP-1 and 20.8% at Riga CHPP-2.

Latvenergo Group makes investments on a regular basis and thus not only achieves technological improvements, but also reduces its environmental impact. In 2017, the long-term Daugava HPP hydropower unit reconstruction programme was continued, while Riga CHPP-1 was equipped with a flue-gas condensing economiser, which allows for more efficient use of fuel.

Energy efficiency measures also play a role in the rational use of the Group's resources, reduction of costs and mitigation of its environmental impact. Latvenergo AS has introduced and certified an energy management system in compliance with ISO 50001. In 2017, Liepājas enerģija SIA also received a certificate regarding the compliance of its energy management system with this standard. Energy management at Latvenergo Group involves the continuous assessment of energy efficiency indicators and their improvement through efficient use of energy sources in production, enhancement of the energy efficiency of buildings and structures, and modernisation of the vehicle fleet in accordance with energy efficiency principles.

Renewable energy

Latvenergo Group uses three types of renewable energy sources – water, wind and wood – to generate electricity and thermal energy. In 2017, 56% of all energy produced at the Group was generated using renewable energy sources, mostly water. By consumption of primary resources, the share of renewables was 70% in total electricity generation and 6% in total thermal energy generation.

Maintenance and renovation of the existing Daugava HPPs' capacities plays a vital role in maintaining a high proportion of renewable energy. The Latvenergo Group strategy also provides for moving towards diversification of the existing generation capacities and the development of new ones in line with the criteria for diversification of primary generation resources and low emission projects.

Compliance with environmental requirements

To ensure compliance with environmental legislation, Latvenergo Group actively cooperates with national environmental institutions, providing them with information related to environmental protection, ensuring compliance with the conditions of the permits received and consulting on issues related to environmental protection.

The Commission Implementing Decision (EU) 2017/1442 of July 2017 sets forth stricter requirements for large combustion plants with regard to the concentration of harmful substances in flue gases. These requirements are also binding on the Riga CHPPs and must be implemented within four years. Taking into account that both CHPPs have been reconstructed, the requirements of the new regulation have already been met to a large degree.

Air pollution

One of the most topical global environmental issues, which is gaining more and more attention, is greenhouse gas-induced climate change. Modernisation of Latvenergo Group facilities, replacing older and less efficient equipment with one that complies with the best and latest methodologies, is a significant contribution to the mitigation of climate change and the achievement of the Group's goals.

In 2017, the European Union continued to develop laws and regulations on climate and energy for the period after 2020. On the way towards CO_2 emissions reduction, changes are expected in the operation of the EU Emissions Trading Scheme (EU ETS). Latvenergo Group expects that the drafting and implementation of the new legislation will create fair and equal conditions for EU ETS participants and that emissions allowance prices will reflect the advantages of efficient and environmentally friendly technologies on the electricity market.

To limit pollutant emissions from combustion plants and to comply with emissions limits specified by laws and regulations, Latvenergo Group performs pollution monitoring and accounting, and plans and implements energy efficiency and environmental protection activities. Modernisation of the facilities is important in terms of both efficiency and environmental protection.

Biodiversity

Among the key principles of Latvenergo Group's Environmental Policy are preservation of biodiversity and mitigating the environmental impact of its operations. The Group continuously plans and implements measures that are aimed at preserving biodiversity, the main initiatives in this field being bird protection and replenishment of fish stocks.

Performance Indicators

301-1
302-1

Materials used by weight or volume and energy consumption within the organisation

Latvenergo Group uses renewable energy sources (water, wind and wood) as well as fossil fuel (primarily natural gas and other fuels in smaller amounts) to generate electricity and thermal energy. In 2017, renewables accounted for 51% of total consumption of energy sources, while fossil fuel accounted for 49%. The share of renewables in overall energy source consumption depends on the amount of energy generated, which is mainly determined by hydrological conditions and market factors (see the section "Generation and Trade").

Electricity generation and thermal energy generation have different primary energy source consumption ratios for renewable and fossil energy sources. By consumption of primary resources, the amount of electricity generated in 2017 from renewable energy sources (water, wind and wood) was 70% or 4,014 GWh, and 30% or 1,720 GWh was generated using natural gas. The high proportion of renewable energy sources in electricity production was ensured primarily through generation at the Daugava HPPs.

The amount of thermal energy generated from woodchips was 157 GWh, constituting about 6% of the total amount of thermal energy generated at Latvenergo Group. Woodchips are used to generate thermal energy at Kegums Boiler House and two Liepaja generation facilities: a biomass-fired combined heat and power plant and a biomass-fired boiler house. The amount of thermal energy generated from natural gas and, in small amounts, diesel fuel was 94% or 2,462 GWh.

In 2017, energy consumption for generation processes (i.e. the Group's own use) was 105 GWh or 1.3% of the energy generated.

In 2017, the fuel used for vehicles included 1,066 thousand litres of petrol and 1,728 thousand litres of diesel fuel, which is, respectively, 18% and 29% less than in 2016.

Accounting and calculation of energy sources is carried out based on continuous measurement or according to suppliers' documentation and internal records and in compliance with the requirements of the laws and regulations of the Republic of Latvia, greenhouse gas emissions permits, and the EU.

303-1

Water withdrawal by source

Latvenergo Group uses water resources mainly for the support of generation processes. A relatively small amount of water is used for various technological needs and also for water supply to external users.

The Group's water consumption includes surface, underground and supply system water. In 2017, water used for operational needs amounted to 1,582 thousand m^3, including 85% or 1,345 thousand m^3 of surface water, 9% or 145 thousand m^3 of underground water and 6% or 92 thousand m^3 of supply system water.

The largest consumer of surface water is Riga CHPP-2, which consumed 1,340 thousand m^3 of water for generation needs in 2017. 33% of this amount – 443 thousand m^3 – was cooling water. The consumption of water resources at Riga CHPP-2 is affected by the operational modes of the generation facilities and the amount of energy generated. The largest consumer of underground water is Riga CHPP-1, which consumed 60 thousand m3 of underground water to feed the heating networks.

The data on water consumption are based on meter readings.

Consumption of primary energy resources (2013–2017)

	Unit	2013	2014	2015	2016	2017
Water, wind*	TJ	10,278	6,946	6,511	8,834	15,391
Wood	TJ	522	718	693	759	767
Total renewable energy resources	**TJ**	**10,800**	**7,664**	**7,204**	**9,593**	**16,158**
Natural gas	TJ	20,168	17,459	19,194	20,185	15,607
Diesel fuel	TJ	1	6	2	1	1
Total fossil energy resources	**TJ**	**20,169**	**17,465**	**19,196**	**20,186**	**15,608**
TOTAL	**TJ**	**30,969**	**25,129**	**26,400**	**29,779**	**31,766**

* the amount of resources evaluated as the amount of energy generated using these resources (3.6 GJ=1 MWh)

Consumption of primary energy resources for electricity generation (2013–2017)

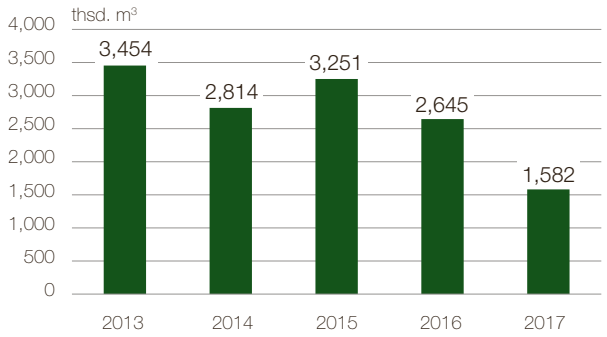
	Unit	2013	2014	2015	2016	2017
Water, wind*	TJ	10,278	6,946	6,511	8,834	15,391
Wood	TJ	59	173	181	193	189
Total renewable energy resources	**TJ**	**10,337**	**7,119**	**6,692**	**9,027**	**15,580**
Natural gas	TJ	10,253	8,391	10,910	10,583	6,477
Total fossil energy resources	**TJ**	**10,253**	**8,391**	**10,910**	**10,583**	**6,477**
TOTAL	**TJ**	**20,590**	**15,510**	**17,602**	**19,610**	**22,057**

* the amount of resources evaluated as the amount of energy generated using these resources (3.6 GJ=1 MWh)

Consumption by primary energy resources for thermal energy generation (2013–2017)

	Unit	2013	2014	2015	2016	2017
Wood	TJ	463	545	512	566	578
Total renewable energy resources	**TJ**	**463**	**545**	**512**	**566**	**578**
Natural gas	TJ	9,915	9,068	8,284	9,602	9,130
Diesel fuel	TJ	1	6	2	1	1
Total fossil energy resources	**TJ**	**9,916**	**9,074**	**8,286**	**9,603**	**9,131**
TOTAL	**TJ**	**10,379**	**9,619**	**8,798**	**10,169**	**9,709**

Total water withdrawal (2013–2017)



304-2

Significant impacts of activities, products, and services on biodiversity

Bird protection

On bird protection and research, Latvenergo Group cooperates with the Latvian Ornithological Society (LOS). Particular attention is paid to the protection of white storks. The White Stork Monitoring Project, carried out by Latvenergo Group and the LOS in order to gather information on the white stork population in Latvia, is now in its seventh year. At least 12,000 white stork couples nest in Latvia, and power line poles are their most frequent nesting sites. In 2017, 9,359 white stork nests were found on electricity line poles in Latvia. To ensure compliance with electricity supply safety requirements and reduce the number of white stork fatalities on electric lines, 1,059 potentially dangerous nests were removed from electricity line poles in 2017 following approval from the environmental authorities. During the nesting period, the birds are disturbed only in exceptional cases where the safety of the electricity supply or the public is endangered.

Replenishment of fish stock and reinforcement of the Daugava riverbanks

In compliance with applicable law, Latvenergo Group makes annual contributions to replenish fish stocks in the Daugava River basin. In 2017, these payments amounted to EUR 1,035 thousand. Approximately 600 thousand salmon and sea trout smolt fry, 700 thousand pike perch, whitefish and vimba fry, and 12 million lamprey larvae were released into the Daugava River basin in the reporting year.

Latvenergo Group cooperates with Mēs zivīm, a fish conservation society, on issues related to replenishment of fish stock. In April 2017, 400 artificial spawning nests were placed in the Kegums HPP and Riga HPP reservoirs to stimulate the replenishment of common fish species in the Daugava River basin. In order to reduce fish die-off during the summer season, when the water level is lowered to perform repair work at the HPPs, the Group adjusts the HPP operation modes and, in cooperation with the fish conservation society, arranges the survey of the exposed areas.

In cooperation with Mēs zivīm and the Ogre Region Municipality, the Vedze River Clean-up Project was implemented in 2017. As part of the project, the 12-km-long river was cleared of fallen trees and beaver dams, improving the water flow rate and ecological quality and providing more favourable conditions for salmonids and brook lamprey. Upon completion of the clean-up, 2,000 brown trout fry were released into the Daugava River basin, supplementing the fish stock of the Daugava basin water bodies.

At the beginning of 2017, changes in laws and regulations on covering the reinforcement costs of the Daugava riverbanks came into force, and starting from 2017 these costs are covered through the natural resource tax on water used at HPPs for electricity generation. EUR 6.8 million was paid as tax in the reporting year.

Study of fish migration and natural replenishment possibilities in the Daugava River basin

In 2017, a study on fish migration and natural replenishment possibilities in the Daugava River basin, which was initiated in 2013, continued. The purpose of the study is to understand the behaviour of Atlantic salmon in spawning places in the Ogre River and analyse the ability of this species to acclimatise. In the autumn of 2017, 20 marked salmon were released into the Ogre River. In the spring of 2018, the researchers plan to obtain data that will allow for assessing the potential of the Ogre River more accurately and planning further measures for fish migration and natural replenishment.

In September 2017, LIFE Connects, a cooperation project between Sweden and Latvia for improving river connectivity and habitats, was presented to the EU's LIFE Programme for the Environment and Climate Action. The aim of the Group within this project is to evaluate if and by what means the natural replenishment of migratory fish can be partially restored in the Daugava River basin.

305-1

Direct greenhouse gas (GHG) emissions

The amount of direct greenhouse gas emitted by Latvenergo Group is determined by fuel consumption, which, in turn, depends on the amount of energy generated and the operational modes selected by the plants. In 2017, Latvenergo Group's combustion plants emitted 882 thousand tonnes of CO_2, which is a decrease of 23% compared to the previous year. The decrease in CO_2 emissions was mainly due to a substantial increase in electricity output at the Daugava HPPs in 2017 in comparison with the preceding year.

CO_2 emissions are calculated in compliance with the requirements of the laws and regulations of the Republic of Latvia, the greenhouse gas emissions permits for CHPP-1 and CHPP-2, and the EU. The total amount of the Group's emissions is composed of:

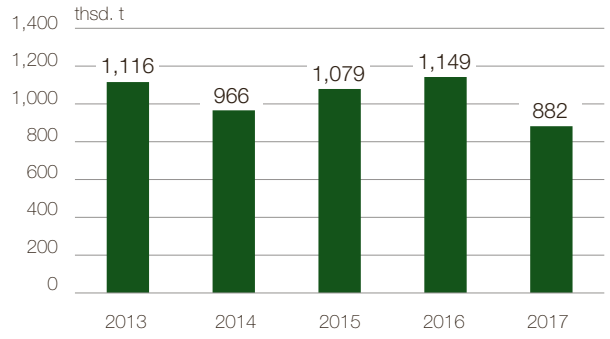
- emissions from facilities that participate in the EU ETS (combustion plants with total rated thermal input exceeding 20 MW);
- emissions from non-participating facilities (9.9 tonnes of CO_2).

This amount also includes emissions associated with supporting the energy generation process.

The Group also operates plants that contain sulphur hexafluoride (SF6) gas and cooling installations that contain gases with an insignificant global warming potential. They are closed installations where no gas leakage has been detected; therefore, these gases are not included in the calculation.

Use of fuel by Latvenergo Group vehicles also results in CO_2 emissions. In 2017, the volume of CO_2 emissions from vehicles was 7.1 thousand tonnes or approximately 1% of total emissions.

CO_2 emissions (2013–2017)



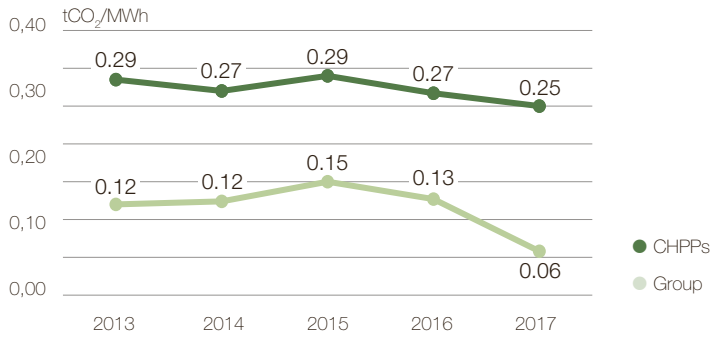
305-4

Greenhouse gas (GHG) emissions intensity

The specific CO_2 emissions indicators per unit of electricity generated by the entire Group describe the allocation and efficiency of renewable energy sources and fossil fuel: the lower the indicators, the larger the share of electricity generated from renewable energy sources, and the higher the performance efficiency of the Riga CHPPs' facilities.

In 2017, CO_2 emissions per unit of electricity generated were 0.06 tonnes CO_2/MWh at the Group overall and 0.25 tonnes CO_2/MWh at the Riga CHPPs. In 2017, the decrease in overall CO_2 emissions intensity was determined by the significant increase in electricity generated at the Daugava HPPs.

CO_2 emissions per unit of electricity generated (2013–2017)



305-7

NO_x, SO_2 and other significant air emissions

The emission of harmful substances into the atmosphere depends directly on the amount of energy generated, the type of fuel used, the efficiency of its consumption, and the technology.

- Natural gas is the most environmentally friendly type of fossil fuel, and Latvenergo Group uses it not only at the Riga CHPPs, but also, where possible, at the Liepaja plants and at small boiler houses. However, apart from carbon dioxide, combustion of natural gas emits nitrogen oxides (NO_x) and carbon monoxide (CO) into the atmosphere.
- Latvenergo Group uses diesel as the back-up fuel at the Riga CHPPs. When burning diesel fuel, insignificant amounts of sulphur dioxide (SO_2) and particulate matter emissions are produced. Diesel fuel emits hydrocarbons during storage.
- Wood combustion at small boiler houses and at the Liepaja plants produces NO_x, CO and particulate matter emissions.

Emissions amounts from combustion plants that comply with the provisions of the Industrial Emissions Directive are determined on the basis of continuous measurement. Emissions from small and medium-sized combustion plants (up to 50 MW installed capacity) are determined with the help of emissions factors specified by laws and regulations.

NO_x, CO, SO_2 and other emissions (2013–2017)

	Unit	2013	2014	2015	2016	2017
NO_x	t	792	623	737	803	613
NO_x from combustion plants	kg/MWh	0.18	0.16	0.17	0.16	0.15
NO_x Group combined	kg/MWh	0.11	0.11	0.12	0.11	0.07
CO	t	397	415	319	361	318
CO from combustion plants	kg/MWh	0.09	0.10	0.08	0.07	0.08
CO Group combined	kg/MWh	0.06	0.07	0.05	0.05	0.04
SO_2	t	3	1	4	4	5
Other*	t	14	17	4	17	19

* including emissions of solid particles and hydrocarbons

307-1

Non-compliance with environmental laws and regulations

In 2017, five planned thematic inspections were performed by the State Environmental Service of the Ministry of Environmental Protection and one planned control was carried out by the Health Inspectorate. No significant warnings or sanctions were issued by the regulatory bodies as a result of the inspections of the Group's operations in 2017.

In January 2017, petroleum product leakage occurred at Pļaviņas HPP, regarding which the Madona Regional Environmental Board drew up a violation report. On this basis, a decision on an administrative violation was made and a fine of EUR 1,600 was levied. Limitation and clean-up of the consequences of the pollution was carried out at the spill location, and the measures necessary to reduce or completely exclude the occurrence of such pollution in the future were identified.

EU5

Allocation of CO_2 emissions allowances or equivalent, broken down by carbon trading framework

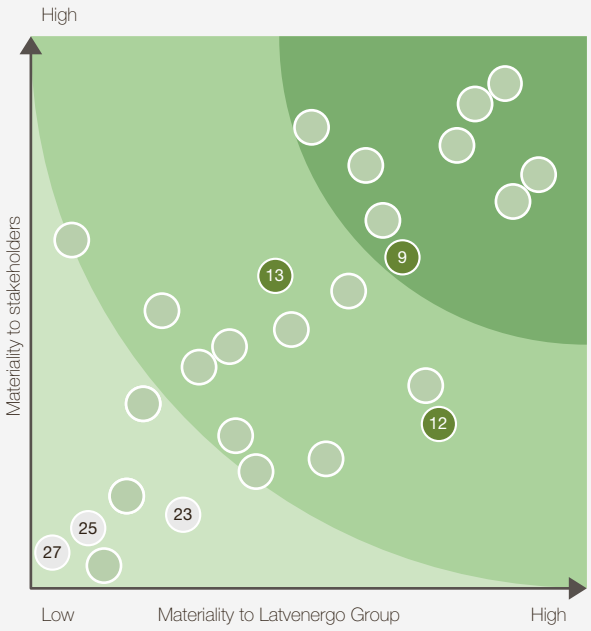
The EU ETS sets forth that free emissions allowances are granted only for thermal energy generation, and the number of allowance units granted will be gradually reduced to 30% of the necessary amount by 2020. In 2017, the Riga CHPPs were granted 295,942 allowance units and the Liepaja plants were granted 18,218 allowance units for thermal energy generation. One allowance unit is equivalent to one tonne of CO_2 emitted. See Note 13b to the Annual Report for the allowance units purchased, used and sold.

CO_2 emissions allowances granted (2013-2017)

	Unit	2013	2014	2015	2016	2017
Riga CHPPs	number	502,865	442,778	392,255	343,330	295,942
Liepaja plants	number	36,536	29,025	29,855	21,158	18,218

4.6. EMPLOYEES AND THE WORK ENVIRONMENT

Employment and the Work Environment topics



- 9 Health and safety
- 12 Workplace compliance
- 13 Employee development
- 23 Human rights and workplace diversity
- 25 Work-life balance
- 27 Employee involvement and freedom of association

Management Approach

Latvenergo Group's management acknowledges that its employees, with their diversity and variety of competences, provide a valuable opportunity to view operational aspects from different perspectives and thus achieve better results. The Group attracts and develops managers and leaders capable of driving its advancement and ensuring that its employees' competences contribute to the achievement of goals and future needs. Employee engagement and desire to implement innovative ideas in both improving the work environment and enhancing the Group's competitiveness is an important resource; therefore, guidelines for working with high potential employees were developed in 2017 and their implementation will start in 2018.

Personnel Management Policy and basic principles

The main tasks of Latvenergo Group's human resource management are subject to its strategy and aimed at ensuring that the conduct of each and every employee is in line with the Group's values: responsibility, efficiency and openness. Latvenergo Group's Personnel Management Policy was updated in early 2017. The Policy supports the areas of personnel management outlined in the Latvenergo Group Strategy 2017–2022:

- employee engagement in order to promote growth, productivity and innovation;
- management of excellence-oriented skills and competences and leadership development to achieve the Group's goals;
- comprehensive diversity management, achieving full engagement of all employees and their ability to fulfil their potential, regardless of any constraints;
- a balanced motivation system that supports excellence and leadership.

Key personnel management principles laid down in the Policy:

- social responsibility: a safe work environment, equal employment conditions and equal treatment of all employees are implemented and maintained;
- social dialogue with employees and their representatives;
- competence development, knowledge sharing and knowledge transfer;
- engagement and responsibility for the performance of the work to ensure achievement of goals;
- support for diversity, new knowledge and innovation;
- honesty and mutual respect in the relationship between the employer and employees: the employer and employees are equal partners who build their relationships adhering to general ethical principles and taking care to avoid conflict of interest situations.

In all areas of its operation, Latvenergo Group respects fundamental human rights, which are enshrined in the Constitution of the Republic of Latvia, in applicable laws and in international treaties binding on Latvia. The work environment and processes are created so as to prevent the possibility that the human rights of the employees of the Group and its subcontractors may be infringed or violated, insofar as the Group is able to influence this.

Safe work environment

Latvenergo Group pays special attention to creating a safe work environment. Through internal monitoring of the work environment and compliance with the requirements of laws and regulations of the Republic of Latvia, the Group develops an annual plan for occupational safety measures aimed at maintaining a safe work environment. Latvenergo Group provides its employees with workplaces, personal protective equipment and technical resources that are appropriate for their job. It also organises employee training on occupational safety and safe working methods. The Group's occupational health and safety management system is compliant with OHSAS 18001 and aims to minimise occupational health and safety risks at the company.

Latvenergo Group pays continuous attention to employees' views on the safety of the work environment. To update the assessment of the work environment, the employee opinion poll of 2017 included additional questions about the safety of the work environment, and 96% of the respondents replied that they generally felt safe at their workplace. Increased attention was also paid to the development of new, innovative informative materials, such as the e-learning programme on first aid, so that any employee may acquire new knowledge or brush up existing knowledge regarding first aid.

Occupational safety measures are ensured not only for Latvenergo Group employees, but also for employees of the Group's service providers. The Group instructs and trains the employees of all its contractors on safe work performance. Contractors manage their own human resources, and the Group supervises their activities at its facilities.

Employee growth

Employee engagement is a prerequisite for growth, development and attainment of goals. Work performance and productivity depend on employees' sense of engagement and belonging. Therefore, an anonymous survey is conducted annually to find out employees' views on various aspects of the work environment; it also identifies the level of employee engagement. The results of the 2017 survey demonstrate a consistently high level of engagement: the average rating of engagement aspects was 6.04 on a seven-point scale. In 2017, the employee commitment index (TRI*M) was put forward as one of the Group's performance indicators, and this indicator will be measured annually as part of the employee survey in the future.

To increase the efficiency of processes, the Group continuously improves the self-service system for employees, which ensures fast and efficient information exchange and maintenance of various management processes. Since 2017, the full goal management process, including goal attainment monitoring, has been carried out in this system. Moreover, digitalisation of job descriptions and competence management processes for the electrical installations maintenance personnel was started in 2017, and it is set to be completed by the end of 2018.

Employee development

Latvenergo Group takes care of employee development to ensure the attainment of the Group's goals and strategic competences. In 2017, particular attention was paid to:

- improving managers' skills in assessing employees' competences, creating a common understanding of the strategic competence model (264 managers trained);
- improving sales skills (180 employees trained);
- building stress management skills (284 employees trained);
- applying regulations on the protection of personal data in practice (340 employees trained).

Latvenergo Group's employees can improve their skills and knowledge in the way most convenient for them: by taking the opportunity provided by the employer to acquire the necessary information through internal and external face-to-face training and on the Group's e-learning platform. Employees may supplement their knowledge and skills both on the recommendation of managers and on their own initiative.

Knowledge continuity

Ensuring knowledge continuity is essential for the sustainability of Latvenergo Group's operations. The Group encourages employees to accumulate knowledge and transfer it to colleagues, putting great emphasis on the training of new employees and timely preparation of successors at workplaces that require specific and unique technical knowledge.

One of the Group's priorities in terms of knowledge transfer is provision of quality practical training to students of higher and secondary vocational educational institutions through an increasing number of paid internship opportunities at the Group's companies every year. In 2017, Latvenergo Group provided 180 students with paid internship opportunities. The Group cooperates with educational institutions in Latvia, encouraging studies in the field of engineering sciences and the development of the future workforce in Latvia in general.

In 2017, Latvenergo AS and Sadales tīkls AS signed an agreement with the Employers' Confederation of Latvia for the implementation of the ESF project: Participation of Students of Vocational Educational Institutions in Work Environment-Based Training and Company Placements. In addition to traditional company placements or internships, the project provides for expansion of work environment-based training, which is a new method in the Latvian vocational education system.

In continuing to improve the quality of practical training, 30 mentors were trained under the mentor training programme in 2017. Eight mentors learnt about the experience of similar companies at the Croatian energy company HEP Group. In May, Latvenergo was admitted as a member of the European Alliance for Apprenticeships, which demonstrates the ability to ensure the quality of practical training.

Performance Indicators

Number of employees and the Collective Bargaining Agreement

102-8
102-41

The strategy of Latvenergo Group focuses on the sustainability and strengthening of competitiveness, which provides for maximising efficiency, including revision and further centralisation of processes. In 2017, the Group launched an efficiency programme through which it plans to downsize the number of employees by about a quarter until 2022. Consequently, the number of employees at Latvenergo Group decreased in 2017 and at the end of the year the Group employed 3,908 people.

Distribution of employees by operating segments (2013–2017)

	Unit	2013	2014	2015	2016	2017
Generation and trade	number	971	989	992	987	949
Distribution	number	2,505	2,545	2,568	2,521	2,344
Lease of transmission system assets*	number	444	443	11	10	9
Corporate functions	number	592	586	606	613	606
TOTAL	**number**	**4,512**	**4,563**	**4,177**	**4,131**	**3,908**

* On 1 January 2015, 430 Latvenergo Group employees were transferred to Augstsprieguma tīkls AS along with the functions of transmission system asset construction and maintenance.

The workforce has a relatively high proportion of male individuals; it is 71% male and 29% female. This is related to industry specifics, which require a large number of technical positions.

The majority of employment contracts at Latvenergo Group are concluded on a full-time basis and for an indefinite period. In 2017, only 8 employees or 0.2% of the workforce had part-time agreements (0.2% of male and 0.5% of female employees at the Group), and 1.9% of the employment contracts were concluded for a fixed term (1% of male and 4.2% of female employees). No significant changes in these indicators have occurred compared to previous years.

In the interest of the social security and wellbeing of its employees, the Group's companies Latvenergo AS, Sadales tīkls AS, Latvijas elektriskie tīkli AS and Enerģijas publiskais tirgotājs AS have signed a Collective Bargaining Agreement with the Enerģija trade union. In addition to meeting the requirements of laws and regulations, the Agreement provides protection for employees' economic and social interests.

In 2017, the Collective Bargaining Agreement was applicable to 97% of the Group's employees, and in recent years this percentage has remained constant. The Collective Bargaining Agreement applies not only to trade union members, who currently constitute approximately 60% of the Group's total number of employees, but to all employees of the abovementioned companies. Thus, equal treatment of social guarantees is ensured for all employees and the likelihood of conflict between employees and the employer is reduced.

402-1

Minimum notice period(s) regarding operational changes

Latvenergo Group regularly notifies employees and the trade union about its business activities, current events, development and planned structural changes. The Collective Bargaining Agreement provides that the employer must give no less than one month's notice to the trade union before a request for consent to terminate an employment contract with an employee. Regarding collective redundancies, consultations with the trade union must be started no later than one month before notifying the State Employment Agency. Employees must be informed about organisational changes leading to redundancies no later than five days following the decision.

403-2

Types of injury and rates of injury, occupational diseases, lost days and absenteeism

Eight accidents occurred in 2017 at Latvenergo Group, six of which were not serious. No work-related fatalities occurred at the Group in 2017. Accidents are registered, investigated and analysed in compliance with the regulatory acts of the Republic of Latvia. Appropriate additional training is also conducted for employees.

Six cases of accidents among contractors' employees were registered in 2017 (three in 2016).

Rates of injury and absenteeism* (2013-2017)

	Unit	2013	2014	2015	2016	2017
Injury rate (IR)	index	0.34	0.23	0.23	0.23	0.23
Occupational diseases rate (ODR)	index	0.05	0.10	0.03	0.20	0.15
Lost day rate (LDR)	index	15	8	15	8	22
Accidents (not serious)	number	11	8	5	7	6
Accidents (serious)	number	2	1	2	1	2
Accidents (fatal)	number	0	0	1	0	0
Occupational diseases	number	2	4	1	7	5
Absentee rate (AR) **	%	3.9	3.5	4.5	4.7	5.1

Rates of injury and absenteeism by gender* (2015–2017)

		2015		2016		2017	
	Unit	Women	Men	Women	Men	Women	Men
Injury rate (IR)	index	0.00	0.23	0.03	0.20	0.03	0.20
Occupational diseases rate (ODR)	index	0.03	0.00	0.11	0.09	0.09	0.06
Lost day rate (LDR)	index	0.0	14.6	0.3	7.4	0.2	21.8
Accidents (not serious)	number	0	5	1	6	0	6
Accidents (serious)	number	0	2	0	1	1	1
Accidents (fatal)	number	0	1	0	0	0	0
Occupational diseases	number	1	0	4	3	3	2
Absentee rate (AR) **	%	6.5	3.7	6.3	4.1	6.6	4.4

*

$$IR = \frac{\text{number of accidents}}{\text{total hours worked}} * 200{,}000 \qquad LDR = \frac{\text{lost days due to accidents}}{\text{total hours worked}} * 200{,}000$$

$$ODR = \frac{\text{number of occupational diseases}}{\text{total hours worked}} * 200{,}000 \qquad AR = \frac{\text{number of missed (absentee) days}}{\text{planned number of working days}} * 100$$

** including maternity leave and incapacity to work not related to occupational accidents and diseases (numbers for 2012–2014 do not include data on Elektrum Eesti OÜ and Elektrum Lietuva UAB)

403-4

Health and safety topics covered in formal agreements with trade unions

The Latvenergo Collective Bargaining Agreement comprises labour protection issues and cooperation in their resolution. This includes the following:

- the employer, the trade union and the employees have confirmed their responsibility regarding the improvement of the labour safety system, including the evaluation of work environment risks and minimisation of their impact;
- agreement on the term of office of trustees, which is five years, and their engagement in the improvement of labour safety;
- the employer's obligations, including in a situation where an accident at work has occurred.

404-1

Average hours of training per year per employee

In 2017, a total of 2,557 employees participated in face-to-face training at Latvenergo Group, with a total of 68,242 hours devoted to it. An average of 18 hours per employee was devoted to training. Average rates by position levels were as follows:

- 29 hours for managers;
- 17 hours for specialists;
- 18 hours for skilled workers;
- and 13 hours per employee in other positions.

Concerning employee training by gender, male employees of the Group spent an average of 19 hours in training, while female employees spent an average of 16 hours in training. Internal training, experience sharing events and discussions involving all employees are organised at least once a year.

The Group puts great emphasis on training its technical staff in the latest technologies, which is why both internal courses and training by equipment suppliers are organised for technical specialists. In 2017, 192 technical specialists were trained during a total of 1,776 hours. A total of 70 employees obtained professional qualifications through training financed by the employer, devoting 37,920 hours to training during the reporting year.

In 2017, e-learning opportunities were used by 2,193 employees who completed 2,717 e-learning activities, of which 1,501 were programme learning and 1,216 were tests.

EU15

Percentage of employees eligible to retire in the next 5 and 10 years broken down by job category

The Group maintains a balanced succession and generational replacement according to the specifics of its work environment. Accordingly, no significant changes compared to 2016 have occurred in the share of employees who might retire within the next 10 years.

Retirement time (31.12.2017.)

Profession groups		5 years		10 years	
	Unit	Women	Men	Women	Men
Managers	%	0.2	0.9	0.6	1.5
Professionals	%	3.4	5.9	5.7	10.1
Craft and related trades workers	%	0.3	4.2	0.3	8.5
Other professions	%	0.9	1.0	2.0	1.6
TOTAL	**%**	**4.8**	**12.0**	**8.6**	**21.7**

EU18

Percentage of contractor and subcontractor employees that have undergone relevant health and safety training

Latvenergo Group instructs and trains all (i.e. 100%) of the employees of its contractors on safe work performance, as required by Latvian laws and regulations, energy standards and mutual agreements. The Group's labour safety specialists instruct persons employed by contractors. Instructions and applicable documents on safe performance of work, with which the contractors' employees must familiarise themselves, are also available electronically.

ANNEXES TO THE SUSTAINABILITY REPORT

5.1. GREEN BOND REPORT

The green bond programme was launched in June 2015, with the first tranche of EUR 75 million. Thus, Latvenergo AS became the first state-owned company in Eastern Europe to issue green bonds. In April 2016, Latvenergo AS issued additional green bonds in the amount of EUR 25 million, completing the bond programme of EUR 100 million.

The green bonds issued by Latvenergo AS are listed on the Baltic Bond List of Nasdaq Riga AS. The ISIN code of the bonds is LV0000801777. The bond issuance was organised by SEB banka AS. The maturity date of the bonds is 10 June 2022, with a fixed annual interest rate (coupon) of 1.9%.

The green bond programme was implemented as a continuation of the Latvenergo AS bond issue launched in 2012 and of the diversification of financing sources. Currently, the total value of bonds outstanding is EUR 135 million, constituting 17% of the Group's total borrowings.

The main requirement for green bonds is that the funds raised are used exclusively for specified environmental projects, promoting the use of renewable energy sources, energy efficiency, environmental protection and a sustainable environment. The selection criteria for eligible projects, the selection procedure, creation of a special account and regular reporting are set out in the Latvenergo Green Bond Framework available on the Latvenergo website.

The Green Bond Framework was awarded the highest possible rating – Dark Green – by CICERO, an independent environmental expert. This indicated the compliance of the planned eligible projects with long-term environmental protection and climate change reduction targets as well as good corporate governance and transparency.

Moody's assigned the highest green bond assessment grade – GB1 (excellent) – and the Baa2 rating with a stable outlook for the green bonds, which corresponds to Latvenergo's credit rating. Latvenergo was commended for its transparent and well-considered decision-making process, transparent and comprehensible management of proceeds from the bond issue, and effective reporting and disclosure practices.

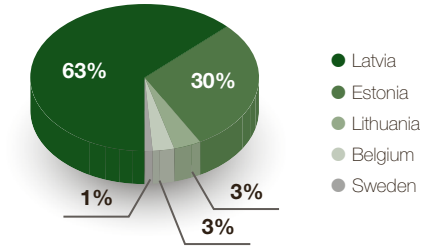
The funds raised within the green bond programme were invested in generation, transmission and distribution projects. The largest eligible projects are the Daugava HPP hydropower unit reconstruction programme and the energy infrastructure project *Kurzeme Ring*.

In January 2017, an internal audit was conducted on the management of proceeds from the bond issue and the compliance of the selection of eligible projects with the Green Bond Framework. The audit concluded that the processes had been implemented appropriately.

The eligible projects of the green bond programme are divided into four groups:

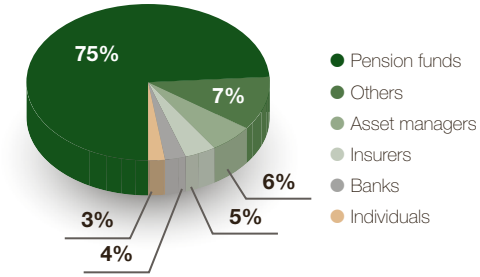
	renewable energy – building of new renewable energy capacities and reconstruction of existing ones – hydropower, bioenergy (non-food), wind energy and related infrastructure;
	energy efficiency – building and reconstruction of transmission and distribution networks to reduce network losses and ensure possibilities for the connection of renewable energy capacities; smart grid projects;
	environmental protection – flood protection, waste management and water resource management;
	sustainable environment – environmental research and development, and programmes in the areas of environmental protection and biodiversity.

Investors by region*



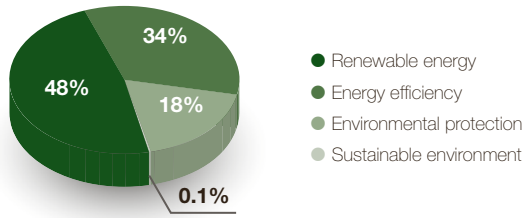
* according to the coupon payment of June 2017

Investors by type*



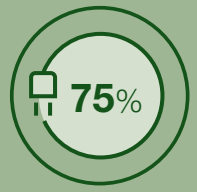
* according to the coupon payment of June 2017

Investment by project group



Eligible projects of the green bond programme

Group operating segment (share of total eligible costs)	Eligible projects		Eligible costs, EUR million	Project objectives and benefits
GENERATION 66.0%		Reconstruction of hydropower units and technological equipment at Daugava HPPs	47.9	Extending the service life of the hydropower units and increasing their capacity and efficiency ratios. Maintaining a high share of renewables in energy generation. Increasing the safety of operation of the Daugava HPPs. Reducing the oil leakage risk. Implementation of the programme allows for a reduction of CO_2 emissions of up to 18,000 tons per year. In 2017, the share of renewable energy generated by the Group was 75%.
		Renovation of hydroengineering structures at the Daugava HPPs and Aiviekste HPP	18.1	Improving the resilience and safety of hydroengineering structures and dams and extending their service life. Reducing accident risk probability at dams and managing flood risk more efficiently, thus diminishing the potential impact on the public, property and the environment.
		Study of migratory fish replenishment in the Daugava River	0.07	Reducing the impact on biodiversity. Potential measures to offset the impact of the Daugava HPPs on fish stocks more efficiently and to reduce the impact on biodiversity will be identified and explored.
DISTRIBUTION 9.1%		Building and reconstruction of electricity lines and transformer points	7.2	Reducing the duration of power interruptions and electricity losses. Extending the service life of the distribution grid. Since 2014, interruption duration and interruption frequency indexes have been reduced substantially (SAIDI by 30% and SAIFI by 44%). The reduction of CO_2 emissions achieved as a result of the total decrease in distribution losses in this period is 5,000 tons.
		Smart electricity meters	1.9	Reducing the duration of power interruptions and electricity losses. Opportunities for more efficient electricity consumption and use of smart energy efficiency products and services. At the end of 2017, more than 405,000 smart meters have been installed; these account for 36% of the total fleet of electricity meters and measure 78% of the total amount of electricity consumed by customers.
		Annual monitoring of white storks	0.004	Reducing the impact on biodiversity. Data on the stork population and the proportion of their nests located on electricity line poles have been obtained.
LEASE OF TRANSMISSION SYSTEM ASSETS 24.9%		Second stage of *Kurzeme Ring: Grobiņa-Ventspils*	24.9	Expanding interconnection capacity (in accordance with the EU climate and energy targets for 2030), which in turn facilitates the integration of renewable energy sources into the transmission grid, increases the security of the electricity supply and promotes competition in the electricity market. The total length of the new 330 kV electricity lines of *Kurzeme Ring* is set to be around 330 km and the planned capacity is 800 MW. The length of the electricity lines built within the second phase *Grobiņa-Ventspils* is 117 km.
	TOTAL		**100.0**	



Share of renewable energy generated

Reduction of CO_2 emissions*

Reduction in SAIDI since 2014

* Potential reduction of CO_2 emissions as a result of reconstruction of the Daugava HPPs' hydropower units – 18,000 tons per year (at a CO_2 emissions intensity of 0.424 tCO_2/MWh when operating Riga CHPP-2 in condensation mode); reduction of CO_2 emissions as a result of the lesser amount of distribution losses since 2014 – 5,000 tons.

5.2. MATERIALITY OF SUSTAINABILITY TOPICS AND CORRESPONDING GRI TOPICS

Sustainability topics	Corresponding GRI topics	Materiality of topics within the Group		
		Generation and trade	**Distribution**	**Lease of Transmission Assets**
		Latvenergo AS, Enerģijas publiskais tirgotājs AS, Elektrum Eesti OÜ, Elektrum Lietuva UAB, Liepājas enerģija SIA	Sadales tīkls AS	Latvijas elektriskie tīkli AS
Efficiency of generation plants	■ System efficiency ■ Access			
Emergency planning	■ Disaster/emergency planning and response			
Contribution to the economy	■ Economic performance			
Public policy making	■ Public policy			
Availability and efficiency of distribution system	■ System efficiency ■ Access			
Customer satisfaction	■ General Standard Disclosures			
Compliance and fair business	■ Anti-corruption ■ Anti-competitive behaviour ■ Socio-economic compliance			
Resource consumption in production	■ Materials ■ Water			
Health and safety	■ Occupational health and safety ■ Employment			
Data security	■ Customer privacy			
Environmental compliance	■ Environmental compliance			
Workplace compliance	■ Employee and management relations			
Employee development	■ Training and education ■ Employment			
Information availability	■ Provision of information			
Air pollution	■ Emissions			
Community contribution	■ Economic performance			
Energy consumption	■ Energy			
Renewable energy	■ Materials ■ Energy			
Fair marketing communication	■ Marketing and labelling			
Support received from state	■ Economic performance			
Impact on local communities	■ Local communities ■ Customer health and safety			
Biodiversity	■ Biodiversity			

5.3. GRI INDEX

General Standard Disclosures

		Page	External assurance
	Organisation profile		
102-1	Name of the organization	9	√
102-2	Activities, brands, products, and services	9, 38–48	√
102-3	Location of headquarters	9	√
102-4	Location of operations	9	√
102-5	Ownership and legal form	9	√
102-6	Markets served	9	√
102-7	Scale of the organization	9–10	√
102-8	Information on employees and other workers	69	√
102-9	Supply chain	28–29	√
102-10	Significant changes to the organization and its supply chain	9–11, 28–29, 38–47	√
102-11	Precautionary Principle or approach	26–27	√
102-12	External initiatives	34	√
102-13	Membership of associations	33–34	√
EU1	Installed capacity, broken down by primary energy source and by regulatory regime	39	√
EU2	Net energy output broken down by primary energy source and by regulatory regime	39	√
EU3	Number of residential, industrial, institutional and commercial customer accounts	43, 45	√
EU4	Length of above and underground transmission and distribution lines by regulatory regime	45–47	√
EU5	Allocation of CO_2 emissions allowances or equivalent, broken down by carbon trading framework	67	√
	Strategy		
102-14	Statement from senior decision-maker	6–7	√

		Page	External assurance
	Ethics and integrity		
102-16	Values, principles, standards, and norms of behavior	9, 18–19, 26–27	√
	Governance		
102-18	Governance structure	18–21, 25	√
	Stakeholder engagement		
102-40	List of stakeholder groups	30–32	√
102-41	Collective bargaining agreements	69	√
102-42	Identifying and selecting stakeholders	30–32	√
102-43	Approach to stakeholder engagement	30–32	√
102-44	Key topics and concerns raised	30–32, 58–59	√
	Reporting practice		
102-45	Entities included in the consolidated financial statements	9	√
102-46	Defining report content and topic Boundaries	50–51	√
102-47	List of material topics	51	√
102-48	Restatements of information	8	√
102-49	Changes in reporting	51	√
102-50	Reporting period	8	√
102-51	Date of most recent report	8	√
102-52	Reporting cycle	8	√
102-53	Contact point for questions regarding the report	8	√
102-54	Claims of reporting in accordance with the GRI Standards	8	√
102-55	GRI content index	77–79	√
102-56	External assurance	26–27, 81–82	√

Specific Standard Disclosures

	GRI Standards topics		GRI Standards disclosures	Page	External assurance
	Economic Performance				
GRI 201:	Economic performance	103	Management approach	52, 78	√
		201-1	Direct economic value generated and distributed	53	√
		201-3	Defined benefit plan obligations and other retirement plans	53	√
		201-4	Financial assistance received from government	54	√
GRI EU:	System efficiency	103	Management approach	52-53, 78	√
		EU11	Average generation efficiency of thermal plants by energy source and by regulatory regime	54	√
		EU12	Distribution losses as a percentage of total energy	54	√
	Society				
GRI 413:	Local communities	103	Management approach	56, 78	√
		413-1	Operations with local community engagement, impact assessments, and development programs	57	√
GRI 205:	Anti-corruption	103	Management approach	55, 78	√
		205-2	Communication and training about anti-corruption policies and procedures	57	√
		205-3	Confirmed incidents of corruption and actions taken	57	√
GRI 415:	Public policy	103	Management approach	56, 78	√
		415-1	Political contributions	57	√
GRI 206:	Anti-competitive behaviour	103	Management approach	55, 78	√
		206-1	Legal actions for anti-competitive behavior, anti-trust, and monopoly practices	57	√
GRI 419:	Socio-economic compliance	103	Management approach	55, 78	√
		419-1	Non-compliance with laws and regulations in the social and economic area	57	√
GRI EU:	Customer health and safety	103	Management approach	60, 78	√
		EU25	Number of injuries and fatalities to the public involving company assets, including legal judgments, settlements and pending legal cases of diseases	61	√
GRI EU:	Disaster/emergency planning and response	103	Management approach	56, 78	√
	Product Responsibility				
GRI 417:	Marketing and labelling	103	Management approach	60, 78	√
		417-3	Incidents of non-compliance concerning marketing communications	61	√
GRI 418:	Customer privacy	103	Management approach	59, 78	√
		418-1	Substantiated complaints concerning breaches of customer privacy and losses of customer data	61	√
GRI EU:	Provision of information	103	Management approach	60, 78	√
GRI EU:	Access	103	Management approach	60, 78	√
		EU26	Percentage of population unserved in licensed distribution or service areas	61	√
		EU27	Number of residential disconnections for non-payment, broken dfown by duration of disconnection and by regulatory regime	62	√
		EU28	Power outage frequency (SAIFI)	62	√
		EU29	Average power outage duration (SAIDI)	62	√
		EU30	Average plant availability factor by energy source and by regulatory regime	54	√

	GRI Standards topics		GRI Standards disclosures	Page	External assurance
Environmental Protection					
GRI 301:	Materials	103	Management approach	63, 78	√
		301-1	Materials used by weight or volume	65	√
GRI 302:	Energy	103	Management approach	63-64, 78	√
		302-1	Energy consumption within the organization	65	√
GRI 303:	Water	103	Management approach	63, 78	√
		303-1	Water withdrawal by source	65	√
GRI 304:	Biodiversity	103	Management approach	64, 78	√
		304-2	Significant impacts of activities, products, and services on biodiversity	66	√
GRI 305:	Emissions	103	Management approach	64, 78	√
		305-1	Direct (Scope 1) GHG emissions	66	√
		305-4	GHG emissions intensity	67	√
		305-7	Nitrogen oxides (NO_x), sulfur oxides (SO_x), and other significant air emissions	67	√
GRI 307:	Environmental compliance	103	Management approach	64, 78	√
		307-1	Non-compliance with environmental laws and regulations	67	√
Employees and Work Environment					
GRI 402:	Employee and management relations	103	Management approach	68, 78	√
		402-1	Minimum notice periods regarding operational changes	70	√
GRI 403:	Occupational health and safety	103	Management approach	68, 78	√
		403-2	Types of injury and rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities	70	√
		403-4	Health and safety topics covered in formal agreements with trade unions	70	√
GRI 404:	Training and education	103	Management approach	69, 78	√
		404-1	Average hours of training per year per employee	71	√
GRI EU:	Employment	103	Management approach	69, 78	√
		EU15	Percentage of employees eligible to retire in the next 5 and 10 years broken down by job category	71	√
		EU18	Percentage of contractor and subcontractor employees that have undergone relevant health and safety training	71	√

5.4. ABBREVIATIONS

AS	*akciju sabiedrība* (Eng. joint-stock company)
BIAC	Business and Industry Advisory Committee
BICG	The Baltic Institute of Corporate Governance
CCO	Chief Commercial Officer
CDO	Chief Development Officer
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CICERO	The Center for International Climate and Environmental Research – Oslo
COO	Chief Operating Officer
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CTSO	Chief Technology and Support Officer
CSR	corporate social responsibility
Daugava HPPs	Daugava hydropower plants
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECL	Employers' Confederation of Latvia
EU	European Union
EU ETS	European Union Emission Trading Scheme
GHG	greenhouse gas
GRI	Global Reporting Initiative
HPP	hydropower plant
ICOLD	International Commission on Large Dams
IFRS	International Financial Reporting Standards
ISIN	International Securities Identification Number
ISO	International Organization for Standardization
LAHC	Latvian Association of Heat Supply Companies
LAPEEC	Latvian Association of Power Engineers and Energy Constructors
LCCI	Latvian Chamber of Commerce and Industry
LGA	local government agency
LIAA	Investment and Development Agency of Latvia
LOS	Latvian Ornithological Society
LUA	Latvian University of Agriculture
MP	mandatory procurement
MPC	mandatory procurement component
OECD	Organization for Economic Cooperation and Development
OHSAS	Occupational Health and Safety Assessment Series of Standards
OÜ	*Osaühing* (Eng. private limited company)
PUC	Public Utilities Commission
Riga CHPPs	Riga combined heat and power plants
Riga CHPP-1	The first combined heat and power plant in Riga
Riga CHPP-2	The second combined heat and power plant in Riga
RTU	Riga Technical University
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SES	Stakeholder Engagement Standard
SET	subsidised electricity tax
SFRS	State Fire and Rescue Service
SIA	*sabiedrība ar ierobežotu atbildību* (Eng. limited liability company)
SJSC	state joint-stock company
TSO	transmission system operator
UAB	*Uždaroji Akcinė Bendrovė* (Eng. private limited-liability company)
WEC LNC	World Energy Council, Latvian National Committee
WPP	wind power plant

Building a better working world

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INDEPENDENT PRACTITIONER'S ASSURANCE REPORT ON SUSTAINABILITY REPORT

To the management of Latvenergo AS:

This report is intended for the management of Latvenergo AS for the purpose of reporting on sustainability report, including GRI Content Index as referred to and summarised on page 77–79, of Latvenergo AS and its subsidiaries (hereinafter 'the Group') for the year ended 31 December 2017 prepared in accordance with the GRI Sustainability Reporting Standards 'In accordance' – Core option ('GRI Standards') issued by the Global Reporting Initiative ('GRI'), a non-profit organisation with secretariat based in Amsterdam, the Netherlands (hereinafter – 'Sustainability Report').

Subject Matter Information and Applicable Criteria

As prescribed in our engagement letter dated 13 September 2017 we have performed limited assurance engagement on the Sustainability Report of the Group prepared in accordance with GRI Standards.

Our assurance does not comprise the assumptions used by the Group or whether or not it is possible for the Group to reach certain future targets described in the report (e.g. goals, expectations and ambitions).

Specific Purpose of the Report

This report is intended for the purposes specified in the first paragraph above. The report refers exclusively to the Sustainability Report and must not be associated with the Group's financial statements as a whole.

Responsible Party's Responsibilities

The Group's management is responsible for the preparation of the Sustainability Report in accordance with GRI Standards. In particular, the Group's s management is responsible for internal controls being designed and implemented to prevent the Sustainability Report from being materially misstated.

In addition, the Group's management is responsible for ensuring that the documentation provided to the practitioner is complete and accurate. The Group's management is also responsible for maintaining the internal control system that reasonably ensures that the documentation described above is free from material misstatements, whether due to fraud or error.

Practitioner's Responsibilities

We conducted our assurance engagement in accordance with International Assurance Standards, particularly ISAE 3000 (revised). These regulations require that we comply with ethical standards and plan and perform our assurance engagement to obtain limited assurance about the Sustainability Report.

We apply International Standard on Quality Control 1 (ISQC 1), and accordingly, we maintain a robust system of quality control, including policies and procedures documenting compliance with relevant ethical and professional standards and requirements in law or regulation.

We comply with the independence and other ethical requirements of the IESBA Code of Ethics for Professional Accountants, which establishes the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The procedures selected depend on the practitioner's judgment. The procedures include, in particular, inquiry of the personnel responsible for financial reporting and risk management and additional procedures aimed at obtaining evidence about the Sustainability Report.

The assurance engagement performed represents a limited assurance engagement. The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is lower.

In respect of the subject matter information mentioned above we have performed mainly the following procedures:

- interviews with the responsible management, at Group level, subsidiary level, and at selected business units in order to assess if the qualitative and quantitative information stated in the Sustainability Report is complete, accurate and sufficient;
- review of internal and external documents in order to assess if the information stated in the Sustainability Report is complete, accurate and sufficient;
- an evaluation of the design of the systems and processes used to obtain, manage and validate sustainability information;

- verifying the information included in the Sustainability Report through enquires to the relevant management of the Group;
- a reconciliation of financial information with the Group's Consolidated Annual Report for the financial year 2017;
- an assessment of the overall impression of the Sustainability Report, and its format, taking into consideration the consistency of the stated information with applicable criteria;
- testing performance data, on a selective basis, substantively at both an operational and corporate level;
- inspecting documentation to corroborate statements of management and senior executives in our interviews;
- a reconciliation of the reviewed information with the sustainability information in the Group's Consolidated Annual Report for the financial year 2017.

Practitioner's conclusion

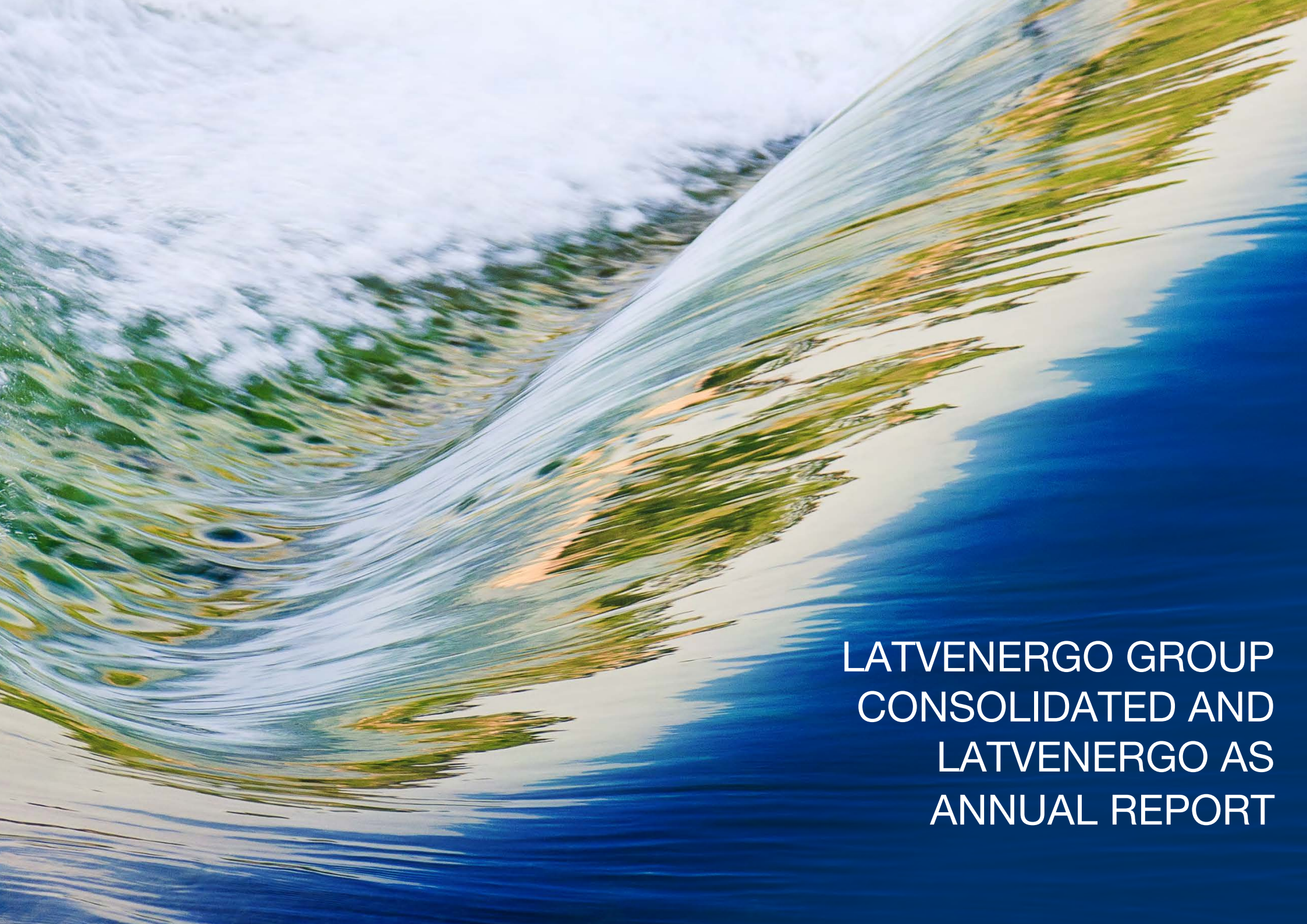
Based on the procedures performed and evidence obtained, we are not aware of any material amendments that need to be made to the Sustainability Report, including GRI Content Index as referred to and summarised on page 77–79, for it to be in accordance with GRI Sustainability Reporting Standards 'In accordance' – Core option issued by the Global Reporting Initiative.

SIA Ernst & Young Baltic

Licence No. 17

Diāna Krišjāne
Chairperson of the Board
Latvian Certified Auditor
Certificate No. 124

Riga, 17 April 2018



LATVENERGO GROUP CONSOLIDATED AND LATVENERGO AS ANNUAL REPORT

LATVENERGO GROUP KEY FIGURES

Financial figures

EUR'000

	2017	2016	2015	2014	2013
Revenue	925,627	931,619	929,128	1,010,757	1,099,893
EBITDA[1]	541,696	393,399	307,015	236,838	248,694
Operating profit[2]	234,082	160,773	108,188	49,243	61,091
Profit before tax[3]	224,114	148,945	92,535	31,510	48,841
Profit	322,021	130,593	85,039	29,790	46,149
Dividends[4]	90,142	77,413	31,479	23,605	40,618
Total assets	4,415,725	3,901,231	3,517,372	3,486,576	3,575,358
Non–current assets	3,343,404	3,388,954	3,113,719	3,109,253	3,128,064
Total equity	2,846,891	2,418,713	2,096,702	2,020,801	2,021,714
Borrowings	826,757	791,566	797,483	827,222	944,675
Net debt[5]	590,754	607,586	692,940	706,211	689,252
Net cash flows from operating activities	338,209	341,186	246,278	135,329	146,540
Investments	243,811	200,677	190,461	177,607	224,868

Financial ratios

	2017	2016	2015	2014	2013
EBITDA margin[6]	58.5%	42.2%	33.0%	23.4%	22.6%
Operating profit margin[7]	25.3%	17.3%	11.6%	4.9%	5.6%
Profit before tax margin[8]	24.2%	16.0%	10.0%	3.1%	4.4%
Profit margin[9]	34.8%	14.0%	9.2%	2.9%	4.2%
Equity–to–asset ratio[10]	64%	62%	60%	58%	57%
Net debt / EBITDA[11]	1.1	1.7	2.3	2.9	2.6
Net debt / equity[12]	0.21	0.25	0.33	0.35	0.34
Current ratio[13]	3.2	1.7	1.9	1.3	1.6
Return on assets (ROA)[14]	7.7%	3.5%	2.4%	0.8%	1.3%
Return on equity (ROE)[15]	12.2%	5.8%	4.1%	1.5%	2.3%
Return on capital employed (ROCE)[16]	6.8%	5.3%	3.8%	1.7%	2.1%
Dividend pay–out ratio[17]	66%	82%	90%	92%	92%

Operational figures

		2017	2016	2015	2014	2013
Total electricity supply, incl.:	GWh	10,371	10,140	9,868	9,427	9,408
Retail*	GWh	6,923	7,665	7,961	8,800	8,065
Wholesale**	GWh	3,448	2,474	1,907	627	1,343
Electricity generated	GWh	5,734	4,707	3,882	3,625	4,854
Thermal energy generated	GWh	2,612	2,675	2,408	2,560	2,566
Number of employees		3,908	4,131	4,177	4,563	4,512
Moody's credit rating		Baa2 (stable)	Baa2 (stable)	Baa2 (stable)	Baa3 (stable)	Baa3 (stable)

* Including operating consumption

** Including sale of energy purchased within the mandatory procurement on the Nord Pool

[1] EBITDA – earnings before interest, income tax, share of result of associates, depreciation and amortisation, and impairment of intangible assets and property, plant and equipment

[2] Operating profit – earnings before income tax, finance income and costs

[3] Profit before tax – earnings before income tax

[4] Dividends paid to the equity holder of the Parent Company. (see Note 20 b)

[5] Net debt = borrowings at the end of the year minus cash and cash equivalents at the end of the year

[6] EBITDA margin = EBITDA / revenue

[7] Operating profit margin = operating profit / revenue

[8] Profit before tax margin = profit before tax / revenue

[9] Profit margin = profit / revenue

[10] Equity–to–asset ratio = total equity at the end of the year / total assets at the end of the year

[11] Net debt / EBITDA = (net debt at the beginning of the year + net debt at the end of the year) * 0.5 / EBITDA (12-months rolling)

[12] Net debt / equity = net debt at the end of the year / equity at the end of the year

[13] Current ratio = current assets at the end of the year / current liabilities at the end of the year

[14] Return on assets (ROA) = profit / average value of assets ((assets at the beginning of the year + assets at the end of the year) / 2)

[15] Return on equity (ROE) = profit / average value of equity ((equity at the beginning of the year + equity at the end of the year) / 2)

[16] Return on capital employed (ROCE) = operating profit / (average value of equity ((equity at the beginning of the year + equity at the end of the year) / 2) + average value of borrowings ((borrowings at the beginning of the year + borrowings at the end of the year) / 2))

[17] Dividend pay–out ratio = dividends / profit of the Parent Company

LATVENERGO AS KEY FIGURES

Financial figures

EUR'000

	2017	2016	2015	2014*	2013*
Revenue	498,580	513,563	521,146	564,550	809,575
EBITDA[1]	387,100	241,606	180,982	105,052	121,007
Operating profit[2]	177,416	141,071	90,475	18,158	27,880
Profit before tax[3]	185,906	156,290	103,212	35,045	29,928
Profit	150,891	137,441	94,750	34,800	25,659
Dividends[4]	90,142	77,413	31,479	23,605	40,618
Total assets	3,649,200	3,204,394	3,124,054	3,104,592	3,231,169
Non–current assets	2,546,014	2,626,560	2,638,048	2,634,150	2,678,442
Total equity	2,382,638	2,177,069	2,114,900	2,047,666	2,042,434
Borrowings	814,772	778,323	782,965	810,681	921,370
Net debt[5]	581,917	597,126	681,146	721,715	676,616
Net cash flows from operating activities	202,798	201,427	174,797	94,604	9,097
Investments	89,278	79,913	78,694	52,465	66,627

* all financial figures for 2013 – 2014 re–measured according to IFRS principles

Financial ratios

	2017	2016	2015	2014	2013
EBITDA margin[6]	77.6%	47.0%	34.7%	18.6%	14.9%
Operating profit margin[7]	35.6%	27.5%	17.4%	3.2%	3.4%
Profit before tax margin[8]	37.3%	30.4%	19.8%	6.2%	3.7%
Profit margin[9]	30.3%	26.8%	18.2%	6.2%	3.2%
Equity–to–asset ratio[10]	65%	68%	68%	66%	63%
Net debt / equity[11]	0.24	0.27	0.32	0.35	0.33
Current ratio[12]	4.3	2.3	3.0	1.9	2.1
Return on assets (ROA)[13]	4.4%	4.3%	3.0%	1.1%	0.8%
Return on equity (ROE)[14]	6.6%	6.4%	4.6%	1.7%	1.3%
Return on capital employed (ROCE)[15]	5.8%	4.8%	3.1%	0.6%	1.0%
Dividend pay–out ratio[16]	66%	82%	90%	92%	92%

Operational figures

		2017	2016	2015	2014	2013
Retail electricity supply	GWh	4,619	5,290	5,422	5,748	5,984
Electricity generation	GWh	5,687	4,660	3,833	3,577	4,811
Thermal energy generation	GWh	2,354	2,422	2,179	2,312	2,310
Number of employees		1,431	1,472	1,464	1,439	1,428
Moody's credit rating		Baa2 (stable)	Baa2 (stable)	Baa2 (stable)	Baa3 (stable)	Baa3 (stable)

[1] EBITDA – earnings before interest, income tax, share of result of associates, depreciation and amortisation, and impairment of intangible assets and property, plant and equipment
[2] Operating profit – earnings before income tax, finance income and costs
[3] Profit before tax – earnings before income tax
[4] Dividends paid to the equity holder of the Parent Company. (see Note 20 b)
[5] Net debt = borrowings at the end of the year minus cash and cash equivalents at the end of the year

[6] EBITDA margin = EBITDA / revenue
[7] Operating profit margin = operating profit / revenue
[8] Profit before tax margin = profit before tax / revenue
[9] Profit margin = profit / revenue
[10] Equity–to–asset ratio = total equity at the end of the year / total assets at the end of the year
[11] Net debt / equity = net debt at the end of the year / equity at the end of the year
[12] Current ratio = current assets at the end of the year / current liabilities at the end of the year
[13] Return on assets (ROA) = profit / average value of assets ((assets at the beginning of the year + assets at the end of the year) / 2)
[14] Return on equity (ROE) = profit / average value of equity ((equity at the beginning of the year + equity at the end of the year) / 2)
[15] Return on capital employed (ROCE) = operating profit / (average value of equity ((equity at the beginning of the year + equity at the end of the year) / 2) + average value of borrowings ((borrowings at the beginning of the year + borrowings at the end of the year) / 2))
[16] Dividend pay–out ratio = dividends / profit of the Parent Company

MANAGEMENT REPORT

Latvenergo Group – the largest power supply company in the Baltic States

Latvenergo Group (the Group) is the largest power supply provider in the Baltics operating in electricity and thermal energy generation and trade, natural gas trade, electricity distribution services and lease of transmission system assets. The parent company of Latvenergo Group is Latvenergo AS which is a power supply utility operating in electricity and thermal energy generation and trade, as well as natural gas trade in Latvia.

Operating Environment

In 2017, there was a convergence of electricity prices between the Nordic and the Baltic bidding areas. The average electricity spot price in the Latvian bidding area decreased by 3.9%, reaching 34.68 EUR/MWh. At the same time, the average electricity spot price in the Finnish bidding area increased to 33.19 EUR/MWh, while in the Swedish bidding area (SE4) it rose to 32.18 EUR/MWh.

Electricity price convergence between the Nordics and the Baltics

Electricity price convergence was mainly influenced by higher availability of the transmission interconnections (NordBalt and Estlink), lower water levels at Scandinavian hydropower reservoirs, and the relatively high level of electricity generation at the Daugava HPPs.

Until 3 April 2017, Latvian natural gas supply had been a fully regulated service and Latvijas Gāze AS was the only merchant in the territory of Latvia for natural gas supply service. On 3 April 2017, according to Energy Law stipulations, the natural gas market in Latvia was opened. After opening of the gas market, Latvenergo Group diversified its natural gas purchase portfolio, and now natural gas is also purchased from alternative sources of supply, including the Klaipeda Natural Gas Terminal. Meanwhile, use of Inčukalns Underground Gas Storage provides for timely reduction of natural gas purchase price risk exposure.

The natural gas market is open in Latvia

The price of natural gas in Latvia is affected by oil, coal and CO_2 emission prices. Due to the increase in oil, coal and CO_2 emission prices, there was an increase in the price of natural gas. In 2017, the average price of natural gas at the GASPOOL trading platform was 19.7% higher than in 2016, and at TTF it was 19.1% higher.

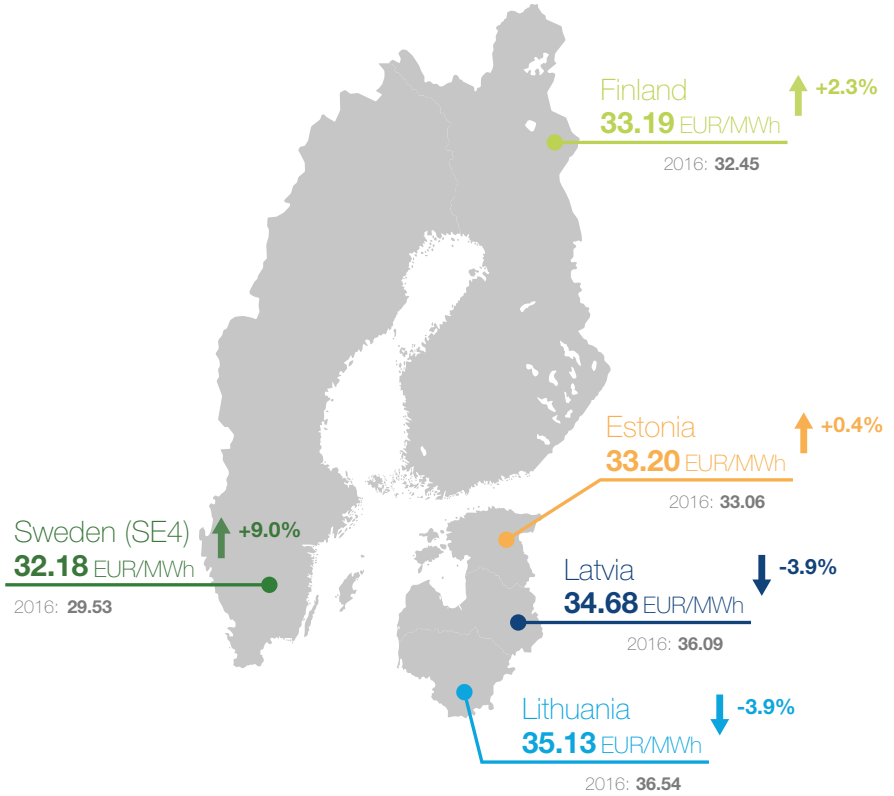
Significant Events

Latvenergo receives a one-off compensation for the Riga CHPPs' capacity payments

On 22 September 2017, the Cabinet of Ministers of the Republic of Latvia accepted the order "On the conceptual report 'Compound Measures for the Development of the Electricity Market'". It provides for an efficient and sustainable reduction of the mandatory procurement public service obligation fee for electricity users. The report envisages the establishment of a mechanism under which the state would reduce its future commitments in cogeneration power plants with installed electrical capacity above 100 MW by paying out a one-off payment, agreeing to a reduction of the support intensity in the future.

In October 2017, Latvenergo AS applied for a one-off compensation from the state, at the same time opting out of the receipt of 75% of the annual electrical capacity payments for cogeneration power plants Riga combined heat and power plant (CHPP)-1 and Riga CHPP-2. On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order which supports the reduction of the guaranteed support payments during the remaining support period for the installed capacity of Latvenergo AS Riga CHPPs. According to the order, Latvenergo AS obtained a government grant in the amount of EUR 454.4 million. The grant is divided into two parts, with the stipulation that EUR 140 million should be recognized as other income in the Group's and Latvenergo AS statement of profit or loss in 2017, while EUR 314.4 million should be recognized as deferred income in even distribution over the coming reporting periods and fulfilling obligations until the end of the support period – September 23, 2028. The compensation is financed by applying the rights of the state as

Electricity wholesale price on Nord Pool power exchange



the Shareholder to carry out a capital release of Latvenergo AS which is done subsequently to the financial year end - in March 2018.

In the recent years, financial results of Latvenergo Group and Latvenergo AS have improved substantially. As of 31 December 2017, the Group's asset value reaches EUR 4.4 billion and its equity is EUR 2.8 billion. As of 31 December 2017, the Group's net debt to equity was 21% and its net debt to EBITDA ratio was 1.1. As of 31 December 2017 Parent Company's asset value reaches EUR 3.6 billion and its equity is EUR 2.4 billion, and the Parent Company's net debt to equity was 24%.

The impact of the abovementioned actions and results on the financial stability of Latvenergo Group has also been evaluated by the credit rating agency Moody's, which has published an Issuer Comment, but has not revised the credit rating of Latvenergo AS or its future outlook. Moody's sees that Latvenergo will be able to maintain adequate financial flexibility and key financial metrics at a level that corresponds to the current rating Baa2 with a stable future outlook.

With application for the compensation, Latvenergo AS has contributed to the reduction of mandatory procurement public service obligation fee (MP PSO fee). As of 1 January 2018, the fee has been reduced by 1 EUR/MWh and is now 25.79 EUR/MWh compared to the previous value of 26.79 EUR/MWh. Further MP PSO fee reduction is currently one of the issues under consideration by the government of Latvia.

Tax reform in Latvia

Starting from 2018 tax reform is implemented in Latvia. Henceforth, in accordance with the Law on Corporate Income Tax, CIT is not applied to profits, it is applied to distributed profits as dividends. As of 1 January 2018, distributed profits and conditionally distributed profits are taxed at a rate of 20% of the gross amount or 20/80 of the net amount. The calculated CIT on dividend payout is recognized in the profit and loss statement as expenses in the reporting period in which dividend payout is announced. CIT is applied to other conditionally distributed profits, which are recognized in the profit and loss statement as expenses at the moment costs are incurred.

New CIT regulation eliminated all temporary differences between the financial accounting basis and tax basis of assets and liabilities as of 1 January 2018. This means that deferred tax assets or liabilities will no longer be recognised in the balance sheet as of 31 December 2017. In accordance with the International Financial Reporting Standards, all deferred tax liabilities previously incurred are reversed and recorded as income in the profit and loss statement or in the balance sheet equity reserves, depending on how the deferred tax liabilities were originally recognized.

The value of Latvenergo Group's fixed assets exceeds EUR 3 billion. Taking into consideration the great value of its fixed assets, the Group has been making significant investments in order to ensure the reconstruction of its existing assets and construction of new assets. The considerable amount of investments made over many years have created significant deferred tax liabilities. At the end of 2016, deferred tax liabilities amounted to EUR 316 million. At the end of 2017, part of the deferred tax liabilities was reversed as income in the profit and loss statement (deferred income tax in the amount of EUR 149 million) and the remaining part was recorded in the long-term revaluation reserve (EUR 167 million).

Operating Results

Generation

In the reporting year, the total amount generated by Latvenergo Group's power plants comprised 5,734 GWh of electricity and 2,612 GWh of thermal energy.

Significantly higher electricity output generated at the Daugava HPPs

Overall, the amount of electricity generated increased by 22% compared to the previous year. In 2017, the amount of power generated at the Daugava HPPs increased by 74% compared to the previous year, reaching 4,270 GWh (in 2016: 2,449 GWh), which comprised 74% of the total electricity generated at the Group (2016: 52%). The increase was fostered by higher water inflow in the river Daugava. Electricity output generated at the Daugava HPPs in 2017 was the largest since 1998 and the third largest in observation history since the year 1966.

Taking into consideration increased production at the Daugava HPPs, the amount of power generated at the Riga CHPPs in 2017 decreased by 36% compared to the previous year, amounting to 1,411 GWh. The Riga CHPPs operated in a market conjuncture by effectively planning operating modes and fuel consumption.

In the reporting year, the total amount generated by Latvenergo Group's power plants comprised 5,734 GWh of electricity and 2,612 GWh of thermal energy (Latvenergo AS – 5,687 GWh and 2,354 GWh respectively).

The total amount of thermal energy generated by Latvenergo Group in 2017 decreased by 2% compared to the previous year. The decrease was influenced mainly by the relatively warm weather in the heating season. In addition, three independent heat producers started their operation in the Riga TEC-2 zone, thus increasing competition in the thermal energy market.

Trade

In 2017, Latvenergo Group maintained its leading position among energy companies in the Baltics. Latvenergo Group had approximately 27% of the market share of the Baltic electricity retail market.

Latvenergo – one of the leading electricity suppliers in the Baltics

The Group supplied 6.9 TWh of electricity to Baltic retail customers (in 2016: 7.7 TWh). The decrease in the amount of electricity supplied was primarily related to intensified competition in the business customer segment.

The overall amount of retail electricity trade outside Latvia accounts for 1/3 of the total, reaching 2.3 TWh. The electricity trade volume in Latvia is 4.6 TWh, while in Lithuania it is 1.3 TWh and in Estonia it is 1 TWh.

Latvenergo Group has managed to maintain a stable client portfolio in the Baltics. Its total number of electricity customers reaches 834 thousand, including more than 35 thousand foreign clients.

In 2017, two new products were introduced for the household segment. One of them is Elektrum Smart House, which allows for remote control of heating and home appliances. The second product is Elektrum solārais, which provides an opportunity to use independently generated electricity from sunlight.

Latvenergo launches natural gas trade to customers in Latvia and Estonia

In the reporting year, the Group also commenced natural gas trade to business customers in Latvia and Estonia by offering 12-month fixed-price contracts. The first contracts were signed with approximately 100 customers. Latvenergo is the second largest consumer of natural gas in the Baltics.

Financial Results

In 2017, Latvenergo Group's revenue remained at the same level as the previous year and comprises EUR 925.6 million. During the reporting year, Latvenergo Group's EBITDA increased by 38%, reaching EUR 541.7 million. The Group's EBITDA was positively impacted mainly by:

- 74% greater electricity output at the Daugava HPPs.
- one-off compensation for the Riga CHPPs' capacity payments in amount of EUR 454.4 million. Part of the compensation payment, in the amount of EUR 140 million, is recognized as the Group's revenue in 2017 and the remaining part, in the amount of EUR 314.4 million, is recognized as a deferred income in the Group's balance sheet.

The Group's EBITDA and profit has increased

However, the results were negatively impacted by lower electricity sales prices in the Baltics. Since 2016, the decrease in electricity prices in the Baltics has been impacted by the operation of the NordBalt electricity interconnection. The Group's net profit in 2017 is EUR 322.0 million, which consists of the Group's annual operating result in the amount of EUR 172.9 million and a deferred tax reversal in the amount of EUR 149.1 million as a result of the corporate income tax reform.

In line with the profit growth, also the financial ratios have similarly improved and they are in line with the Group's strategy and expectations.

In 2017, Latvenergo AS revenue decreased by 3% and comprises EUR 498.6 million. EBITDA increased by 60%, reaching EUR 387.1 million. Latvenergo AS EBITDA was impacted by the same factors as Latvenergo Group's EBITDA, details of which are set above. Latvenergo AS net profit in 2017 is EUR 150.9 million (2016: EUR 137.4 million).

Investments

In 2017, the total amount of the Group's investment increased by EUR 43 million or 21% compared to the previous year, it amounted to EUR 243.8 million. The increase resulted mainly from the greater investment in the transmission segment and the generation segment. Latvenergo AS investment amounted EUR 89.3 million in 2017 (2016: EUR 79.9 million).

Investment in power network assets – approximately 2/3 of the total

To ensure high quality power network service, technical parameters and operational safety, a significant amount is invested in the modernization of the power network. In the reporting year, the amount invested in power network assets represented 65% of total investment.

Investments in distribution assets during the reporting year reached EUR 107.7 million. The purpose of investments in the distribution segment is to promote the quality and security of the energy supply, reduce the frequency and duration of power supply disruptions caused by planned and unplanned maintenance, and ensure the appropriate voltage quality. Investments in modernization of distribution assets have increased the quality of distribution services by lowering System Average Interruption Frequency Index (SAIFI) and System Average Interruption Duration Index (SAIDI) indicators. Since 2013, SAIDI has decreased by 58% and SAIFI has decreased by 38%.

During the reporting year, investment in transmission system assets was in the amount of EUR 63.1 million. The amount of investments increased two and a half times compared to the previous year. The largest investment was made in the energy infrastructure project Kurzeme Ring. In 2017, EUR 34.7 million was invested in this project. The Kurzeme Ring project will increase the safety level of power supply in the Kurzeme region and Latvia as a whole, providing an opportunity for more efficient use of the Lithuania-Sweden marine cable NordBalt and allowing further integration of the Baltics into the Nordic electricity market.

Contributing to environmentally friendly projects, in 2017, EUR 41.8 million was invested in the Daugava hydropower plants' (HPPs) hydropower unit reconstruction. Gradual overhaul of eleven Daugava HPPs hydropower units is planned for completion until 2022. It will provide for further 40–year operation of the units. The estimated total reconstruction costs will exceed EUR 200 million. At the end of the reporting year, work completed within the scope of the contract reached EUR 128.4 million. The first reconstructed hydropower unit of Plavinas HPP was put into operation at the end of 2017.

Funding

Latvenergo Group finances its investments from its own resources and external long-term borrowings, which are regularly sourced in financial and capital markets in a timely manner.

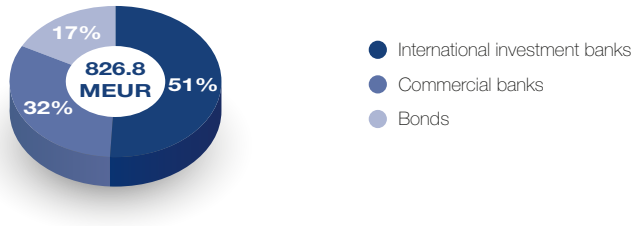
Best investor relations among Baltic bond issuers

Latvenergo AS is the first company in the Baltics to receive the Nasdaq exchange award "Best Investor Relations in the Baltics among Bond Issuers". Along with the award, Latvenergo AS was invited to the Nasdaq MarketSite studio in Times Square, New York. On 14 August, Āris Žīgurs, Chief Executive Officer of the Latvenergo AS, rang the traditional Nasdaq MarketSite trading session opening bell.

On December 15, 2017, the first repayment of the principal amount of maturing bonds amounting to EUR 70 million was executed.

As of 31 December 2017, the Group's borrowings amount to EUR 826.8 million (31 December 2016: EUR 791.6 million), comprising loans from commercial banks, international investment banks, and bonds amounting to EUR 135 million, of which EUR 100 million are green bonds.

Debt by source of financing



As of 31 December 2017, the net borrowings of Latvenergo Group are EUR 590.8 million (31 December 2016: EUR 607.6 million), while the net debt / EBITDA ratio is 1.1 (31 December 2016: 1.7).

On 7 September 2017, the credit rating agency Moody's did not revise the credit rating of Latvenergo AS at the Baa2 level with a stable future outlook. In the assessment, Moody's also took into account the one-off compensation from the state, the planned changes in the support intensity for the Riga CHPPs and the planned Latvenergo AS capital release.

Corporate Governance

In the reporting year, Latvenergo Group's corporate governance improvement process has been continued.

Improved Corporate Governance

In March 2017, the Supervisory Board of Latvenergo AS established the Human Resources Committee for personnel management matters. The Human Resources Committee has been assigned the duty of preparing proposals for the Supervisory Board regarding the selection, remuneration and performance evaluation of the personnel of the Management Board, Audit Committee and internal audit of Latvenergo AS and the combining of positions. The Committee consists of three members who are elected by the Supervisory Board from among the Members of the Supervisory Board. Mārtiņš Bičevskis, Baiba Anda Rubesa and Andris Liepiņš were elected to the Committee.

Due to the amendments to the Law on the Financial Instruments Market, Supervisory Board Members Andris Ozoliņš and Andris Liepiņš were added to the Audit Committee in March 2017.

Along with the financial results of Latvenergo Group, also the Corporate Governance Report of Latvenergo AS for 2017 is published. The company has complied with all applicable principles of corporate governance in all key material aspects.

Non-Financial Report

Latvenergo Group has prepared a non-financial report in accordance with the Law on the Financial Instruments Market (Article 56[4]).

Latvenergo Group complies not only with the statutory requirements, but also voluntarily takes responsibility for its impact on society, the environment and the national economy, thus contributing to the sustainable development of the Group. By providing value added products and services, the Group aspires to operational processes that do not undermine public welfare and health, and have no adverse effect on the environment. Through corporate social responsibility (CSR) activities, the Group promotes a responsible business environment in the Baltic region. In everyday work the Group follow the principles of the Corporate Social Responsibility in compliance with the ISO 26000:2010 standard.

The Latvenergo Group's Corporate Social Responsibility policy specifies the basic CSR principles, directions and criteria. The Group implements CSR activities in line with its operations and strategic goals, raising public awareness of responsible business conduct and the energy industry, making a substantial long-term impact and ensuring the involvement of large groups of society.

Along with the sustainable and well-considered investments in the energy generation and network development, Latvenergo Group makes a direct economic contribution to the whole society – through the taxes paid to the state budget, dividends, and job creation. Efficiency plays an important role throughout the energy generation and supply process, thus improving the competitiveness and the service quality.

Responsibility is one of the Latvenergo Group's values and a fundamental principle of the corporate governance. The Group and its employees take responsibility for tasks performed in compliance with the requirements of the applicable laws and regulations. Latvenergo Group conducts its business in a transparent, ethical, safe, reliable and a fair manner, ensuring the information to the stakeholders and engaging them in the Group's activities.

The Group's activities are focused on providing such electricity services that meet customers' needs and are competitive. At the same time, Latvenergo Group is building loyal and mutually rewarding relationships with its customers. Meanwhile, the electricity distribution services are based on the qualitative and reliable electricity supply to the residents of Latvia. In order to achieve these goals, the Group complies with the fundamental principles of the cost-effectiveness and operational excellence.

The Group is aware of the role of the environmental protection for a sustainable development and implements the key principles related to the environmental protection in all its operations. Continuing the progress made so far, the Latvenergo Group's Strategy 2017–2022 sets the environmental protection as one of its priorities regarding the energy generation and supply.

The Latvenergo Group's management acknowledges that its employees – their diversity and competencies – provide a valuable opportunity to view things from different perspectives, thus achieving better results. The Group attracts and develops managers and leaders capable of driving its advancement and ensuring that its employees' competences contribute to the achievement of the goals set and are suitable for future needs. The Group's management has set employee engagement and development and the creation of a work environment that promotes innovation as the basis for the successful future growth of the Group and its employees.

Non-financial report is in accordance with the GRI Standards

For more information on CSR activities, description of the policies and procedures in relation to those matters, the outcome of the policies, risks and risk management, and non-financial key performance indicators, please see the Sustainability Report 2017 which is available on the Latvenergo website: https://www.latvenergo.lv/eng/investors/reports/. The report is prepared in accordance with the GRI Standards – Core option requirements.

Further Development

On 19 October 2016, the Shareholder Meeting approved Latvenergo Group's strategy for 2017–2022.

Taking into consideration the main challenges within the industry and business environment, three main operational objectives are defined in the strategy:

- strengthening of a sustainable and economically sound market position in core markets (in the Baltics) while considering geographic and / or product / service expansion;
- development of a generation portfolio that fosters synergy with trade and that promotes an increase in value for the Group;
- development of a customer-driven, functional, safe and efficient power network.

Along with the strategy approval, Latvenergo Group's financial targets have been set in the strategy. The targets are divided into three groups – profitability, capital structure and dividend policy.

The financial targets are set to ensure:

- ambitious, yet achievable profitability, which is consistent with the average ratios of benchmark companies in the European energy sector and provides for an adequate return on the business risk;
- an optimal and industry-relevant capital structure that limits potential financial risks;
- an adequate dividend policy that is consistent with the planned investment policy and capital structure targets.

Target group	Ratio	Year 2022
Profitability	Return on equity (ROE)	> 6%
Capital structure	Net debt to equity	< 50%
	Net debt to EBITDA	< 3 times
Dividend policy	Dividend payout ratio	> 80%

Strategy development included a detailed analysis of the industry and operating environment, an evaluation of business opportunities, and discussions with industry experts and stakeholders.

Comprehensive Efficiency Programme

Taking into consideration the defined development directions of the Group, on 14 November 2017 the Management Board of Latvenergo AS approved the Strategic Development and Efficiency Programme. While the strategic development section includes major strategic projects, the efficiency section provides for the revision, centralization and digitalization of the Group's processes in order to maintain the Group's profitability in the long term considering the increase in costs due to inflation. The estimated efficiency potential for the Group's EBITDA is up to EUR 30 million. This is the Group's largest optimization plan in the last decade, and it will allow the Group to increase its value in the long-term and to remain competitive in an open market and a changing energy industry.

Financial Risk Management

The activities of Latvenergo Group and Latvenergo AS are exposed to a variety of financial risks: market risks, credit risk, and liquidity and cash flow risk. Latvenergo Group's Financial Risk Management Policy focuses on eliminating the potential adverse effects from such risks on financial performance. In the framework of financial risk management, Latvenergo Group and Latvenergo AS uses various financial risk controls and hedging to reduce certain risk exposures.

a) Market risks

I) Price risk

Price risk might negatively affect the financial results of the Group and the Parent Company due to falling revenue from generation and a mismatch between floating market prices and fixed retail prices.

The main sources of Latvenergo Group's and Latvenergo AS exposure to price risk are the floating market prices of electricity on the Nord Pool power exchange in Baltic bidding areas and the fuel price for CHPPs. The financial results of the Group and the Parent Company may be negatively affected by the volatility of the electricity market price, which depends on the weather conditions in the Nordic countries, global prices of resources, and the influence of local factors (water availability and ambient air temperature) on electricity generation opportunities. Due to supply-demand factors and seasonal fluctuations, natural gas price volatility may have a negative effect on the difference between fixed retail electricity prices in contracts with customers and variable generation costs at CHPPs.

In order to hedge the price risk, the Group and the Parent Company enters into long-term fixed price customer contracts, uses electricity financial derivatives and enters into fixed price contracts for natural gas supply. The impact of price risk on generation is hedged gradually – 80%–90% of projected electricity output is sold prior to the upcoming year. Further hedging of risk is limited by the seasonal generation pattern of the Daugava HPPs.

II) Interest rate risk

Latvenergo Group's and Latvenergo AS interest rate risk mainly arises from long-term borrowings at variable rates. They expose the Group and the Parent Company to the risk that finance costs might increase significantly when the reference rate surges. Most of the borrowings from financial institutions have a variable interest rate, comprising 3, 6 or 12-month EURIBOR and a margin. The Group's Financial Risk Management Policy stipulates maintaining at least 35% of its borrowings as fixed interest rate borrowings (taking into account the effect of interest rate swaps and issued bonds) with a duration of 2–4 years. Taking into account the effect of interest rate swaps and bonds with a fixed interest rate, 54% of the Group's and 55% of the Parent Company's borrowings had a fixed interest rate with an average period of 2.0 years both for the Group and the parent Company as of 31 December 2017.

III) Currency risk

Foreign currency exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency other than the functional currency.

As of 31 December 2017, all borrowings of Latvenergo Group and Latvenergo AS are denominated in euros, and during the reporting year, there was no substantial exposure to foreign currency risk in relation to the Group's investments.

The Financial Risk Management Policy provides for management of the Group's and the Parent Company's foreign currency exchange risk against functional currency. To manage the Group's and the Parent Company's foreign currency exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy envisages use of forward contracts.

b) Credit risk

Credit risk is managed at the Latvenergo Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, and receivables. Credit risk exposure of receivables is limited due to the large number of Group customers as there is no significant concentration of credit risk with any single counterparty or group of counterparties with similar characteristics.

Credit risk related to cash and short-term deposits with banks is managed by balancing the placement of financial assets in order to simultaneously choose the best offers and reduce the probability of incurrence of loss. No credit limits were exceeded during the reporting year, and the management does not expect any losses due to the occurrence of credit risk.

c) Liquidity risk and cash flow risk

Latvenergo Group's liquidity and cash flow risk management policy is to maintain a sufficient amount of cash and cash equivalents and the availability of long and short-term funding through an adequate amount of committed credit facilities in order to meet existing and expected commitments and compensate for fluctuations in cash flows due to the occurrence of a variety of financial risks. On 31 December 2017, Latvenergo Group's liquid assets (cash and short-term deposits up to 3 months) reached EUR 236.0 million (2016: EUR 184.0 million), while the Latvenergo AS liquid assets reached EUR 232.9 million (2016: EUR 181.2 million).

The Group and the Parent Company continuously monitors cash flow and liquidity forecasts, which comprise the undrawn borrowing facilities and cash and cash equivalents.

Events after the Reporting Period

All significant events that would materially affect the financial position of the Latvenergo Group and Latvenergo AS after the reporting period are disclosed in Note 27 of the Group's and the Parent Company's Financial Statements.

Statement of Management Responsibility

Based on the information available to the Management Board of Latvenergo AS, the Latvenergo Group Consolidated and Latvenergo AS Annual Report 2017, including the Management Report, have been prepared in accordance with the International Financial Reporting Standards and in all material aspects present a true and fair view of the assets, liabilities, financial position, profit and loss and its cash flows of Latvenergo Group and Latvenergo AS. Information provided in the Management Report is accurate.

The Management Board of Latvenergo AS:

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Āris Žīgurs
Chairman of the Management Board

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Guntars Baļčūns
Member of the Management Board

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Uldis Bariss
Member of the Management Board

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Māris Kuņickis
Member of the Management Board

17 April 2018

Profit Distribution

Fulfilling the requirements of the Article No. 41 of the law "On the State budget 2018" that determines the amount of dividends payable in the year 2018, the Management Board of Latvenergo AS proposes to pay out in dividends EUR 94.2 million, that consists from Latvenergo AS profit of 2017 in the amount of EUR 29.8 million and profit of 2016 in the amount of EUR 64.4 million, and the rest of Latvenergo AS profit of 2017 – EUR 121.1 million, to leave undistributed as retained earnings with a purpose to take the decision on pay out as dividends simultaneously with the decision on the distribution of Latvenergo AS profit of 2018.

FINANCIAL STATEMENTS

Statement of Profit or Loss

EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Revenue	6	925,627	931,619	498,580	513,563
Other income	7	149,950	6,656	147,502	3,115
Raw materials and consumables used	8	(346,911)	(385,814)	(153,954)	(186,258)
Personnel expenses	9	(113,289)	(96,019)	(44,892)	(39,165)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	13 a, 14 a	(307,614)	(232,626)	(209,684)	(100,535)
Other operating expenses	10	(73,681)	(63,043)	(60,136)	(49,649)
Operating profit		**234,082**	**160,773**	**177,416**	**141,071**
Finance income	11 a	1,243	2,328	11,433	12,958
Finance costs	11 b	(11,211)	(14,156)	(12,054)	(14,772)
Dividends received from subsidiaries	15 a	–	–	9,111	17,033
Profit before tax		**224,114**	**148,945**	**185,906**	**156,290**
Current income tax	12	(51,199)	(23,498)	(45,097)	(20,331)
Deferred tax changes	12	149,106*	5,146	10,082*	1,482
Profit for the year		**322,021**	**130,593**	**150,891**	**137,441**
Profit attributable to:					
– Equity holder of the Parent Company		319,670	129,045	150,891	137,441
– Non–controlling interests		2,351	1,548	–	–
Basic earnings per share (in euros)	20 c	0.250	0.100	0.117	0.107
Diluted earnings per share (in euros)	20 c	0.250	0.100	0.117	0.107

* in 2017 deferred tax liabilities reversed in the Statement of Profit or Loss in accordance with the changes of tax regulations and laws of the Republic of Latvia starting from1 January 2018

The notes on pages 96 to 146 are an integral part of these Financial Statements.

Statement of Comprehensive Income

EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Profit for the year		**322,021**	**130,593**	**150,891**	**137,441**
Comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):					
Gains from change in hedge reserve	20 a, 21 c	5,422	2,847	5,422	2,847
Net comprehensive income to be reclassified to profit or loss in sub-sequent periods		**5,422**	**2,847**	**5,422**	**2,847**
Comprehensive income / (loss) not to be reclassified to profit or loss in subsequent periods (net of tax):					
Gains on revaluation of property, plant and equipment	20 a	18,842	269,485	18,842	–
Gains / (losses) as a result of re–measurement on defined post–employment benefit plan	22 a	3,460	(2,308)	1,053	(890)
Reversal of deferred income tax	12	169,978	–	119,503	–
Net comprehensive income not to be reclassified to profit or loss in subsequent periods		**192,280**	**267,177**	**139,398**	**(890)**
Comprehensive income for the year, net of tax		**197,702**	**270,024**	**144,820**	**1,957**
Total comprehensive income for the year		**519,723**	**400,617**	**295,711**	**139,398**
Attributable to:					
– Equity holder of the Parent Company		517,372	399,069	295,711	139,398
– Non–controlling interests		2,351	1,548	–	–

The notes on pages 96 to 146 are an integral part of these Financial Statements.

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Āris Žīgurs
Chairman of the Management Board

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Guntars Baļčūns
Member of the Management Board

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Uldis Bariss
Member of the Management Board

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Māris Kuņickis
Member of the Management Board

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Liāna Ķeldere
Accounting director of Latvenergo AS

17 April 2018

Statement of Financial Position

EUR'000

	Notes	Group		Parent Company	
		31/12/2017	31/12/2016	31/12/2017	31/12/2016
ASSETS					
Non–current assets					
Intangible assets	13 a	13,413	14,534	17,461	18,769
Property, plant and equipment	14 a	3,308,985	3,355,797	1,231,454	1,322,518
Investment property	14 b	753	563	64,807	72,833
Non–current financial investments	15	40	40	817,048	817,048
Non–current loans to subsidiaries	25 e, f	–	–	397,976	377,380
Other non–current receivables	17 b	3,229	986	284	978
Investments in held–to–maturity financial assets	21 a	16,984	17,034	16,984	17,034
Total non–current assets		**3,343,404**	**3,388,954**	**2,546,014**	**2,626,560**
Current assets					
Inventories	16	76,247	41,458	61,744	9,118
Prepayment for inventories	16	81	–	80	16,693
Receivables from contracts with customers	17 a	105,369	118,925	82,799	102,056
Other current receivables	17 b	646,761	155,033	18,079	11,603
Deferred expenses		3,241	3,227	2,205	2,189
Current loans to subsidiaries	25 e, f	–	–	700,805	245,324
Derivative financial instruments	21 c	4,619	6,134	4,619	6,134
Investments in held–to–maturity financial assets	21 a	–	3,520	–	3,520
Cash and cash equivalents	18	236,003	183,980	232,855	181,197
Total current assets		**1,072,321**	**512,277**	**1,103,186**	**577,834**
TOTAL ASSETS		**4,415,725**	**3,901,231**	**3,649,200**	**3,204,394**

EUR'000

	Notes	Group		Parent Company	
		31/12/2017	31/12/2016	31/12/2017	31/12/2016
EQUITY AND LIABILITIES					
EQUITY					
Share capital	19	1,288,715	1,288,715	1,288,715	1,288,715
Reserves	20 a	1,126,521	937,074	791,906	650,020
Retained earnings		423,613	185,840	302,017	238,334
Equity attributable to equity holder of the Parent Company		**2,838,849**	**2,411,629**	**2,382,638**	**2,177,069**
Non–controlling interests		8,042	7,084	–	–
Total equity		**2,846,891**	**2,418,713**	**2,382,638**	**2,177,069**
LIABILITIES					
Non–current liabilities					
Borrowings	21 b	718,674	635,620	710,125	627,691
Deferred income tax liabilities	12	–	315,759	–	126,260
Provisions	22	21,910	18,643	8,835	7,924
Derivative financial instruments	21 c	4,914	7,946	4,914	7,946
Deferred income on contracts from customers	23 a	142,132	141,817	–	–
Other liabilities and deferred income	23 b, c	350,926	53,590	286,085	1,055
Total non–current liabilities		**1,238,556**	**1,173,375**	**1,009,959**	**770,876**
Current liabilities					
Trade and other payables	24	147,072	117,817	94,689	85,569
Deferred income on contracts from customers	23 a	12,500	11,605	–	–
Other deferred income	23 b, c	31,728	2,417	29,358	59
Income tax payable		27,725	17,718	24,739	16,549
Borrowings	21 b	108,083	155,946	104,647	150,632
Derivative financial instruments	21 c	3,170	3,640	3,170	3,640
Total current liabilities		**330,278**	**309,143**	**256,603**	**256,449**
TOTAL EQUITY AND LIABILITIES		**4,415,725**	**3,901,231**	**3,649,200**	**3,204,394**

The notes on pages 96 to 146 are an integral part of these Financial Statements.

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Member of the Management Board

Māris Kuņickis
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

17 April 2018

Statement of Changes in Equity

EUR'000

	Notes	Group						Parent Company			
		Attributable to equity holders of the Parent Company				Non–controlling interests	TOTAL	Attributable to equity holders of the Parent Company			
		Share capital	Reserves	Retained earnings	Total			Share capital	Reserves	Retained earnings	TOTAL
As of 31 December 2015		**1,288,531**	**669,596**	**131,662**	**2,089,789**	**6,913**	**2,096,702**	**1,288,531**	**649,779**	**176,590**	**2,114,900**
Increase in share capital	14 a, 19	184	–	–	**184**	–	**184**	184	–	–	**184**
Dividends for 2015	20 b	–	–	(77,413)	**(77,413)**	(1,377)	**(78,790)**	–	–	(77,413)	**(77,413)**
Disposal of non–current assets revaluation reserve net of deferred income tax	20 a	–	(4,854)	4,854	**–**	–	**–**	–	(2,606)	2,606	**–**
TOTAL contributions and profit distributions recognised directly in equity		**184**	**(4,854)**	**(72,559)**	**(77,229)**	**(1,377)**	**(78,606)**	**184**	**(2,606)**	**(74,807)**	**(77,229)**
Profit for the year		–	–	129,045	**129,045**	1,548	**130,593**	–	–	137,441	**137,441**
Other comprehensive income / (loss)	20 a	–	272,332	(2,308)	**270,024**	–	**270,024**	–	2,847	(890)	**1,957**
TOTAL comprehensive income for the year		**–**	**272,332**	**126,737**	**399,069**	**1,548**	**400,617**	**–**	**2,847**	**136,551**	**139,398**
As of 31 December 2016		**1,288,715**	**937,074**	**185,840**	**2,411,629**	**7,084**	**2,418,713**	**1,288,715**	**650,020**	**238,334**	**2,177,069**
Implementation effect of IFRS 15 'Revenue from Contracts with Customers'	2.29	–	–	(10)	**(10)**	–	**(10)**	–	–	–	**–**
As of 1 January 2017		**1,288,715**	**937,074**	**185,830**	**2,411,619**	**7,084**	**2,418,703**	**1,288,715**	**650,020**	**238,334**	**2,177,069**
Dividends for 2016	20 b	–	–	(90,142)	**(90,142)**	(1,393)	**(91,535)**	–	–	(90,142)	**(90,142)**
Disposal of non–current assets revaluation reserve net of deferred income tax	20 a	–	(4,377)	4,377	**–**	–	**–**	–	(1,762)	1,762	**–**
TOTAL contributions and profit distributions recognised directly in equity		**–**	**(4,377)**	**(85,765)**	**(90,142)**	**(1,393)**	**(91,535)**	**–**	**(1,762)**	**(88,380)**	**(90,142)**
Profit for the year		–	–	319,670	**319,670**	2,351	**322,021**	–	–	150,891	**150,891**
Other comprehensive income	12, 20 a	–	193,824	3,878	**197,702**	–	**197,702**	–	143,648	1,172	**144,820**
TOTAL comprehensive income for the year		**–**	**193,824**	**323,548**	**517,372**	**2,351**	**519,723**	**–**	**143,648**	**152,063**	**295,711**
As of 31 December 2017		**1,288,715**	**1,126,521**	**423,613**	**2,838,849**	**8,042**	**2,846,891**	**1,288,715**	**791,906**	**302,017**	**2,382,638**

The notes on pages 96 to 146 are an integral part of these Financial Statements.

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Māris Kuņickis
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

17 April 2018

Statement of Cash Flows

EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Cash flows from operating activities					
Profit before tax		224,114	148,945	185,906	156,290
Adjustments:					
– Amortisation, depreciation and impairment of intangible assets and property, plant and equipment	13 a, 14 a	307,614	232,626	209,684	100,535
– Loss from disposal of non–current assets		5,476	4,143	1,601	395
– Interest costs	11 b	9,825	14,156	10,667	14,772
– Interest income	11 a	(1,221)	(2,302)	(11,410)	(12,931)
– Fair value loss / (gains) on derivative financial instruments	8, 11	3,435	(7,275)	3,435	(7,275)
– Received dividends from subsidiaries	15 a	–	–	(9,111)	(17,033)
– Increase / (decrease) in provisions	22	6,726	(287)	1,966	272
– Unrealised income on currency translation differences	11 b	(22)	(26)	(22)	(26)
Operating profit before working capital adjustments		**555,947**	**389,980**	**392,716**	**234,999**
Increase in inventories		(34,870)	(16,667)	(36,013)	(17,423)
Increase in receivables from contracts with customers and other receivables		(7,770)	(10,170)	(123,095)	(9,501)
Increase / (decrease) in trade and other liabilities		(123,783)	(844)	6,790	3,594
Cash generated from operating activities		**389,524**	**362,299**	**240,398**	**211,669**
Interest paid		(11,484)	(15,529)	(12,324)	(16,136)
Interest received		1,390	2,457	11,632	13,306
Paid corporate income tax		(41,221)	(8,041)	(36,908)	(7,412)
Net cash flows from operating activities		**338,209**	**341,186**	**202,798**	**201,427**

Statement of Cash Flows continued on the right side

Statement of Cash Flows (continued)

EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Cash flows from investing activities					
Loans issued to subsidiaries	25 e, f	–	–	(81,889)	(78,446)
Repayment of loans issued to subsidiaries	25 e, f	–	–	60,225	80,319
Purchase of intangible assets and PPE		(233,744)	(185,674)	(88,793)	(67,282)
Proceeds on financing from EU funds and other financing		–	242	–	–
Proceeds from investments in subsidiaries	15 a	–	–	9,111	17,033
Proceeds from redemption of held–to–maturity assets		3,569	7,914	3,569	7,914
Net cash flows used in investing activities		**(230,175)**	**(177,518)**	**(97,777)**	**(40,462)**
Cash flows from financing activities					
Proceeds from issued debt securities (bonds)		–	26,267	–	26,267
Repayment of issued debt securities (bonds)	21 b	(70,000)	–	(70,000)	–
Proceeds on borrowings from financial institutions	21 b	186,500	55,744	185,000	55,000
Repayment of borrowings	21 b	(80,976)	(87,452)	(78,221)	(85,441)
Dividends paid to non–controlling interests	20 b	(1,393)	(1,377)	–	–
Dividends paid to equity holder of the Parent Company	20 b	(90,142)	(77,413)	(90,142)	(77,413)
Net cash flows used in financing activities		**(56,011)**	**(84,231)**	**(53,363)**	**(81,587)**
Net increase in cash and cash equivalents		**52,023**	**79,437**	**51,658**	**79,378**
Cash and cash equivalents at the beginning of the year	18	183,980	104,543	181,197	101,819
Cash and cash equivalents at the end of the year	**18**	**236,003**	**183,980**	**232,855**	**181,197**

The notes on pages 96 to 146 are an integral part of these Financial Statements.

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Māris Kuņickis
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

17 April 2018

NOTES TO THE FINANCIAL STATEMENTS

1. Corporate Information

All shares of public limited company Latvenergo, parent company of Latvenergo Group (hereinafter – Latvenergo AS or the Parent Company) are owned by the Republic of Latvia and are held by the Ministry of Economics of the Republic of Latvia. The registered address of the Parent Company is 12 Pulkveža Brieža Street, Riga, Latvia, LV–1230. According to the Energy Law of the Republic of Latvia, Latvenergo AS is designated as a national economy object of State importance and, therefore, is not subject to privatisation.

Latvenergo AS is power supply utility engaged in electricity and thermal energy generation, as well as sales of electricity. Latvenergo AS is one of the largest corporate entities in the Baltics.

Latvenergo AS heads the Latvenergo Group (hereinafter – the Group) that includes the following subsidiaries:

- Sadales tīkls AS (since 18 September 2006) with 100% interest held;
- Elektrum Eesti OÜ (since 27 June 2007) and its subsidiary Elektrum Latvija SIA (since 18 September 2012) with 100% interest held;
- Elektrum Lietuva UAB (since 7 January 2008) with 100% interest held;
- Latvijas elektriskie tīkli AS (since 10 February 2011) with 100% interest held;
- Liepājas enerģija SIA (since 6 July 2005) with 51% interest held;
- Enerģijas publiskais tirgotājs AS (since 25 February 2014) with 100% interest held.

Latvenergo AS and its subsidiaries Sadales tīkls AS, Latvijas elektriskie tīkli AS and Enerģijas publiskais tirgotājs AS are also shareholders with 48.15% interest held in company Pirmais Slēgtais Pensiju Fonds AS that manages a defined–contribution corporate pension plan in Latvia.

Latvenergo AS shareholding in subsidiaries, associates and other non–current financial investments is disclosed in Note 15.

The Management Board of Latvenergo AS since 16 November 2015 until 28 February 2018 was comprised of the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Guntars Baļčūns and Guntis Stafeckis. The Management Board of Latvenergo AS since 1 March 2018 until the date of approving of the Latvenergo Group Consolidated and Latvenergo AS Annual Report 2017 was comprised of the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Guntars Baļčūns.

On 16 December 2016 was established the Supervisory Board of Latvenergo AS and it was comprised of the following members: Andris Ozoliņš (Chairman), Andris Liepiņš (Deputy Chairman), Baiba Anda Rubesa, Mārtiņš Bičevskis and Martin Sedlacky.

The Supervisory body – Audit Committee since 4 December 2015 until the date of approving of the Latvenergo Group Consolidated and Latvenergo AS Annual Report 2017 was comprised of the following members: Torben Pedersen (Chairman), Svens Dinsdorfs and Marita Salgrāve, and since 3 March 2017 until the date of approving of the Latvenergo Group Consolidated and Latvenergo AS Annual Report 2017 also of Andris Ozoliņš and Andris Liepiņš.

The Financial Statements for year 2017 include the financial information in respect of the Latvenergo Group and Latvenergo AS for the year ending 31 December 2017 and comparative information for year 2016. Where it has been necessary, comparatives for year 2016 are reclassified using the same principles applied for preparation of the Financial Statements for 2017.

The Management Board of Latvenergo AS has approved the Latvenergo Group and Latvenergo AS Financial statements 2017 on 17 April 2018. The Financial Statements are subject to Shareholder's approval on the Shareholder's Meeting.

2. Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of these Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. Where it is necessary comparatives are reclassified.

2.1. Basis of Preparation

The Financial Statements of the Latvenergo Group and Latvenergo AS are prepared in accordance with the International Financial Reporting Standards as adopted for use in the European Union (IFRS). Due to the European Union's endorsement procedure, the standards and interpretations not approved for use in the European Union are also presented in this note as they may have impact on the Financial Statements in the following periods if endorsed.

The Financial Statements are prepared under the historical cost convention, except for some financial assets and liabilities (including derivative financial instruments) measured at fair value and property, plant and equipment carried at revalued amounts as disclosed in the accounting policies presented below.

All amounts shown in these Financial Statements are presented in thousands of euros (EUR'000 or EUR thousand).

The preparation of the Financial Statements in conformity with IFRS 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 the Management's best knowledge of current events and actions, actual results ultimately may differ from those. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the Financial Statements are disclosed in Note 2.2 and Note 4.

Adoption of new and/or changed IFRS and International Financial Reporting Interpretations Committee (IFRIC) interpretations

The following new and/or amended International Financial Reporting Standards or interpretations published or revised during the reporting year, which became effective for the reporting period started from 1 January 2017, have been adopted by the Group and the Parent Company:

- *IAS 12: Recognition of Deferred Tax Assets for Unrealized Losses (Amendments).* The objective of the Amendments is to clarify the requirements of deferred tax assets for unrealized losses in order to address diversity in practice in the application of IAS 12 Income Taxes. The specific issues where diversity in practice existed relate to the existence of a deductible temporary difference upon a decrease in fair value, to recovering an asset for more than its carrying amount, to probable future taxable profit and to combined versus separate assessment. The application of these Amendments had no effect on the Group's and the Parent Company's financial statements.
- *IAS 7: Disclosure Initiative (Amendments).* The objective of the Amendments is to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The Amendments specify that one way to fulfil the disclosure requirement is by providing a tabular reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including changes from financing cash flows, changes

arising from obtaining or losing control of subsidiaries or other businesses, the effect of changes in foreign exchange rates, changes in fair values and other changes. The application of these Amendments had no effect on the Group's and the Parent Company's financial statements.

- The IASB has issued the ***Annual Improvements to IFRSs 2014 – 2016 Cycle***, which is a collection of amendments to IFRSs. The following annual improvement has not yet been endorsed by the EU. This improvement did not have an effect on the Group's and the Parent Company's financial statements.
  - *IFRS 12 Disclosure of Interests in Other Entities:* The amendments clarify that the disclosure requirements in IFRS 12, other than those of summarized financial information for subsidiaries, joint ventures and associates, apply to an entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale, as held for distribution, or as discontinued operations in accordance with IFRS 5. These Amendments had no effect on The Group's and the Parent Company's financial statements as the Group and the Parent Company does not have any interests classified as held for sale.

Adoption of new standards issued and not yet effective, but early adopted by the Group and the Parent Company

- *IFRS 15: Revenue from Contracts with Customers.*
  The standard is effective for annual periods beginning on or after 1 January 2018.
  IFRS 15 establishes a five-step model that will apply to revenue earned from a contract with a customer (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary activities (e.g., sales of property, plant and equipment or intangibles).
  The Group and the Parent Company has applied IFRS 15 Revenue from contracts with customers for the first time in the 2017 financial statements with initial application date as of 1 January 2017 and has chosen a modified retrospective application of IFRS 15 (point 2.29.). Implementation of standard has changed the total amount of revenue recognised for customer contracts and contract liabilities, as well as timing of revenue recognition. The Group and the Parent Company does not have significant impact on its financial statements as the Group and the Parent Company does not have significant long–term contracts with multi–element arrangements in scope of IFRS 15 and therefore impact on total revenue of the Group and the Parent Company is not significant, however it has affected recognition of revenue from distribution system services for efficient use of connection load for its variable consideration. Adoption of new standard is disclosed in Note 2.29.

Standards issued and not yet effective, but are relevant for the Group's and the Parent Company's operations and not early adopted by the Group and the Parent Company

- *IFRS 9: Financial Instruments.* In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.
  The Group and the Parent Company plan to adopt the new standard on the required effective date and will not restate comparative information. During 2017, the Group and the Parent Company has performed an impact assessment of all three aspects of IFRS 9. This assessment is based on currently available information and may be subject to changes arising from further reasonable and supportable information being made available to the Group and the Parent Company in 2018 when the Group and the Parent Company will adopt IFRS 9.
  Overall, the Group and the Parent Company expects no significant impact on its statement of financial position and equity except for the effect of applying the impairment requirements of IFRS 9. The Group and the Parent Company expect an increase in the loss allowance resulting in a negative impact on equity.

a) Classification and measurement
From a classification and measurement perspective, the new standard requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI) and amortised cost. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or fair value through OCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as the requirements of IAS 39. Classification and measurement requirements of IFRS 9 other than those related to impairment and calculation of expected credit losses are not expected to have significant impact on the Group`s and Parent Company's financial statements.
Based on assessment performed It is expected to continue measuring at fair value all financial assets currently held at fair value. Loans and receivables from contracts with customers will be continued to be measured at amortised cost under IFRS 9. Parent Company's loans to its subsidiaries as well as trade receivables of the Group and the Parent Company are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. The Group and the Parent Company analysed the contractual cash flow characteristics of those instruments and concluded that they meet the criteria for amortised cost measurement under IFRS 9. Therefore, reclassification for these instruments is not required. IAS 39 allowed an entity to measure investments in equity instruments at cost if those instruments do not have a quoted price in an active market and their fair value cannot be reliably measured. Under IFRS 9, there is no such possibility and investments in equities need to be measured at fair value in accordance with IFRS 13. Consequently, Group and Parent Company expects that an additional effort will be needed to value such investments.

b) Impairment
IFRS 9 will also fundamentally change the credit loss recognition methodology. The standard will replace IAS 39's incurred loss approach with a forward-looking expected loss (ECL) approach. IFRS 9 requires the Group and the Parent Company to record expected credit losses on all of its debt securities, loans, receivables from contracts with customers and cash and its equivalents, either on a 12-month or lifetime basis. The Group and the Parent Company will apply the simplified approach and record lifetime expected losses on all receivables, including receivables from contracts with customers. IFRS 9 allows using a provision matrix as a practical expedient for determining expected credit loss rates (ECLs) on trade receivables. The Group and the Parent Company expects to use provision matrix based on historical observed default rates, adjusted for forward-looking estimates. IFRS 9 impairment requirements are applied retrospectively, with transition impact recognized in retained earnings. Based on assessment performed to date, the transition impact (net of tax) on the opening balance of the Group's retained earnings at 1 January 2018 is estimated to fall within the range of EUR 397 – 854 thousand (Parent Company: approximately EUR 583 – 1,087 thousand). The results of the assessment presented above are preliminary and based on the facts and

circumstances as at 1 January 2018. Due to the possibility of changes in assumptions and estimations, the actual impact of adopting IFRS 9 on 1 January 2018 may be subject to change.

c) Hedge accounting

The Group and the Parent Company determined that all existing hedge relationships that are currently designated in effective hedging relationships will continue to qualify for hedge accounting under IFRS 9. As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, applying the hedging requirements of IFRS 9 will not have a significant impact on the Group's and the Parent Company's financial statements.

- ***IFRS 16: Leases.*** The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases on their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The Group and the Parent Company will adopt IFRS 16 for the financial year beginning as of 1 January 2019. The Group and the Parent Company has assessed that the impact of adoption of this Standard will be material on the Group's and the Parent Company's financial statements, and considers that as the lessee the Group and the Parent Company will have to recognize right-of-use assets in its financial statements. Upon implementation of IFRS 16, among other considerations, the Group and the Parent Company will make an assessment on the identified right-of-use assets, non–cancellable lease terms (including the extension and termination options) and lease payments (including fixed and variable payments, termination option penalties etc.). Detailed analysis on implementation of IFRS 16 will be finished in 2018.
- ***IAS 40: Transfers to Investment Property (Amendments).*** The Amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The Amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. These Amendments have not yet been endorsed by the EU. The Group's and the Parent Company's Management has assessed the impact of the implementation of the Amendments, but does not consider that these Amendments will have a significant effect to the Group's and the Parent Company's financial statements.
- ***IFRIC INTERPRETATION 22: Foreign Currency Transactions and Advance Consideration.*** The Interpretation is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Interpretation clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation covers foreign currency transactions when an entity recognizes a non-monetary asset or a non-monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income. The Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. This Interpretation has not yet been endorsed by the EU. The Group's and the Parent Company's Management has assessed the impact of the implementation of the IFRIC Interpretation, but does not consider that it will have a significant effect to the Group's and Company's financial statements, as the Group and the Parent Company has not transactions in foreign currencies.
- ***IFRIC INTERPRETATION 23: Uncertainty over Income Tax Treatments.*** The Interpretation is effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12. The Interpretation provides guidance on considering uncertain tax treatments separately or together, examination by tax authorities, the appropriate method to reflect uncertainty and accounting for changes in facts and circumstances. This Interpretation has not yet been endorsed by the EU. The Group's and the Parent Company's Management has not yet evaluated the impact of the implementation of the IFRIC Interpretation, but does not consider that it will have a significant effect to the Group's and the Parent Company's financial statements.
- ***IFRS 9: Prepayment features with negative compensation (Amendment).*** The Amendment is effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The Amendment allows financial assets with prepayment features that permit or require a party to a contract either to pay or receive reasonable compensation for the early termination of the contract (so that, from the perspective of the holder of the asset there may be 'negative compensation'), to be measured at amortized cost or at fair value through other comprehensive income. These Amendments have not yet been endorsed by the EU. The Group's and the Parent Company's Management has not yet evaluated the impact of the implementation of the IFRIC Interpretation, but does not consider that it will have a significant effect to the Group's and the Parent Company's financial statements.

Standards issued but not yet effective and not applicable for the Group and the Parent Company

- ***IFRS 2: Classification and Measurement of Share based Payment Transactions (Amendments).*** The Amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Amendments provide requirements on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, for share-based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. These Amendments have not yet been endorsed by the EU. Management has assessed that these Amendments of the Standard will not have a significant effect to the Group's and the Parent Company's financial statements, as the Group and the Parent Company does not accomplish share-based payment transactions.
- ***IAS 28: Long-term Interests in Associates and Joint Ventures (Amendments).*** The Amendments are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The Amendments relate to whether the measurement, in particular impairment requirements, of long-term interests in associates and joint ventures that, in substance, form part of the 'net investment' in the associate or joint venture should be governed by IFRS 9, IAS 28 or a combination of both. The Amendments clarify that an entity applies IFRS 9 Financial Instruments, before it applies IAS 28, to such long-term interests for which the equity method is not applied. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying IAS 28. These Amendments have not yet been endorsed by the EU. Management has assessed that these Amendments of the Standard will not have a significant effect to the Group's and the Parent Company's financial statements, as the Group and the Parent Company does not have such long-term interests.
- ***Amendment in IFRS 10: Consolidated Financial Statements and IAS 28: Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture.*** The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed

in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. In December 2015 the IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting. The amendments have not yet been endorsed by the EU. Management has assessed that these Amendments of the Standard will not have a significant effect to the Group's and the Parent Company's financial statements, as the Group and the Parent Company does not estimate to sell or invest such assets.

The Management of the Group and the Parent Company will not adopt these amendments because they will not be applicable for the Group and the Parent Company.

Improvements to IFRSs

The *IASB* has issued the *Annual Improvements to IFRSs 2014 – 2016 Cycle*, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2018 for IFRS 1 First-time Adoption of International Financial Reporting Standards and for IAS 28 Investments in Associates and Joint Ventures. Earlier application is permitted for IAS 28 Investments in Associates and Joint Ventures. These annual improvements have not yet been endorsed by the EU.

- *IFRS 1 First-time Adoption of International Financial Reporting Standards.* This improvement deletes the short-term exemptions regarding disclosures about financial instruments, employee benefits and investment entities, applicable for first time adopters.
- *IAS 28 Investments in Associates and Joint Ventures.* The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

The Group and the Parent Company has assessed that these improvements will have no impact on the Group's and the Parent Company's financial statements.

The *IASB* has issued the *Annual Improvements to IFRSs 2015 – 2017 Cycle*, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. These annual improvements have not yet been endorsed by the EU.

- *IFRS 3 Business Combinations and IFRS 11 Joint Arrangements:* The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it re-measures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not re-measure previously held interests in that business.
- *IAS 12 Income Taxes:* The amendments clarify that the income tax consequences of payments on financial instruments classified as equity should be recognized according to where the past transactions or events that generated distributable profits has been recognised.
- *IAS 23 Borrowing Costs:* The amendments clarify paragraph 14 of the standard that, when a qualifying asset is ready for its intended use or sale, and some of the specific borrowing related to that qualifying asset remains outstanding at that point, that borrowing is to be included in the funds that an entity borrows generally.

The adoption of these amendments may result in changes to accounting policies or disclosures but impact of adoption on the financial position or performance of the Group and the Parent Company has not yet assessed.

2.2. Consolidation (Group)

a) Subsidiaries

Subsidiaries, which are those entities where the Group has control over the financial and operating policies of the entity, financial reports are consolidated. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee).

Subsidiaries' financial reports are consolidated from the date on which control is transferred to the Parent Company and are no longer consolidated from the date when control ceases. General information about entities included in consolidation and its primary business activities are disclosed in Note 15.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured, as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Costs directly attributable to the acquisition are expensed to the Statement of Profit or Loss as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in business combination are measured initially at their fair values at the acquisition date.

Intercompany transactions, balances and unrealised gains on transactions between the Group's entities are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

b) Transactions with non–controlling interests and owners

The Group treats transactions with non–controlling interests as transactions with equity owners of the Group's Parent Company. Changes in a Parent's ownership interest in a subsidiary that do not result in the Parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). For purchases from non–controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in the Group's equity.

c) Associates

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Currently the Group has no investments in associates (Note 15, 4 h).

2.3. Disclosures of reportable segments

For segment reporting purposes the division into operating segments is based on the Latvenergo Group's and the Parent Company's internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the operating segment decision maker.

The Group divides its operations into three main operating segments – generation and trade, distribution and lease of transmission system assets. The Parent Company divides its operations into one main operating segment – generation and trade.

In addition, corporate functions, that cover administration and other support services, are presented in the Group and the Parent Company as separate segment (Note 5).

2.4. Foreign currency translation

a) Functional and presentation currency

Items included in the Financial Statements are measured using the currency of the primary economic environment in which the Group's entity operates ("the functional currency"). The Financial Statements have been prepared in euros (EUR), which is the Parent Company's functional currency, and presented in thousands of EUR. All figures, unless stated otherwise are rounded to the nearest thousand.

b) Transactions and balances

All transactions denominated in foreign currencies are translated into functional currency at the exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into functional currency using the exchange rate at the last day of the reporting year. The resulting gain or loss is charged to the Statement of Profit or Loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions.

2.5. Intangible assets

Intangible assets are measured on initial recognition at historical cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

Assets under development are recognised in Statement of Financial Position within intangible assets and measured at cost until the intangible assets are completed and received.

a) Usage rights, licenses and software

Usage rights, licenses and software are shown at historical cost less accumulated amortisation and accumulated impairment losses. Amortisation is calculated using the straight–line method to allocate the cost of usage rights, licenses and software over their estimated useful lives. Computer software development costs recognised as assets are amortised over their estimated useful lives, not exceeding a period of use defined in agreement or five years.

Connection usage rights are the payments for the rights to use the transmission or distribution system's power grid. Connection usage rights are recognized in the basis of upfront payments to transmission or distribution system operator for connection installation services. Connection usage rights are measured at cost net of amortisation and accumulated impairment that is calculated on straight–line basis to allocate the cost of connection usage rights to the residual value over the estimated period of relationship with a supplier (connection installer) – 20 years.

b) Greenhouse gas emission allowances

Emission rights for greenhouse gases (or allowances) are recognised at purchase cost. Allowances received from the Government free of charge are recognised at zero cost as off–balance sheet assets. Emission rights are recognised at cost when the Group or the Parent Company is able to exercise the control. In those cases when the quantity of emitted greenhouse gases exceeds the quantity of allowances allocated by the state free of charge, the Group and the Parent Company purchases additional allowances and carrying value of those allowances is determined on the basis of the market price of greenhouse gas emission allowances at the reporting period. Allowances are accounted for within 'Intangible assets' (see Note 13 b).

2.6. Property, plant and equipment

Property, plant and equipment (PPE) are measured on initial recognition at cost. Following initial recognition PPE are stated at historical cost or revalued amount (see point 2.8) less accumulated depreciation and accumulated impairment loss, if any.

The acquisition cost comprises the purchase price, transportation costs, installation, and other direct expenses related to the acquisition or implementation. The cost of the self–constructed item of PPE includes the cost of materials, services and workforce. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group or the Parent Company and the cost of an item can be measured reliably. All other repair and maintenance expenses are charged directly to the Statement of Profit or Loss when the expenditure is incurred. Borrowing costs are capitalised proportionally to the part of the cost of fixed assets under construction over the period of construction. Effective part of the changes in the fair value of forward foreign currencies exchange contracts, the purpose of which is to hedge currency exchange risk on PPE items, are also capitalised and included in the Statement of Profit or Loss along with the expenses of depreciation over the useful life of the asset or at the disposal of the asset.

If an item of PPE consists of components with different useful lives and acquisition costs of such components are significant concerning the PPE value, these components are accounted as separate items.

Land is not depreciated. Depreciation on the other assets is calculated using the straight–line method to allocate their cost over their estimated useful lives, as follows:

Type of property, plant and equipment (PPE)	Estimated useful life, years
Buildings and facilities, including	
– Hydropower plants, combined heat and power plants	15 – 100
– Electricity transmission and distribution lines	30 – 50
Technology equipment and machinery, including (TEM)	
– Hydropower plants	10 – 40
– Combined heat and power plants	3 – 25
– Transmission and distribution machinery and equipment	8 – 40
Other property, plant and equipment	2 – 25

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see point 2.9).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. Those are included in the Statement of Profit or Loss. If revalued property, plant and equipment have been sold, appropriate amounts are reclassified from revaluation reserve to retained earnings.

All fixed assets under construction are stated at historical cost and comprised costs of construction of assets. The initial cost includes construction and installation costs and other direct costs related to construction of fixed assets. Assets under construction are not depreciated as long as the relevant assets are completed and ready for intended use, but are tested for impairment annually, either individually or at the cash-generating unit level. The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

2.7. Investment property

Investment properties are land or a building or part of a building held by the Group and the Parent Company as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business. Investment property generates cash flows independently of the other assets held. The investment properties are initially recognised at cost and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses. The applied depreciation rates are based on estimated useful life set for respective fixed asset categories – from 15 to 80 years.

2.8. Revaluation of property, plant and equipment

Revaluations have been made with sufficient regularity to ensure that the carrying amount of property, plant and equipment items subject to valuation does not differ materially from that which would be determined using fair value at the end of reporting period.

The following Daugava hydropower plants, transmission system and distribution system property, plant and equipment groups are revalued regularly but not less frequently than every five years:

a) Revalued buildings and facilities:
- Daugava hydropower plants' buildings and facilities,
- Buildings and facilities of transmission system,
- Buildings and facilities of distribution system;

b) Revalued technology equipment and machinery:
- Daugava hydropower plants' technology equipment and machinery,
- Technology equipment and machinery of transmission system,
- Technology equipment and machinery of distribution system;

c) Revalued other equipment:
- Other equipment of Daugava hydropower plants',
- Other equipment of transmission system,
- Other equipment of distribution system.

Increase in the carrying amount arising on revaluation net of deferred tax is credited to the 'Other comprehensive income' as "Non–current assets revaluation reserve" in shareholders' equity. Decreases that offset previous increases of the same asset are charged in 'Other comprehensive income' and debited against the revaluation reserve directly in equity; all other decreases are charged to the current year's Statement of Profit or Loss.

At the date of revaluation, initial carrying amounts and accumulated depreciation are increased or decreased proportionately with the change in the carrying amount of the asset so that the carrying amount of the asset after the revaluation equals its revalued amount.

Non–current assets revaluation reserve is decreased and transferred to retained earnings at the moment, when revalued asset has been written off or disposed.

Revaluation reserve cannot be distributed in dividends, share capital, used for indemnity, reinvested in other reserves, or used for other purposes.

2.9. Impairment of assets

Assets that are subject to depreciation or amortisation and land are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value using a post–tax discount rate that reflects the current market expectations regarding the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash–generating unit to which the asset belongs. Impairment losses are recognised in the Other Comprehensive Income within PPE revaluation reserve for the assets accounted at revalued amount and in the Statement of Profit or Loss within amortisation, depreciation and impairment charge expenses for the assets that are accounted at cost, less depreciation and impairment, and for the assets accounted at revalued amount in case if impairment charge exceeds revaluation surplus previously recognised on individual asset.

The key assumptions used in determining recoverable amount of the asset are based on the Group entities' or the Parent Company's management best estimation of the range of economic conditions that will exist over the remaining useful life of the asset, on the basis of the most recent financial budgets and forecasts approved by the management for a maximum period of 10 years. Assets are reviewed for possible reversal of the impairment whenever events or changes in circumstances indicate that impairment must be reviewed. The reversal of impairment for the assets that are accounted at cost, less depreciation and impairment, is recognised in the Statement of Profit or Loss. Reversal of impairment loss for revalued assets is recognised in the Statement of Profit or Loss to the extent that an impairment loss on the same revalued asset was previously recognised in the Statement of Profit or Loss; the remaining reversals of impairment losses of revalued assets are recognised in Other Comprehensive Income.

2.10. Leases

a) The Group or the Parent Company is the lessee

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the Statement of Profit or Loss on a straight–line basis over the period of the lease (Note 14 e).

b) The Group or the Parent Company is the lessor

Assets leased out under operating leases are recorded within investment property at historic cost less depreciation and accumulated impairment loss. Depreciation is calculated on a straight–line basis to write down each asset to its estimated residual value over estimated useful life. Rental income from operating lease and advance payments received from clients (less any incentives given to lessee) are recognised in the Statement of Profit or Loss on a straight–line basis over the period of the lease (Note 14 e).

2.11. Inventories

Inventories are stated at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Cost is determined using the weighted average method, except of natural gas inventory where cost is determined using FIFO method.

Purchase cost of inventories consists of the purchase price, import charges and other fees and charges, freight–in and related costs as well as other costs directly incurred in bringing the materials and goods to their present location and condition. The value of inventories is assigned by charging trade discounts, reductions and similar allowances.

Existence of inventories as of the end of reporting period is verified during stock–taking.

At the end of each reporting year the inventories are reviewed for any indications of obsolescence. In cases when obsolete or damaged inventories are identified allowances are recognised. During the reporting year at least each month revaluation of the inventories is performed with the purpose to identify obsolete and damaged inventories. Allowances for an impairment loss are recognised for those inventories.

The following basic principles are used in determining impairment losses for idle and obsolete inventories:

a) Inventories (smaller spare parts or stocks) for machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 12 months are impaired in amount of 90%,

b) Inventories (smaller spare parts or stocks) for machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 6 months are impaired in amount of 45%,

c) Other inventories that haven't turned over during last 6 months are impaired in amount of 50%,

d) Allowances are not calculated for the inventory of hydropower plants and heating materials necessary to ensure uninterrupted operations of hydropower and combined heat and power plants, for natural gas and scraps.

e) All other inventories that haven't turned over during last 12 months are fully impaired.

2.12. Receivables from contracts with customers and other receivables

Receivables from contracts with customers are recognised initially at fair value and subsequently carried at amortised cost. An allowance for impairment of receivables from contracts with customers is established when there is objective evidence that the Group or the Parent Company will not be able to collect all amounts due according to the original terms of repayment. Significant financial difficulties of the debtor, probabilities that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue) are considered as indicators that the trade receivable is impaired.

Receivables from contracts with customers are classified in groups:

a) Electricity, natural gas trade and related services receivables, including distribution system services,
b) Heating receivables,
c) Other receivables from contracts with customers (IT & telecommunication services, connection service fees and other services).

An allowance for impairment of doubtful debts is calculated on the basis of receivables from contracts with customers aging analysis according to estimates defined by the Group entities management and the Parent Company's management, which are revised at least once a year. Allowances for electricity, natural gas trade and related services receivables are calculated for debts overdue 45 days, and, if the debt is overdue for more than 181 days, allowances are established at 100%. For heating and other receivables allowances are calculated for debts overdue 31 days, and, if the date of payment is overdue for more than 91 days, allowances are established at 100% (see Note 17 a).

Individual impairment assessments are performed for the debtors:

a) In Latvia – if their debt balance exceeds EUR 700 thousand or they have a financial difficulties and debt repayment schedule has been individually agreed, allowances are calculated individually,
b) In Lithuania and Estonia – if their debt balance exceeds EUR 200 thousand or they have a financial difficulties and debt repayment schedule has been individually agreed, allowances are calculated individually,
c) If debtor has been announced as insolvent, allowances are established at 100%.

The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the Statement of Profit or Loss within 'Other operating expenses' as selling expenses and customer service costs. When a receivable is uncollectible, it is written off against the allowance account for receivables from contracts with customers. Subsequent recoveries of amounts previously written off are credited against selling and customer services costs in the Statement of Profit or Loss.

2.13. Cash and cash equivalents

Cash and cash equivalents include cash balances on bank accounts, demand deposits at bank and other short–term deposits with original maturities of three months or less. Cash and cash equivalents also are consisting of restricted cash, that are excluded from cash and cash equivalents in the Statement of Cash Flows (see Note 18).

2.14. Dividend distribution

Dividend distribution to the Parent Company's shareholders is recognised as a liability in the Financial Statements in the period in which the dividends are approved by the Parent Company's shareholders.

2.15. Pensions, post–employment and employee termination benefits

a) Pension obligations

The Group and the Parent Company makes monthly contributions to a closed defined contribution pension plan on behalf of its employees. The plan is managed by the non–profit public limited company Pirmais Slēgtais Pensiju Fonds, with the participation of the Group companies amounting for 48.15% (Parent Company – 46.30%) of its share capital. A defined contribution plan is a pension plan under which the Group and the Parent Company pays contributions into the plan. The Group and the Parent Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods. The contributions amount to 5% of each pension plan member's salary. The Group and the Parent Company recognizes the contributions to the defined contribution plan as an expense when an employee has rendered services in exchange for those contributions.

b) Provisions for post–employment obligations arising from collective agreement

In addition to the aforementioned plan, the Group and the Parent Company provides certain post–employment benefits to employees whose employment meets certain criteria. Obligations for benefits are calculated taking into account the current level of salary and number of employees eligible to receive the payment, historical termination rates as well as number of actuarial assumptions.

The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

The liability recognised in the Statement of Financial Position in respect of post–employment benefit plan is the present value of the defined benefit obligation at the end of the reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds. The Group and the Parent Company uses projected unit credit method to establish its present value of fixed benefit obligation and related present and previous employment expenses. According to this method it has been stated that each period of work makes benefit obligation extra unit and the sum of those units comprises total Group's and the Parent Company's obligations of post–employment benefits. The Group and the Parent Company uses objective and mutually compatible actuarial assumptions on variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts).

Actuarial gains or losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Statement of Comprehensive Income in the period in which they arise. Past service costs are recognised immediately in the Statement of Profit or Loss.

c) Provisions for termination benefits

Termination benefits are measured in accordance with IAS 19 and are payable when employment is terminated by the Group Companies before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The Group and the Parent Company recognises termination benefits at the earlier of the following dates: (a) when the Group entity can no longer withdraw the offer of those benefits; and (b) when the Group entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of terminations benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to present value. Management judgements related to the measurement of provisions for termination benefits is disclosed in Note 4.

2.16. Income tax

Corporate income tax includes current and deferred taxes.

a) Corporate income tax

Latvia

Current corporate income tax is applied at the rate of 15% on taxable income generated by a company during the taxation period.

Legal entities will not be required to pay income tax on earned profits starting from 1 January 2018 in accordance with amendments made to the Corporate Income Tax Law of the Republic of Latvia issued on 28 July 2017. Corporate income tax will be paid on distributed profits and deemed profit distributions. Consequently, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits. Starting from 1 January 2018, both distributed profits and deemed profit distributions will be subject to the tax rate of 20% of their gross amount, or 20/80 of net expense. Corporate income tax on dividends is recognized in the statement of profit or loss as expense in the reporting period when respective dividends are declared, while, as regards other deemed profit items, at the time when expense is incurred in the reporting year.

Lithuania

Current corporate income tax is applied at the rate of 15% on taxable income generated by a company during the taxation period.

Income tax expense for the period comprises current income tax and deferred income tax. Current income tax charges are calculated on current profit before tax using the tax rate 15% in accordance with applicable tax regulations as adjusted for certain non–deductible expenses/non–taxable income and are based on the taxable income reported for the taxation period.

Estonia

Under the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Corporate income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non–business related disbursements and adjustments of the transfer price. The tax rate on the net dividends paid out of retained earnings is 20/80. In certain circumstances, it is possible to distribute dividends without any additional income tax expense. The corporate income tax arising from the payment of dividends is accounted for as a liability and expense in the period in which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

b) Deferred income tax

Latvia

Deferred corporate income tax arising from temporary differences in the timing of the recognition of items in the tax returns and these financial statements was calculated using the liability method. Deferred corporate income tax assets and liabilities were determined on the basis of the tax rates that were expected to apply when the timing differences reverse.

Deferred tax assets and liabilities are not recognized for the year 2017 in accordance with amendments to the legislation of the Republic of Latvia, which entered into force on 1 January 2018. Accordingly, deferred tax liabilities which have been calculated and recognized in previous reporting periods are reversed through the current statement of profit or loss or other comprehensive income (depending on whether the original entry was recorded in the statement of profit or loss or other comprehensive income) in the financial statements for the year ended 31 December 2017, as it is laid down in the IAS 12, changes in the tax legislation must be presented in financial statements in the period when they are adopted (Note 12).

Lithuania

Deferred income tax is provided in full, using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted by the end of reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit of the respective Group entity will be available against which the temporary differences can be utilised.

Estonia

Due to the nature of the taxation system, the entities registered in Estonia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise.

2.17. Subsidised Energy Tax

In order to limit the increase of the mandatory procurement public service obligation (PSO) fee for electricity consumers in Latvia, a Subsidised Energy Tax (SET) has been introduced for a four–year period as of 1 January 2014, which applies to state support for generators of subsidised electricity. The SET applies both to income from electricity supplied under the mandatory procurement process as well as to mandatory procurement capacity payments for installed capacity at cogeneration plants, achieved from 1 January 2014 till 31 December 2017, in accordance with SET. The tax is differentiated according to the type of energy sources used. For cogeneration plants that use fossil energy sources a 15% tax rate applies to the received support (taxable income) amount, 10% tax rate – plants that use renewable energy sources, 5% – cogeneration plants that use gas, biogas and biomass energy sources and installed electrical capacity in cogeneration plants is below 4 MW. Payers of SET are all producers of subsidised electricity. Revenues from SET are used as a funding for the grant included in the State Budget programme "Electricity user support" to limit the increase of mandatory procurement PSO fee. SET applied for the subsidised electricity produced are recognised in the Statement of Profit or Loss as 'Other operating expenses' (Note 10) at gross amount, but SET for subsidised electricity produced by other producers – as 'Other financial current payables' in the Statement of Financial Position (Note 24).

2.18. Borrowing costs

General and specific borrowing costs directly attributable to the acquisition or construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that the Group and the Parent Company incurs in connection with the borrowing of funds.

2.19. Provisions

Provisions are recognised when the Group or the Parent Company has a present obligation as a result of past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and when a reliable estimate can be made of the amount of the obligation. Provisions are not recognised for future operating losses.

Provisions are presented in the Statement of Financial Position at the best estimate of the expenditure required to settle the present obligation at the end of reporting period. Provisions are used only for expenditures for which the provisions were originally recognised and are reversed if an outflow of resources is no longer probable.

Provisions are measured at the present value of the expenditures expected to be required for settling the obligation by using pre–tax rate that reflects current market assessments of the time value of the money and the risks specific to the obligation as a discount rate. The increase in provisions due to passage of time is recognised as interest expense.

Environmental protection provisions are recognised to cover environmental damages that have occurred before the end of the reporting period when this is required by law or when the Group's or the Parent Company's past environmental policies have demonstrated that the Group and the Parent Company has a constructive present obligation to liquidate this environmental damage. Experts' opinions and prior experience in performing environmental work are used to set up the provisions (see Note 22 c).

2.20. Grants

a) Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. Government grants are recognised as income over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis.

For grants received as part of a package of financial or fiscal aid to which a number of conditions are attached, those elements which have different costs and conditions are identified. Treatment of the different elements determine the periods over which the grant will be earned.

I) Grants related to expense items

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to a company with no future related costs are recognised in profit or loss of the period in which it becomes receivable. Related income is recognised in the Statement of Profit or Loss as 'Other income' (Note 7).

When a grant relates to an expense item, and it has a number of conditions attached, it is initially recognised at fair value as deferred income. Grants are credited to income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed (Note 23). Management judgements related to the measurement of government grants is disclosed in Note 4.

II) Grants related to assets

Property, plant and equipment received at nil consideration are accounted for as grants. Those grants are recognised at fair value as deferred income and are credited to the Statement of Profit or Loss on a straight–line basis over the expected lives of the related assets.

b) Financing provided by European Union funds

The Group and the Parent Company ensures the management, application of internal controls and accounting for the Group's and the Parent Company's projects financed by the European Union funds, according to the guidelines of the European Union and legislation of the Republic of Latvia.

Accounting of the transactions related to the projects financed by the European Union is ensured using separately identifiable accounts. The Group and the Parent Company ensures separate accounting of financed projects with detailed income and expense, non–current investments and value added tax in the relevant positions of the Statement of Profit or Loss and Statement of Financial Position.

2.21. Financial instruments – initial recognition, subsequent measurement and de–recognition

a) Financial assets

I) Initial recognition and measurement

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held–to–maturity investments, available–for–sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of financial assets is determined at initial recognition.

All financial assets are recognised initially at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Group and the Parent Company commits to purchase or sell the asset.

II) Subsequent measurement

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non–current. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the Statement of Profit or Loss. Financial assets designated upon initial recognition at fair value through profit or loss are designated at their initial recognition date and only if the criteria under IAS 39 are satisfied. The Group and the Parent Company has not designated any financial assets at fair value through profit or loss.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value though profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in profit or loss.

Loans and receivables

Loans and receivables are non–derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate (hereinafter – EIR) method, less impairment. The losses arising from impairment are recognised in the Statement of Profit or Loss in finance costs for loans and in other operating expenses for receivables.

Held–to–maturity investments

Non–derivative financial assets with fixed or determinable payments and fixed maturities are classified as held to maturity when exists positive intention and ability to hold them to maturity. After initial measurement, held to maturity investments are measured at amortised cost using the EIR, less impairment. If the Group and the Parent Company were to sell other than an insignificant amount of held–to–maturity financial assets, the whole category would be tainted and reclassified as available for sale. Held–to–maturity financial assets with maturities more than 12 months from the end of the reporting period are included in non–current assets, however those with maturities less than 12 months from the end of the reporting period are classified as current assets.

The Group and the Parent Company follows the IAS 39 guidance on classifying non–derivative financial assets with fixed or determinable payments and fixed maturity as held–to–maturity. This classification requires significant judgement. In making this judgement, the Group and the Parent Company evaluates its intention and ability to hold such investments to maturity (see Note 4 g).

If the Group and the Parent Company fails to keep these investments to maturity other than for specific circumstances explained in IAS 39, it will be required to reclassify the whole class as available–for–sale. Therefore the investments would be measured at fair value not at amortised cost.

Purchases and sales of financial assets held–to–maturity are recognised on trade date – the date on which the Group and the Parent Company commits purchase of the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired. Held–to–maturity financial assets are carried at amortised cost using the effective interest rate method, net of accumulated impairment losses. Gains and losses arising from changes in the amortised value of the financial instruments are included in the Statement of Profit or Loss in the period in which they arise.

Available–for–sale financial assets

Available–for–sale financial assets include equity instruments and debt securities. After initial measurement available–for–sale financial assets are subsequently measured at fair value with unrealised gains or losses recognised in other comprehensive income and credited in the available–for–sale financial assets reserve until the investment is derecognised. The Group and the Parent Company does not have such assets.

III) De–recognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

1) the rights to receive cash flows from the asset have expired,

2) the Group and the Parent Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement; and either (a) the Group and the Parent Company has transferred substantially all the risks and rewards of the asset, or (b) the Group and the Parent Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

b) Financial liabilities

I) Initial recognition and measurement

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group and the Parent Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

Financial liabilities include trade and other payables, bank overdrafts, loans and borrowings, financial guarantee contracts, and derivative financial instruments.

II) Subsequent measurement

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. This category includes derivative financial instruments entered into by the Group and the Parent Company that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the Statement of Profit or Loss.

Loans and borrowings

Loans and borrowings are recognised initially at fair value. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the Statement of Profit or Loss, except for the capitalised part. Borrowings are classified as current liabilities unless the Group and the Parent Company has an unconditional right to defer settlement of the liability at least for 12 months after the end of reporting period.

Trade and other payables

The Group's and the Parent Company's trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

III) De–recognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de–recognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the Statement of Profit or Loss.

2.22. Derivative financial instruments and hedging activities

The Group and the Parent Company uses derivatives such as interest rate swaps and electricity forward and future contracts to hedge risks associated with the interest rate and purchase price fluctuations.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re–measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate (see point 2.23.).

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, on the nature / content of the relevant asset or liability being hedged.

The Group and the Parent Company designates certain derivatives as hedges of a particular risk associated with specific variable rate borrowings (cash flow hedge). Other derivatives are accounted for at fair value through profit or loss.

The Group and the Parent Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group and the Parent Company also documents its assessment, both at hedge inception and on an on–going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of the derivative instruments is presented as current or non–current based on settlement date. Derivative instruments that have maturity of more than twelve months and have been expected to be hold for more than twelve months after the end of the reporting year are classified as non–current assets or liabilities. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

a) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and accumulated in equity within 'Hedging reserve'. The gain or loss relating to the ineffective portion, if such arise, would be recognised immediately in the Statement of Profit or Loss.

Amounts accumulated in equity are recycled in the Statement of Profit or Loss in the periods when the hedged item affects profit or loss.

The gain or loss relating to the ineffective portion of interest rate swaps hedging variable rate borrowings is recognised in the Statement of Profit or Loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the Statement of Profit or Loss.

b) Fair value changes of derivatives through profit and loss

Changes in the fair value of derivatives at fair value through profit or loss, ineffective part of changes in the fair value of hedging derivatives and amounts accumulated in equity that are recycled to the Statement of Profit or Loss, are classified according to the purpose of the derivatives – gains/losses from electricity forward and future contracts are recognised within 'Raw materials and consumables used', while gains / losses from interest rate swap agreements and forward foreign currencies exchange contracts are recognised within 'Finance costs' or 'Finance income'.

2.23. Fair value measurement

The Group and the Parent Company measures financial instruments, such as, derivatives, at fair value at each balance sheet date. Such non–financial assets as investment properties are measured at amortised cost, but some items of property, plant and equipment at revalued amounts. Also fair values of financial instruments measured at amortised cost are disclosed in Note 21 d.

The 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. Fair values are estimated based on market prices and discounted cash flow models as appropriate (see Note 4 c).

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of reporting period. The quoted market prices used for financial assets held by the Group and the Parent Company is the current bid prices.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group and the Parent Company use a variety of methods and make assumptions that are based on market conditions existing at each end of reporting period. Estimated discounted cash flows are used to determine fair value for the remaining financial instruments.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments.

The fair value of electricity forward and future contracts is calculated as discounted difference between actual market and settlement prices multiplied by the volume of the agreement.

If counterparty is a bank, then fair values of financial instruments are obtained from corresponding bank's revaluation reports and in financial statements fair values of financial instruments as specified by banks are disclosed. In case of electricity forward and future contracts concluded with counterparties others than a bank; fair values as calculated by the Group and the Parent Company are disclosed in Financial Statements.

2.24. Revenue recognition

Revenue from contracts with customers (IFRS 15)

Revenue from contracts with customers in scope for IFRS 15 encompasses sold goods or services provided as output of the entity's ordinary activities. The Group and Parent Company uses the following criteria to identify contracts with customers:

- the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- can be identified each party's rights regarding the goods or services to be transferred;
- can be identified the payment terms for the goods or services to be transferred;
- the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract);
- it is probable that the company will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In evaluating whether collectability of an amount of consideration is probable, the Group and the Parent Company uses portfolio approach practical expedient for all energy and related supply services, distribution system services and heat sales customers. Group and the Parent Company reasonably expects that, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. For other customers collectability is assessed individually.

The Group and the Parent Company considers only the customer's ability and intention to pay that amount of consideration when it is due.

Performance obligations are promises in the contracts (either explicitly stated or implied) with Group's and the Parent Company's customers to transfer to the customers either distinct goods or services, or series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Promised goods or services represent separate performance obligations if the goods or services are distinct. A promised good or service is considered distinct if the customer can benefit from the good or service on its own or with other readily available resources (i.e. distinct individually) and the good or service is separately identifiable from other promises in the contract (distinct within the context of the contract). Both of these criteria must be met to conclude that the good or service is distinct.

Major distinct performance obligations identified in the contracts with customers by the Group and the Parent Company include sale of energy and related supply services, provision of distribution system services and sale of heat. Group has assessed that connecting a customer to the distribution grid as a separate performance obligation is not distinct as connection fees to distribution system are not distinct within the context of the contract due to being highly interrelated to sales of distribution services (Note 4 d III).

The Group and the Parent Company has further assessed that in providing Mandatory procurement PSO fees it is acting as an agent due to lack of control over PSO fee (Note 4 d I). The Parent Company has also concluded that it is acting as an agent in the provision of distribution system services and transmission system services because the Parent Company has no control over these services (Note 4 d II).

Where contracts with customers include variable consideration, the Group and the Parent Company estimates at contract inception the variable consideration expected over the life of the respective contracts and updates that estimate each reporting period. A constrained variable consideration is identified in relation to sales of distribution system services (Note 4 d IV).

The Group and the Parent Company recognises revenue when (or as) it satisfies a performance obligation to transfer a promised good or service to a customer. Revenue is recognized when customer obtains control of the respective good or service.

The Group and the Parent Company uses method output method to measure progress towards complete satisfaction of a performance obligations. Revenue from sale of energy and related supply services, provision of distribution system services and sale of heat are recognized over time as a continuous delivery of these goods and services is made over the term of the respective contracts.

Revenue from satisfied performance obligations under such contracts is recognised over time, if one of the following criteria is met:

- customer simultaneously receives and consumes the benefits;
- customer controls the asset as it is created or enhanced;
- the Group's and Parent Company's performance does not create an asset and has a right to payment for performance completed.

Revenue from satisfaction of performance obligations is recognized based on identified transaction price. Transaction price reflects the amount to which the Group and the Parent Company has rights under the present contract. It is allocated to the distinct performance obligations based on standalone selling prices of the goods or services promised in the contract. The Group and the Parent Company allocates transaction price to the distinct performance obligations in proportion to their observable stand-alone selling prices and recognises revenue as those performance obligations are satisfied.

Payment terms for goods or services transferred to customers according to contract terms are within 20 to 45 days from the provision of services or sale of goods. Invoices are mostly issued monthly.

Revenue from contracts with customers is recognised as follows:

I) Revenue recognised over time

Trade of energy and related supply services

Revenue from electricity and natural gas sales are recognised on the basis of issued invoices to customers for supplied electricity on the basis of reported meter readings. Revenue from other energy and related supply services are recognised on the basis of provided services and prices included in contracts with customers. Revenues from trade of electricity in Nord Pool power exchange are based on the calculated market prices in accordance with contract terms, therefore 'right to invoice' practical expedient is used to recognise revenue from such contracts.

Sales of distribution system services (Group)

Revenues from electricity distribution services are based on regulated tariffs that are subject to approval by the Public Utilities Commission and regulations by Cabinet of Ministers of the Republic of Latvia 'Regulations on electricity trade and usage'. The Group recognizes revenue from sales of distribution system services at the end of each month on the basis of the automatically made meter readings or customers' reported meter readings, on the period in which the services are rendered. Revenue is recognized in the amount for which the Group has right to invoice.

Distribution system service fee includes variable consideration, it can be reduced due to use of efficient connection load, which is measured on the basis of the rules defined by the Public Utilities Commission. Reduction is applied to the distribution service fee amounting to 0.5 coefficient after specified annual consumption levels are reached. There are certain limitations for the application of 0.5 coefficient (Note 4 d IV).

Heat sales

Revenue from sales of thermal energy is recognised at the end of each month on the basis of the meter readings and corresponds to the invoiced amount.

Connection fees to distribution system (Group)

Connection fees to distribution system are non-refundable upfront fees paid by customers to secure connection to the distribution network, such fees are not distinct performance obligations as are highly interrelated with distribution system services. Connection fees partly reimburses for the cost of infrastructure to be built needed to connect the respective customer to the network. Connection fees to distribution system fee is calculated in accordance with Latvian regulatory authority (Public Utilities Commission) stated methodology.

Revenue from connection fees to distribution system are initially recognised as contract liabilities and recognised over the estimated customer relationship period of 20 years (Note 4 d III).

Sales of IT & telecommunication services

Other revenue (Note 6), mainly includes revenues derived from information technology services (internet connection services, data communication services), open electronic communication network and telecommunication services to customers. Revenues are recognised on the basis of invoices which are prepared for clients upon usage of services listed in telecommunications billing system. Revenue is recognized in the amount for which the Group and the Parent Company has right to invoice.

II) Revenue recognised applying agent accounting principle

Mandatory procurement PSO fees

Revenue from mandatory procurement public service obligation (PSO) fees in the Group is recognised on net (agent) basis. PSO fee is managed within the context of mandatory procurement process by subsidiary Enerģijas publiskais tirgotājs AS (hereinafter – EPT) and is the difference (residual) between the gross revenue from the sale of electricity (generated by subsidised electricity producers) in Nord Pool power exchange by market price, received mandatory procurement PSO fee, received government grant for compensating the increase of mandatory procurement costs and the related costs. Such costs include costs of purchased electricity under the mandatory procurement from electricity producers who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants (over 4 MW). EPT is acting as

agent in administration of the mandatory procurement process and receives revenue from mandatory procurement administration services (agent fee), which is recognised over time in the Group's Statement of Profit or Loss as "Other revenue" (Notes 6 and 4 d, l).

Revenue from mandatory procurement PSO fees obtained by trader (Parent Company – Latvenergo AS) and distribution system operator (Sadales tīkls AS) is revenue which consists from payments of electricity end–users for covering mandatory electricity procurement costs of electricity public trader - EPT. The Electricity Market Law provides that all electricity end–users in Latvia shall compensate the mandatory electricity purchase costs. As a result, the PSO fees are included in invoices issued by Latvenergo AS and by Sadales tīkls AS and are paid by customers together with unite invoice for electricity and system services. System operators have the obligation to collect revenues of PSO fees from customers or traders and further to transfer these revenues to EPT. PSO fees are based on regulated tariffs that are subject to approval by the Public Utilities Commission. Due to lack of influence and control over PSO fees before they are transferred to a customer, the Group and the Parent Company considers themselves an agent in these transactions. Therefore, PSO fees are recognised in the Statement of Profit or Loss in net amount by applying the agent accounting principles (Note 6, Note 4 d, l).

Distribution system and transmission system services (Parent Company)

The Parent Company on behalf of distribution system operator (DSO) and transmission system operator (TSO) issues unite invoice including per invoice distribution system or transmission system services, and transfers these revenues to DSO or TSO accordingly.

Distribution system services and transmission system services are based on regulated tariffs that are subject to approval by the Public Utilities Commission. Due to lack of influence and control over distribution system and transmission system services before they are transferred to a customer, the Parent Company considers itself an agent in these transactions. Therefore, distribution system and transmission system services are recognised in the Statement of Profit or Loss in net amount by applying the agent accounting principles (Note 4 d, ll).

Revenue for other sources

Lease of transmission system assets (IAS 17) (Group)

Revenues from lease of transmission system assets are recognised on the basis of invoices which are prepared for transmission system operator accordingly to determined fee per lease agreement. Lease of transmission system assets is a lease contract within the scope of IAS 17 Leases. Revenue is disclosed per Note 6 and 14 e.

Connection fees to transmission system (IAS 17) (Group)

Revenue from connection fees to transmission system are within the scope of IAS 17. Connection fees to transmission system are received upfront payments from lessee under operating lease agreement. Upfront payments are recognized as deferred income (Note 23).

Connection fees to transmission system are carried in the Statement of Financial Position as deferred income and amortised to Statement of Profit or Loss on a straight–line basis over 20 years, which is the estimated lease period (see Note 4 i)).

Electricity connection fees to transmission system are recognised by the Group based on the necessity for a connection to the transmission network based on the request of lessee, which acts on behalf of users. For each connection fee a separate arrangement within the base lease agreement is concluded. Connection fee to transmission system partly reimburses the cost of infrastructure to be built and is needed for connection of transmission system user to the network. Connection service fee to transmission system is calculated in accordance with Latvian regulatory authority (Public Utilities Commission) stated methodology.

2.25. Related parties

The parties are considered related when one party has a possibility to control the other one or has significant influence over the other party in making financial and operating decisions. Related parties of the Group and the Parent Company are Shareholder of the Parent Company who controls or who has significant influence over the Parent Company in accepting operating business decisions, members of Latvenergo Group entities' management boards, members of the Supervisory board of the Parent Company, members of Supervisory body of the Parent Company – the Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence.

As the shares of Latvenergo AS belong 100% to the Republic of Latvia, the related parties also include entities under the control or significant influence of the state (Note 25).

2.26. Non–current assets held for sale

The Group and the Parent Company classifies non–current assets as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, and sale is considered highly probable. Non–current assets held for sale are measured at the lower of their carrying amount and fair value less costs of selling.

2.27. Share capital

The Group's share capital consists of the Parent Company's ordinary shares. All shares have been fully paid.

2.28. Events after the reporting period

Events after the reporting period that provide additional information about the Group's and the Parent Company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Events after the reporting period that are not adjusting events are disclosed in the notes when material.

2.29. Changes in accounting policies

The Group and the Parent Company has applied IFRS 15 Revenue from contracts with customers for the first time in the 2017 financial statements with initial application date: 1 January 2017 and has chosen a modified retrospective application of IFRS 15. In accordance with the transition provisions in IFRS 15 the Group and the Parent Company has adopted the standard using the modified retrospective approach with cumulative effect only for the agreements that are not completed as of initial application date.

All relevant figures in the financial statements for the year ended 31 December 2017 have been presented in accordance with IFRS 15. The Group and the Parent Company has assessed its revenue, change in revenue recognition does not have significant impact on financial statements, however it has affected recognition of revenue from distribution system services for efficient use of connection load for its variable consideration.

The cumulative impact of the adoption has been recognised in retained earnings as of 1 January 2017 and comparatives are not restated. Cumulative effect upon adoption of IFRS 15 has decreased Group's retained earnings as of 1 January 2017 by EUR 10 thousand (the Parent Company: nil) and adoption of standard has decreased year 2017 Group revenue by EUR 243 thousand (the Parent Company: nil), that is recognised as deferred income as of 31 December 2017.

The cumulative effect upon adoption of IFRS 15

EUR'000

	Group				Parent Company			
Statement of Financial Position (extract)	**31/12/2016**	**Effect on IFRS 15 adoption**	**Positions reclassified**	**01/01/2017**	**31/12/2016**	**Effect on IFRS 15 adoption**	**Positions reclassified**	**01/01/2017**
ASSETS								
Current assets								
Receivables from contracts with customers	–	–	118,925	118,925	–	–	102,056	102,056
Other current receivables	273,958	–	(118,925)	155,033	113,659	–	(102,056)	11,603
Total current assets	**512,277**	**–**	**–**	**512,277**	**577,834**	**–**	**–**	**577,834**
TOTAL ASSETS	**3,901,231**	**–**	**–**	**3,901,231**	**3,204,394**	**–**	**–**	**3,204,394**
EQUITY AND LIABILITIES								
Equity								
Retained earnings	185,840	(10)	–	185,830	238,334	–	–	238,334
Total equity	**2,418,713**	**(10)**	**–**	**2,418,703**	**2,177,069**	**–**	**–**	**2,177,069**
Non-current liabilities								
Deferred income on contracts with customers	–	–	141,817	141,817	–	–	–	–
Other liabilities and deferred income	195,407	–	(141,817)	53,590	1,055	–	–	1,055
Total non-current liabilities	**1,173,375**	**–**	**–**	**1,173,375**	**770,876**	**–**	**–**	**770,876**
Current liabilities								
Deferred income on contracts with customers	–	10	11,605	11,615	–	–	–	–
Other deferred income	14,022	–	(11,605)	2,417	59	–	–	59
Total current liabilities	**309,143**	**10**	**–**	**309,153**	**256,449**	**–**	**–**	**256,449**
TOTAL EQUITY AND LIABILITIES	**3,901,231**	**–**	**–**	**3,901,231**	**3,204,394**	**–**	**–**	**3,204,394**

In accordance with the IFRS 15 requirements, the disclosure of the impact of adoption on Statement of profit or loss and statement of financial position is as follows:

EUR'000

Statement of Financial Position (extract)	Group 31/12/2017			Parent Company 31/12/2017		
Financial Position	**As reported**	**Without adoption of IFRS 15**	**Effect of Change (higher/(lower))**	**As reported**	**Without adoption of IFRS 15**	**Effect of Change (higher/(lower))**
ASSETS						
Current assets						
Receivables from contracts with customers	105,369	105,369	–	82,799	82,799	–
Other current receivables	646,761	646,761	–	18,079	18,079	–
Total current assets	**1,072,321**	**1,072,321**	**–**	**1,103,186**	**1,103,186**	**–**
TOTAL ASSETS	**4,415,725**	**4,415,725**	**–**	**3,649,200**	**3,649,200**	**–**
EQUITY AND LIABILITIES						
Equity						
Retained earnings	423,613	423,866	(253)	302,017	302,017	–
Total equity	**2,846,891**	**2,847,144**	**(253)**	**2,382,638**	**2,382,638**	**–**
Non-current liabilities						
Deferred income on contracts with customers	142,132	142,132	–	–	–	–
Other liabilities and deferred income	350,926	350,926	–	286,085	286,085	–
Total non-current liabilities	**1,238,556**	**1,238,556**	**–**	**1,009,959**	**1,009,959**	**–**
Current liabilities						
Deferred income on contracts with customers	12,500	12,247	253	–	–	–
Other deferred income	31,728	31,728	–	29,358	29,358	–
Total current liabilities	**330,278**	**330,025**	**253**	**256,603**	**256,603**	**–**
TOTAL EQUITY AND LIABILITIES	**4,415,725**	**4,415,472**	**253**	**3,649,200**	**3,649,200**	**–**

EUR'000

Statement of Profit or Loss (extract)	Group 31/12/2017			Parent Company 31/12/2017		
Profit or Loss	**As reported**	**Without adoption of IFRS 15**	**Effect of Change (higher/(lower))**	**As reported**	**Without adoption of IFRS 15**	**Effect of Change (higher/(lower))**
Revenue	925,627	925,870	(243)	498,580	498,580	–
Distribution system services	301,874	302,117	(243)	–	–	–
Profit / (loss) for the year	**322,021**	**322,264**	**(243)**	**150,891**	**150,891**	**–**

Disaggregation of revenue from contracts with customers has not changed existing categorising and presents the nature of the revenue as reviewed by the management.

3. Financial Risk Management

3.1. Financial risk factors

The Group's and the Parent Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value and cash flow interest rate risk), credit risk, pricing risk and liquidity risk. The Group's and the Parent Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's and the Parent Company's financial performance. The Group and the Parent Company uses derivative financial instruments to hedge certain risk exposures.

Risk management (except for pricing risk) is carried out by the Parent Company's Treasury department (the Group Treasury) according to the Financial Risk Management Policy approved by the Parent Company's Management Board. The Group Treasury identifies, evaluates and hedges financial risks in close co–operation with the Group's operating units / subsidiaries. The Parent Company's Management Board by approving the Financial Risk Management Policy provides written principles for overall risk management, as well as written policies covering specific areas, such as interest rate risk, foreign exchange risk, liquidity risk, and credit risk, use of financial instruments and investment of excess liquidity. Pricing risk management is carried out by the Parent Company's Electricity Trading department according to Electricity Wholesale Regulation approved by the Parent Company's Management Board.

Financial assets by categories

EUR'000

		Group				Parent Company			
	Notes	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through the profit or loss	Held-to-maturity assets	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through the profit or loss	Held-to-maturity assets
Financial assets as of 31 December 2017									
Receivables from contracts with customers	17 a	105,369	–	–	–	82,799	–	–	–
Other current receivables	17 b	641,832	–	–	–	17,938	–	–	–
Loans to subsidiaries	25	–	–	–	–	1,098,781	–	–	–
Other non-current receivables		3,229	–	–	–	284	–	–	–
Derivative financial instruments	21 c, l	–	4,074	545	–	–	4,074	545	–
Held-to-maturity financial assets	21 a	–	–	–	16,984	–	–	–	16,984
Cash and cash equivalents	18	236,003	–	–	–	232,855	–	–	–
		986,433	**4,074**	**545**	**16,984**	**1,432,657**	**4,074**	**545**	**16,984**
Financial assets as of 31 December 2016									
Receivables from contracts with customers	17 a	118,925	–	–	–	102,056	–	–	–
Other trade and current receivables	17 b	149,861	–	–	–	11,436	–	–	–
Loans to subsidiaries	25	–	–	–	–	622,704	–	–	–
Other non-current receivables		986	–	–	–	978	–	–	–
Derivative financial instruments	21 c, l	–	2,154	3,980	–	–	2,154	3,980	–
Held-to-maturity financial assets	21 a	–	–	–	20,554	–	–	–	20,554
Cash and cash equivalents	18	183,980	–	–	–	181,197	–	–	–
		453,752	**2,154**	**3,980**	**20,554**	**918,371**	**2,154**	**3,980**	**20,554**

Financial liabilities by categories

EUR'000

	Notes	Group			Parent Company		
		Derivatives used for hedging	Other financial liabilities at amortised cost	Financial liabilities at fair value through the profit or loss	Derivatives used for hedging	Other financial liabilities at amortised cost	Financial liabilities at fair value through the profit or loss
Financial liabilities as of 31 December 2017							
Borrowings	21 b	–	826,757	–	–	814,772	–
Derivative financial instruments	21 c, I	8,061	–	23	8,061	–	23
Trade and other payables	24	–	115,742	–	–	79,341	–
		8,061	**942,499**	**23**	**8,061**	**894,113**	**23**
Financial assets as of 31 December 2016							
Borrowings	21 b	–	791,566	–	–	778,323	–
Derivative financial instruments	21 c, I	11,563	–	23	11,563	–	23
Trade and other payables	24	–	88,555	–	–	71,197	–
		11,563	**880,121**	**23**	**11,563**	**849,520**	**23**

a) Market risk

I) Foreign currencies exchange risk

The introduction of euro in Latvia as of 1 January 2014 prevented the euro currency risk, which primarily was arising from settlements in foreign currencies for borrowings, capital expenditures and imported electricity. As of 31 December 2017 the Parent Company and the Group had borrowings denominated only in euros (Note 21 b).

The Financial Risk Management Policy provides for management of the Group's and the Parent Company's foreign currencies exchange risk against functional currency. To manage the Group's and the Parent Company's foreign currencies exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy is to use forward contracts. Foreign currencies exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency that is not the Group's and the Parent Company's s functional currency.

The Group Treasury's Financial Risk Management Policy is to hedge all anticipated cash flows (capital expenditure and purchase of inventory) in each major foreign currency that might create significant currency risk. During 2017 the Parent Company and the Group had no capital expenditure project which expected transactions would create significant currency risk.

In 2017 the Parent Company had no certain investments, which were exposed to foreign currency risks. The introduction of euro in Lithuania as of 1 January 2015 prevented the euro currency risk arising from the Parent Company's investments in subsidiary in Lithuania.

II) Cash flow and fair value interest rate risk

As the Group and the Parent Company have significant floating interest–bearing assets and liabilities exposed to interest rate risk, the Group's and the Parent Company`s financial income and operating cash flows are substantially dependent on changes in market interest rates.

During 2017, if euro interest rates had been 50 basis points higher or lower with all other variables held constant, the Group's income from the cash reserves held at bank for the year would have been EUR 994 thousand higher or lower (2016: EUR 906 thousand) and the Parent Company's income from the cash reserves held at bank for the year would have been EUR 986 thousand higher or lower (2016: EUR 892 thousand).

The Group's and the Parent Company's cash flow interest rate risk mainly arises from long–term borrowings at variable rates. They expose the Group and the Parent Company to a risk that finance costs might increase significantly when interest rates rise up. The Group's policy is to maintain at least 35% of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between 2–4 years.

The Group and the Parent Company analyses its interest rate risk exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and hedging. Based on these scenarios, the Group and the Parent Company calculates the impact on profit and loss as well as on cash flows of a defined interest rate shift.

Generally, the Group and the Parent Company raises long–term borrowings at floating rates and based on the various scenarios, the Group and the Parent Company manages their cash flow interest rate risk by using floating–to–fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Thereby fixed rates are obtained that are lower than those available if the Group and the Parent Company borrowed at fixed rates directly. Under the interest rate swaps, the Group and the Parent Company agrees with other parties to exchange, at specified intervals (primarily semi–annually), the difference between fixed contract rates and floating–rate interest amounts calculated by reference to the agreed notional amounts.

To hedge cash flow interest rate risk the Group and the Parent Company has entered into rate swap agreements with total notional amount of EUR 193.5 million (2016: EUR 174.2 million) (Note 21 c, II). 54% of the total Group's and 55% the Parent Company's borrowings as of 31 December 2017 (31/12/2016: 62% and 63% respectively) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration was 2.0 years for the Group and the Parent Company (2016: 2.1 and 2.2 years respectively).

During 2017, if interest rates on euro denominated borrowings at floating base interest rate (after considering hedging effect) had been 50 basis points higher with all other variables held constant, the Group's profit for the year net of taxes would have been EUR 1,166 thousand lower (2016: EUR 1,465 thousand), the Parent Company's profit for the year net of taxes would have been EUR 1,066 thousand lower (2016: EUR 1,408 thousand), while if the rates had been 50 basis points lower – profit for the year net of taxes would have been EUR 704 thousand higher (2016: EUR 974 thousand) for the Group and EUR 654 thousand higher (2016: EUR 917 thousand) for the Parent Company.

The borrowings with floating rates do not impose fair value interest rate risk. Derivatives such as interest rate swaps are the only source of fair value interest rate risk.

As of 31 December 2017, if short and long term euro interest rates had been 50 basis points higher or lower with all other variables held constant fair value of interest rate swaps would have been EUR 51 thousand higher or lower respectively (31/12/2017: EUR 3,238 thousand higher or EUR 3,346 thousand lower), which would have been attributable to the Statement of Other Comprehensive Income as hedge accounting item.

III) Price risk

Price risk is the risk that the fair value and cash flows of financial instruments will fluctuate in the future due to reasons other than changes in the market prices resulting from interest rate risk or foreign exchange risk. The purchase and sale of goods produced and the services provided by the Group and the Parent Company under the free market conditions, as well as the purchases of resources used in production is impacted by the price risk.

The most significant price risk is related to purchase of electricity. To hedge the risk related to changes in the price of electricity the Parent Company during 2017 has purchased electricity forward and future contracts (Note 21 c, III).

b) Credit risk

Credit risk is managed at the Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, outstanding receivables. Credit risk exposure in connection with receivables is limited due to broad range of the Group's and the Parent Company's customers. The Group and the Parent Company has no significant concentration of credit risk with any single counterparty or group of counterparties having similar characteristics. Impairment loss has been deducted from gross accounts receivable (Note 17).

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 18), receivables from contracts with customers and other receivables (Note 17), derivative financial instruments (Note 21 c) and held–to–maturity financial assets (Note 21 a).

Assessment of maximum possible exposure to credit risk

EUR'000

	Notes	Group		Parent Company	
		31/12/2017	31/12/2016	31/12/2017	31/12/2016
Receivables from contracts with customers	17 a	105,369	118,925	82,799	102,056
Receivables for lease	17 b	3,535	3,911	2,443	2,610
Other financial receivables from related parties	17 b	–	–	10,664	6,875
Accrued income	17 b	3,572	1,024	872	1,024
Other non-current financial receivables		3,229	986	284	978
Other current financial receivables	17 b	15,947	2,794	3,959	927
Loans to subsidiaries	25	–	–	1,098,781	622,704
Cash and cash equivalents	18	236,003	183,980	232,855	181,197
Derivative financial instruments	21 c	4,619	6,134	4,619	6,134
Held-to-maturity financial assets	21 a	16,984	20,554	16,984	20,554
		389,258	**338,308**	**1,454,260**	**945,059**

For banks and financial institutions, independently rated parties with own or parent bank's minimum rating of investment grade are accepted. Otherwise, if there is no independent rating, management performs risk control to assess the credit quality of the financial counterparty, taking into account its financial position, past co–operation experience and other factors. After performed assessment individual credit limits are set based on internal ratings in accordance with principles set by the Financial Risk Management Policy. The basis for estimating the credit quality of financial assets not past due and not impaired is credit ratings assigned by the rating agencies or, in their absence, the earlier credit behaviour of clients and other parties to the contract.

For estimation of the credit quality of fully performing receivables two rating categories are used:

- Customers with no overdue receivables,
- Customers with overdue receivables.

Credit limits are regularly monitored.

Credit risk related to cash and short–term deposits with banks is managed by balancing the placement of financial assets in order to maintain the possibility to choose the best offers and to reduce probability to incur losses.

The table below shows the balance of cash and cash equivalents by financial counterparties at the end of the reporting period:

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Investment level credit rating*	227,686	175,911	224,538	173,128
No or non-investment level credit rating	8,317	8,069	8,317	8,069
	236,003	**183,980**	**232,855**	**181,197**

* investment level credit rating assigned for the parent companies of Baltic banks

No credit limits were exceeded during the reporting period, and the Group and the Parent Company management does not expect any losses due to occurrence of credit risk.

c) Liquidity risk

The Group's policy of liquidity risk management is to maintain sufficient amount of cash and cash equivalents, the availability of long and short term funding through an adequate amount of committed credit facilities to meet commitments according to the Group's strategic plans as well as to compensate the fluctuations in the cash flows due to occurrence of variety of financial risks.

Latvenergo Group's liquidity and cash flow risk management policy is to maintain a sufficient amount of cash and cash equivalents (Note 18) and the availability of long and short-term funding through an adequate amount of committed credit facilities in order to meet existing and expected commitments and compensate for fluctuations in cash flows due to the occurrence of a variety of financial risks.

The table below analyses the Group's and the Parent Company's financial liabilities into relevant maturity groupings based on the settlement terms. The amounts disclosed in the table are the contractual undiscounted cash flows. Contractual undiscounted cash flows originated by the borrowings are calculated taking into account the actual interest rates at the end of the reporting period.

Liquidity analysis (contractual undiscounted cash flows)

EUR'000

	Group					Parent Company				
	Less than 1 year	From 1 to 2 years	From 3 to 5 years	Over 5 years	TOTAL	Less than 1 year	From 1 to 2 years	From 3 to 5 years	Over 5 years	TOTAL
As of 31 December 2017										
Borrowings from banks	113,285	119,074	313,149	191,748	**737,256**	109,727	117,985	310,411	194,733	**732,855**
Issued debt securities (bonds)	2,880	2,880	142,041	–	**147,801**	2,880	2,880	142,041	–	**147,801**
Derivative financial instruments	5,304	5,077	3,273	318	**13,972**	3,260	2,534	3,273	318	**9,385**
Financial liabilities (Note 24)*	115,742	–	–	–	**115,742**	79,341	–	–	–	**79,341**
	237,211	**127,031**	**458,463**	**192,066**	**1,014,771**	**195,208**	**123,399**	**455,725**	**195,051**	**969,382**
As of 31 December 2016										
Borrowings from banks	88,142	109,663	279,637	135,335	**612,777**	82,646	106,856	274,674	134,879	**599,055**
Issued debt securities (bonds)	74,915	2,880	42,389	102,577	**222,761**	74,915	2,880	42,389	102,577	**222,761**
Derivative financial instruments	3,737	2,894	4,594	779	**12,004**	3,737	2,894	4,594	779	**12,004**
Financial liabilities (Note 24)*	88,555	–	–	–	**88,555**	71,197	–	–	–	**71,197**
	255,349	**115,437**	**326,620**	**238,691**	**936,097**	**232,495**	**112,630**	**321,657**	**238,235**	**905,017**

* excluding advances received, deferred income, tax related liabilities and other non–current or current non–financial payables

3.2. Capital risk management

The Group's and the Parent Company's objectives when managing capital are to safeguard the Group's and Company's ability to continue as a going concern as well as to ensure necessary financing for investment program and to avoid breaches of covenants, which are linked to capital structure and are stipulated in the majority of loan agreements.

In order to maintain or adjust the capital structure, the Group and the Parent Company may evaluate the amount and timing of raising new debt due to investment programs or initiate new investments in the share capital by shareholder. Also asset revaluation directly influences the capital structure. To comply with loan covenants, the Group and the Parent Company monitors capital on the basis of the capital ratio.

This ratio is calculated by dividing the equity by the sum of total assets and nominal value of issued and outstanding financial guarantees. According to the Group's strategy and defined loan covenants as per loan agreements the capital ratio shall be maintained at least at 30% level.

The capital ratio figures were as follows:

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Total equity	2,846,891	2,418,713	2,382,638	2,177,069
Total assets	4,415,725	3,901,231	3,649,200	3,204,394
Capital Ratio	**64%**	**62%**	**65%**	**68%**

4. Critical Accounting Estimates and Judgements

Estimates and judgments are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group and the Parent Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

a) Estimates concerning property, plant and equipment

I) Useful lives of property, plant and equipment

The Group and the Parent Company makes estimates concerning the expected useful lives and residual values of property, plant and equipment. These are reviewed at the end of each reporting period and are based on the past experience as well as industry practice. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. As of 31 December 2017, the net book amount of property, plant and equipment of the Group totalled EUR 3,309 million and for the Parent Company 1,231 million (31/12/2016: EUR 3,356 million and 1,323 million), and the depreciation charge of the Group for the reporting period was EUR 185.6 million and for the Parent Company 85.9 million (2016: EUR 183.5 million and 84.9 million) (Note 14 a). Estimating of useful lives assessed as impracticable therefore sensitivity analysis of the depreciation rate changes effect in future periods is not disclosed.

II) Recoverable amount of property, plant and equipment

When the events and circumstances indicate a potential impairment, the Group and the Parent Company performs impairment tests for items of property, plant and equipment. For the items of PPE are defined separate cash–generating units – the distribution system assets, transmission system assets, assets of HPPs (Riga, Plavinu, Keguma and Aiviekste HPPs) and assets of Riga combined heat and power plants as disclosed per Note 14 d. According to these tests assets are written down to their recoverable amounts, if necessary. When carrying out impairment tests management uses various estimates for the cash flows arising from the use of the assets, sales, maintenance, and repairs of the assets, as well as in respect of the inflation and growth rates. The estimates are based on the forecasts of the general economic environment, consumption and the sales price of electricity. If the situation changes in the future, either additional impairment could be recognised, or the previously recognised impairment could be partially or fully reversed. Such factors as high maintenance and reconstruction costs, low load of several auxiliaries, comparatively substantial maintenance expense, limited facilities to sell property, plant and equipment in the market and other essential factors have an impact of decreasing of the recoverable amounts. Impairment charges recognised during the current reporting year are disclosed in Note 14 d.

III) Revaluation

External, certified valuers had performed revaluation for part of the Group's and the Parent Company's property, plant and equipment by applying the depreciated replacement cost model. Valuation has been performed according to international standards on property valuation and IAS 36, Impairment of assets, based on current use of property, plant and equipment that is estimated as the highest and best use of these assets. As a result of valuation, depreciated replacement cost was determined for each asset. Depreciated replacement cost is difference between the cost of replacement or renewal of similar asset at the time of revaluation and the obsolescence of an asset that encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence. Physical depreciation was determined proportionally the age of the property, plant and equipment item. In assessment for property, plant and equipment items for which planned reconstruction in the near future additionally was calculated physical depreciation. Remaining useful lifetime of property, plant and equipment items after revaluation was estimated according to estimated total depreciation. Income method is based on the identification and analysis of generation capacity, forecasting of electricity trade prices, analysis of historical generation and operating expenses and forecast of future costs, capital expenditure, net cash flows, as well calculation of discount and capitalisation rates, based on market data.

In 2016 the Group revaluated transmission system assets and distribution system electrical lines. Amounts of revalued distribution system and transmission system assets had been determined as of 1 April 2016. Revaluation on Latvenergo AS property, plant and equipment of Daugava hydropower plants had been determined as of 1 April 2017. For detailed revaluation results see Note 14 c.

b) Recoverable amount of receivables from contracts with customers

The estimated collectability of accounts receivable is assessed on the basis of receivables from contracts with customers aging analysis according to estimates defined by the Group entities management and the Parent Company's management. In case individual assessment is not possible due to the large number of individual balances, receivables are classified into groups of similar credit risk characteristics and are collectively assessed for impairment, using historical loss experience. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The circumstances indicating an impairment loss may include initiated insolvency of the debtor and inability to meet payment terms (point 2.12.). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss incurred (Note 17).

c) Fair value estimation for financial instruments

The following table presents financial assets and liabilities that are measured at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2),
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

EUR'000

		Group				Parent Company			
As of 31 December 2017	**Notes**	**Level 1**	**Level 2**	**Level 3**	**TOTAL balance**	**Level 1**	**Level 2**	**Level 3**	**TOTAL balance**
Assets									
Financial assets at fair value through profit or loss:									
- Electricity trading derivatives	21 c, III	–	545	–	**545**	–	545	–	**545**
Electricity trading derivatives used for hedging	21 c, III	–	4,043	–	**4,043**	–	4,043	–	**4,043**
Interest rate derivatives used for hedging	21 c, II	–	31	–	**31**	–	31	–	**31**
TOTAL assets		**–**	**4,619**	**–**	**4,619**	**–**	**4,619**	**–**	**4,619**
Liabilities									
Financial liabilities at fair value through profit or loss:									
- Electricity trading derivatives	21 c, III	–	23	–	**23**	–	23	–	**23**
Interest rate derivatives used for hedging	21 c, II	–	8,061	–	**8,061**	–	8,061	–	**8,061**
TOTAL liabilities		**–**	**8,084**	**–**	**8,084**	**–**	**8,084**	**–**	**8,084**

EUR'000

		Group				Parent Company			
As of 31 December 2016	Notes	Level 1	Level 2	Level 3	TOTAL balance	Level 1	Level 2	Level 3	TOTAL balance
Assets									
Financial assets at fair value through profit or loss:									
- Electricity trading derivatives	21 c, III	–	3,980	–	**3,980**	–	3,980	–	**3,980**
Electricity trading derivatives used for hedging	21 c, III	–	2,154	–	**2,154**	–	2,154	–	**2,154**
TOTAL assets		**–**	**6,134**	**–**	**6,134**	**–**	**6,134**	**–**	**6,134**
Liabilities									
Financial liabilities at fair value through profit or loss:									
- Electricity trading derivatives	21 c, III	–	23	–	**23**	–	23	–	**23**
Interest rate derivatives used for hedging	21 c, II	–	11,563	–	**11,563**	–	11,563	–	**11,563**
TOTAL liabilities		**–**	**11,586**	**–**	**11,586**	**–**	**11,586**	**–**	**11,586**

d) Estimates concerning revenue recognition from contracts with customers

I) Recognition of mandatory procurement PSO fees

The Group and the Parent Company has applied significant judgement for use of agent principle for recognition of net revenue on mandatory procurement PSO fee (difference between revenue from sale of electricity in Nord Pool power exchange by market price, received mandatory procurement PSO fee, received government grant for compensating the increase of mandatory procurement costs and costs of purchased electricity under the mandatory procurement from electricity generators who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants). Since 1 April 2014 net revenue from mandatory procurement PSO fees is not recognised in the Statement of Profit or Loss, but as assets or liabilities in the Statement of Financial Position by applying agent accounting principle as subsidiary Enerģijas publiskais tirgotājs AS (EPT) is acting in management of the mandatory procurement process as an agent. PSO fee by its nature is considered as part of service that is compensated to administrator of the mandatory procurement process by electricity suppliers and distribution system operators.

Management has considered following indicators that the Group and the Parent Company is acting as an agent:

- the Group or the Parent Company does not have control over the mandatory procurement PSO fee before transferring to the customer;
- the Group or the Parent Company has duty for including the mandatory procurement PSO fee per invoices issued to the end customers, but are not entitled on revenues from mandatory procurement PSO fee. These fees are determined by state support mechanism and are covered by all electricity end-users in proportion to their electricity consumption;
- the Group or the Parent Company have no discretion in establishing mandatory procurement PSO fees price, either directly or indirectly;
- the Group or the Parent Company does not have exposure to rewards associated with mandatory procurement PSO fees.

II) Recognition of distribution system services and transmission system services (Parent Company)

Management has evaluated that it does not have influence and control over distribution system services and transmission system services, therefore acts as an agent. In particular, Management has considered the following indicators that the Parent Company is acting as an agent:

- The Parent Company does not control provision of distribution system and transmission system services;
- The Parent Company includes the distribution system and transmission system services per invoices issued to the customers on behalf of distribution system operator or transmission system operator and receives payment, but is not entitled to the respective revenues.
- The Parent Company has no discretion in distribution system or transmission system services price, either directly or indirectly;
- The Parent Company has no inventory risk that would arise.

III) Recognition of connection service fees to distribution system (Group)

Connection fees to distribution system are not considered as separate (distinct) performance obligations, as are not distinct individually or within the context of the contract. Sales of distribution services are provided after customers have paid for the network connection, therefore network connection fees and sales of distribution services are highly interdependent and interrelated.

Income from connection and other service fees is deferred as an ongoing service is identified as part of agreement to provide distribution system services with customers (Note 2.24) and accounted as deferred income from contracts with customers under IFRS 15 (see Note 23). Connection and other service fees are recognised as income over the estimated customer relationship period. Based on Management estimate, 20 years is the estimated customer relationship period, which is estimated as period after which requested power output for connection object could significantly change due to technological reasons.

Thus period over which revenue is recognised is based on Management estimate, as it is reasonably certain that assets, whose costs are partly reimbursed by connection service fees will be used by distribution system customers for a longer period that original system services agreement term (Note 2.24.).

IV) Recognition of efficient use of permitted load (Group)

Distribution system services from efficient use of permitted load are recognised in accordance with IFRS 15 as constrained variable consideration. Based on historical experience on application of the 0.5 coefficient using a portfolio of data, Management has estimated that from distribution system revenues earned from those customers, who qualified for efficient use of permitted load by meeting certain criteria, are decreased in amount of 6%. See Note 2.24.

e) Recognition and revaluation of provisions

As of 31 December 2017, the Group had set up provisions for environmental protection, post–employment benefits and termination benefits totalling EUR 25.3 million (31/12/2016: EUR 18.6 million) and the Parent Company in amount of EUR 9.7 million (31/12/2016: EUR 7.9 million) (Note 22). The amount and timing of the settlement of these obligations is uncertain. A number of assumptions and estimates have been used to determine the present value of provisions, including the amount of future expenditure, inflation rates, and the timing of settlement of the expenditure. The actual expenditure may also differ from the provisions recognised as a result of possible changes in legislative norms, technology available in the future to restore environmental damages, and expenditure covered by third parties. For revaluation of provisions for post–employment obligations probabilities of retirement in different employees' aging groups as well as variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts) have been estimated. The probabilities and other factors are determined on the basis of previous experience. According to defined development directions per Strategy of Latvenergo Group for the period 2017-2022 approved the Strategic Development and Efficiency Programme. Provisions for employees' termination benefits are recognised on a basis of Strategic Development and Efficiency Programme of Latvenergo Group for the period in which it is planned to implement the efficiency programme (including Latvenergo AS and Sadales tīkls AS efficiency activities), by which it is intended to reduce gradually the number of employees by 2022. The key assumptions made to determine the amount of provisions are provided in Note 22.

f) Evaluation of effectiveness of hedging instruments

The Group and the Parent Company has concluded significant number of forward and future contracts and swap agreements to hedge the risk of the changes in prices of electricity and interest rate fluctuations to which cash flow hedge risk accounting is applied and the gains and losses from changes in the fair value of the effective hedging instruments and items secured against risk are included in respective equity reserve. The evaluation of the effectiveness of the hedging is based on Management's estimates with regard to future purchase transactions of electricity and signed variable interest loan agreements. When hedging instruments turn out to be ineffective, gains/losses from the changes in the fair value are recognised in the Statement of Profit or Loss (Note 21 c).

g) Held-to-maturity financial assets

The management applies judgement in assessing whether financial assets can be categorised as held–to–maturity at initial recognition, in particular (a) its intention and ability to hold the assets to maturity and (b) whether the assets are quoted in an active market. If the Group or the Parent Company fails to keep these investments to maturity other than in certain specific circumstances – for example, selling an insignificant amount or settle a position close to maturity – it will be required to reclassify the entire category as available–for–sale. The investments would therefore be measured at fair value rather than amortised cost. For the estimated fair value of investment securities held–to–maturity as of 31 December 2017 refer to Note 21a.

Evidence of an active market exists if quoted prices are readily and regularly available from an exchange, dealer, broker, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

h) Financial investments

The Group and the Parent Company has applied judgement in determining that it has a financial investment with 48.15% (the Parent Company: 46.30%) interest held in the company Pirmais Slēgtais Pensiju Fonds AS that manages closed pension plan in Latvia as investment that has been valued at cost. The Group and the Parent Company is only a nominal shareholder and do not have significant influence and control over Pirmais Slēgtais Pensiju Fonds AS even though it holds more than 20% of the voting rights as do not have power over its financial and operating policy decisions and all risks and benefits arising from management of pension plan will accrue to the employees who are members of the pension plan and the Group and the Parent Company does not have existing rights that give it the current ability to direct the relevant activities of the investee. The Group and the Parent Company do not have material transactions with its investee except the contributions made on behalf of employees and do not participate in policy-making process. Therefore, this investment has been determined as financial investment in Pirmais Slēgtais Pensiju Fonds AS and not as investment in associate.

i) Recognition of connection service fees to transmission system (IAS 17)

Connection fees to transmission system are recognised as income over the estimated lease period, which is 20 years. The estimated lease period is based on the Management estimate.

Income from connection to transmission system and other service fees is deferred as an ongoing service is identified as part of the agreement with the lessee. Operating lease agreement term is 5 years, the period over which revenue from connection fees is recognised is 20 years, as it is reasonably certain that assets, whose costs are partly reimbursed by connection fee will be leased for a longer period that original lease term.

Based on Management estimate 20 years is the estimated customer relationship period, which is estimated as period after which power output at each specific location would have to be changed due to technological reasons.

j) Lease classification

The Group and the Parent Company has entered into non-cancellable lease agreement and leases its property, plant and equipment. Based on an evaluation of the terms of the agreement, disclosed per Note 14 e, such as rights of the ownership is not transferred as determined by Energy law of the Republic of Latvia, that it retains all the significant risks and rewards of ownership of these assets, and accounts for the agreements as operating leases.

k) Recognition of one-off compensation in relation to Riga cogeneration power plants

In October 2017, the Parent Company applied for a one-off compensation from the state in the amount of EUR 454,413 thousand, at the same time opting out of the receipt of 75% of the annual electrical capacity payments for cogeneration power plants Riga combined heat and power plant Riga CHPP-1 and Riga CHPP-2. On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order No. 685 on one–off compensation to Latvenergo AS on guaranteed support for the installed capacity of cogeneration power plants, therefore the Parent Company obtained a government grant in the amount of EUR 454,413 thousand (see Note 23).

The grant is divided into two parts, it is considered that unconditional grant in amount of 140 000 thousand should be recognized as other income in the Group's and Latvenergo AS statement of profit or loss in 2017, while conditional grant in amount of EUR 314 413 million should be recognized as deferred income and to be allocated to income on a straight-line basis until fulfilling obligation till the end of the support period – September 23, 2028. The order No. 685 of the Cabinet of Ministers of the Republic of Latvia stipulates that fulfilling of obligations in accordance with Regulations No. 221 of Cabinet of Ministers of the Republic of Latvia in relation to the obtained grant is in even distribution over the coming reporting periods till the end of the support period.

5. Operating Segment Information

Operating segments

For segment reporting purposes, the division into operating segments is based on internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the operating segment decision maker.

The Group divides its operations into three main operating segments – generation and trade, distribution and lease of transmission system assets. The Parent Company divides its operations into one main operating segment – generation and trade.

In addition, corporate functions, that cover administration and other support services, are presented in the Group and the Parent Company as separate segment.

Generation and trade comprises the Group's electricity and thermal energy generation operations, which are organised into the legal entities: Latvenergo AS and Liepājas enerģija SIA; electricity trade (including electricity wholesale) in the Baltics carried out by Latvenergo AS, Elektrum Eesti OÜ and Elektrum Lietuva UAB, as well as administration of the mandatory procurement process provided by Enerģijas publiskais tirgotājs AS.

The operations of the distribution operating segment relates to the provision of electricity distribution services in Latvia and is managed by the subsidiary Sadales tīkls AS (the largest distribution system operator in Latvia) and by Latvenergo AS – the owner of real estate assets related to distribution system assets.

The operations of the lease of transmission system assets operating segment is managed both by Latvijas elektriskie tīkli AS – the owner of transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points), which provides financing of investments in these assets, and Latvenergo AS – the owner of real estate assets related to the transmission system assets, providing the lease of these assets to the transmission system operator Augstsprieguma tīkls AS.

The following table presents revenue, profit information and segment assets and liabilities of the Group's and the Parent Company's operating segments. Inter–segment revenue is eliminated on consolidation and reflected in the 'adjustments and eliminations' column. All transactions between segments are made on an arm's length principle.

EUR'000

	Group							Parent Company				
	Generation and trade	Distribution	Lease of transmission system assets	Corporate functions	TOTAL segments	Adjustments and eliminations	TOTAL Group	Generation and trade	Corporate functions	TOTAL segments	Adjustments and eliminations	TOTAL Parent Company
2017												
Revenue												
External customers	554,489	318,851	44,415	7,872	**925,627**	–	**925,627**	448,660	49,920	**498,580**	–	**498,580**
Inter–segment	1,605	1,851	2,541	52,739	**58,736**	(58,736)	**–**	346	29,089	**29,435**	(29,435)	**–**
TOTAL revenue	**556,094**	**320,702**	**46,956**	**60,611**	**984,363**	**(58,736)**	**925,627**	**449,006**	**79,009**	**528,015**	**(29,435)**	**498,580**
Results												
Amortisation, depreciation and intangible assets and property, plant and equipment impairment loss	(194,376)	(76,630)	(24,345)	(12,263)	**(307,614)**	–	**(307,614)**	(191,228)	(18,456)	**(209,684)**	–	**(209,684)**
Segment profit / (loss)	**178,453**	**34,969**	**20,960**	**(300)**	**234,082**	**(9,968)**	**224,114**	**171,306**	**6,110**	**177,416**	**8,490**	**185,906**
Segment assets at the end of the year	**1,956,888**	**1,641,318**	**500,863**	**85,584**	**4,184,653**	**231,072**	**4,415,725**	**1,286,478**	**192,435**	**1,478,913**	**2,170,287**	**3,649,200**
Segment liabilities at the end of the year	**393,759**	**188,025**	**67,502**	**6,551**	**655,837**	**912,997**	**1,568,834**	**383,708**	**8,695**	**392,403**	**874,159**	**1,266,562**
Capital expenditure	74,021	107,683	63,085	10,815	**255,604**	(11,793)	**243,811**	73,150	16,128	**89,278**	–	**89,278**
2016												
Revenue												
External customers	570,828	306,700	45,879	8,212	**931,619**	–	**931,619**	464,928	48,635	**513,563**	–	**513,563**
Inter–segment	13,310	1,712	2,538	46,330	**63,890**	(63,890)	**–**	342	23,060	**23,402**	(23,402)	–
TOTAL revenue	**584,138**	**308,412**	**48,417**	**54,542**	**995,509**	**(63,890)**	**931,619**	**465,270**	**71,695**	**536,965**	**(23,402)**	**513,563**
Results												
Amortisation, depreciation and intangible assets and property, plant and equipment impairment loss	(86,308)	(98,317)	(36,416)	(11,585)	**(232,626)**	–	**(232,626)**	(83,168)	(17,367)	**(100,535)**	–	**(100,535)**
Segment profit / (loss)	**138,185**	**7,154**	**10,642**	**4,792**	**160,773**	**(11,828)**	**148,945**	**130,840**	**10,231**	**141,071**	**15,219**	**156,290**
Segment assets at the end of the year	**1,557,032**	**1,629,107**	**448,707**	**88,431**	**3,723,277**	**177,954**	**3,901,231**	**1,372,835**	**183,922**	**1,556,757**	**1,647,637**	**3,204,394**
Segment liabilities at the end of the year	**63,404**	**190,371**	**46,218**	**7,380**	**307,373**	**1,175,145**	**1,482,518**	**58,318**	**20,453**	**78,771**	**948,554**	**1,027,325**
Capital expenditure	59,964	106,436	25,513	12,664	**204,577**	(3,900)	**200,677**	58,248	21,665	**79,913**	–	**79,913**

The Group's and the Parent Company's revenue from external customers (Note 6)

EUR'000

	Group						Parent Company			
	Gene-ration and trade	Distri-bution	Lease of transmis-sion system assets	Corporate functions	TOTAL Segments	TOTAL Group	Gene-ration and trade	Corporate functions	TOTAL segments	TOTAL Parent Company
Year ended 31 December 2017										
Revenue from contracts with customers recognised over time										
Trade of energy and related supply services	464,030	3,096	–	–	467,126	467,126	370,626	–	370,626	370,626
Distribution system services	1	301,873	–	–	301,874	301,874	–	–	–	–
Heat sales	83,156	75	–	8	83,239	83,239	71,413	9	71,422	71,422
Other revenue	7,300	13,681	–	6,124	27,105	27,105	6,620	33,990	40,610	40,610
Total revenue from contracts with customers	**554,487**	**318,725**	**–**	**6,132**	**879,344**	**879,344**	**448,659**	**33,999**	**482,658**	**482,658**
Other revenue										
Lease of transmission system assets (Note 14 e)	–	–	43,911	–	43,911	43,911	–	–	–	–
Lease of other assets	2	126	–	1,740	1,868	1,868	1	15,921	15,922	15,922
Other revenue	–	–	504	–	504	504	–	–	–	–
Total other revenue	**2**	**126**	**44,415**	**1,740**	**46,283**	**46,283**	**1**	**15,921**	**15,922**	**15,922**
TOTAL revenue, including	**554,489**	**318,851**	**44,415**	**7,872**	**925,627**	**925,627**	**448,660**	**49,920**	**498,580**	**498,580**
Latvia	404,136	318,851	44,415	7,272	774,674	774,674	386,513	48,407	434,920	434,920
Outside Latvia	150,353	–	–	600	150,953	150,953	62,147	1,513	63,660	63,660
Year ended 31 December 2016										
Revenue from contracts with customers recognised over time										
Trade of energy and related supply services	480,754	3,209	–	–	483,963	483,963	386,679	–	386,679	386,679
Distribution system services	2	290,082	–	–	290,084	290,084	–	–	–	–
Heat sales	82,628	73	–	8	82,709	82,709	71,086	7	71,093	71,093
Other revenue	7,442	13,193	–	6,488	27,123	27,123	7,163	33,196	40,359	40,359
Total revenue from contracts with customers	**570,826**	**306,557**	**–**	**6,496**	**883,879**	**883,879**	**464,928**	**33,203**	**498,131**	**498,131**
Other revenue										
Lease of transmission system assets (Note 14 e)	–	–	45,371	–	45,371	45,371	–	–	–	–
Lease of other assets	2	143	1	1,716	1,862	1,862	–	15,432	15,432	15,432
Other revenue	–	–	507	–	507	507	–	–	–	–
Total other revenue	**2**	**143**	**45,879**	**1,716**	**47,740**	**47,740**	**–**	**15,432**	**15,432**	**15,432**
TOTAL revenue	**570,828**	**306,700**	**45,879**	**8,212**	**931,619**	**931,619**	**464,928**	**48,635**	**513,563**	**513,563**
Latvia	432,443	306,700	45,879	7,392	792,414	792,414	430,080	46,962	477,042	477,042
Outside Latvia	138,385	–	–	820	139,205	139,205	34,848	1,673	36,521	36,521

Adjustments and eliminations

Finance income and expenses, fair value gains and losses on financial assets, financial instruments and deferred taxes are not allocated to individual segments as the underlying instruments are managed on a group basis. Taxes and certain financial assets and liabilities, including loans and borrowings are not allocated to those segments as they are also managed on a group basis.

Capital expenditure consists of additions of property, plant and equipment, intangible assets and investment properties including assets from the acquisition of subsidiaries.

Reconciliation of profit — EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Segment profit		**234,082**	**160,773**	**177,416**	**141,071**
Finance income	11 a	1,243	2,328	11,433	12,958
Finance costs	11 b	(11,211)	(14,156)	(12,054)	(14,772)
Dividends received from subsidiaries	15 a	–	–	9,111	17,033
Profit before tax		**224,114**	**148,945**	**185,906**	**156,290**

Reconciliation of assets — EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Segment operating assets		**4,184,653**	**3,723,277**	**1,478,913**	**1,556,757**
Connection usage rights		(26,652)	(32,791)	–	–
Non-current financial investments	15	40	40	817,048	817,048
Loans to subsidiaries	25 f	–	–	1,098,781	622,704
Held-to-maturity financial assets	21 a	16,984	20,554	16,984	20,554
Derivative financial instruments	21 c	4,619	6,134	4,619	6,134
Other assets and assets held for sale		78	37	–	–
Cash and cash equivalents	18	236,003	183,980	232,855	181,197
Operating assets		**4,415,725**	**3,901,231**	**3,649,200**	**3,204,394**

Reconciliation of liabilities — EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Segment operating liabilities		**655,837**	**307,373**	**392,403**	**78,771**
Deferred income tax liabilities	12	–	315,759	–	126,260
Current corporate income tax liabilities		27,725	17,718	24,739	16,549
Borrowings	21 b	826,757	791,566	814,772	778,323
Derivative financial instruments	21 c	8,084	11,586	8,084	11,586
Trade and other payables		50,431	38,516	26,564	15,836
Operating liabilities		**1,568,834**	**1,482,518**	**1,266,562**	**1,027,325**

Non–current assets that consist of intangible assets, property, plant and equipment and investment properties are located in the Group's country of domicile – Latvia as well as in Estonia and Lithuania.

Revenue from major customer in 2017 for the Group amounted to EUR 72,788 thousand and for the Parent Company EUR 72,785 thousand (2016: EUR 79,467 thousand and 98,637 thousand) arising from sales by the generation and trade segment.

6. Revenue

EUR'000

	IFRS or IAS applied	Group		Parent Company	
		2017	2016	2017	2016
Revenue from contracts with customers recognised over time					
Trade of energy and related supply services	IFRS 15	467,126	483,963	370,626	386,679
Distribution system services	IFRS 15	301,874	290,084	–	–
Heat sales	IFRS 15	83,239	82,709	71,422	71,093
Other revenue	IFRS 15	27,105	27,123	40,610	40,359
Total revenue from contracts with customers		**879,344**	**883,879**	**482,658**	**498,131**
Other revenue					
Lease of transmission system assets (Note 14 e)	IAS 17	43,911	45,371	–	–
Lease of other assets (Note 14 e)	IAS 17	1,868	1,862	15,922	15,432
Other revenue	IAS 17	504	507	–	–
Total other revenue		**46,283**	**47,740**	**15,922**	**15,432**
TOTAL revenue		**925,627**	**931,619**	**498,580**	**513,563**

The Group and the Parent Company derives revenue from contracts with customers from Latvia and outside Latvia.

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Latvia	728,991	745,494	421,124	463,961
Outside Latvia	150,353	138,385	61,534	34,170
TOTAL revenue from contracts with customers	**879,344**	**883,879**	**482,658**	**498,131**

Gross amounts transferred to customers by applying agent accounting principle (see Note 4 d), recognized on net basis under trade of energy and related supply services:

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Mandatory procurement PSO fees	114,299	121,764	119,562	125,831
Distribution system services	10,125	2,425	217,999	224,859
Transmission system services	1,750	1,561	1,783	1,615
TOTAL revenue recognised applying agent accounting principle	**126,174**	**125,750**	**339,344**	**352,305**

The Group has recognised the following liabilities from contracts with customers:

EUR'000

	31/12/2017	01/01/2017	31/12/2016
Non–current contract liabilities on deferred income from connection fees (Note 23 I, a)	142,132	141,817	141,817
Current contract liabilities on deferred income from connection fees (Note 23 II, a)	12,247	11,605	11,605
Contract liabilities – deferred income from use of allowed effective electrical load (distribution system services)	253	10	–
TOTAL liabilities	**154,632**	**153,432**	**153,422**

Movement in deferred connection fees – contract liability from contracts with customers for the Group (non–current and current part):

EUR'000

	2017	2016
At the beginning of the year	**153,432**	**153,643**
Received fees	12,848	11,097
Credited to the Statement of Profit or Loss	(11,648)	(11,318)
Charged to the retained earnings	–	10
At the end of the year	**154,632**	**153,432**

In 2017 contract liabilities on deferred income from distribution system services has increased by EUR 243 thousand as expected that the customers who have qualified for 0.5 tariffs for distribution system services from efficient use of permitted load will reach its determined consumption level in the next financial year. This amount was charged to the Statement of Profit or Loss as reduction of distribution system services revenues (see Note 2.29.).

The Group has recognised in year 2017 distribution system services revenues from all contract liabilities and at the beginning of the year cumulative effect in retained earnings upon modified retrospective approach in amount of EUR 10 thousand.

7. Other Income

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
One–off compensation from the state on state support for the installed capacity of CHPPs*	140,000	–	140,000	–
Net gain from sale of assets held for sale and PPE	254	635	929	503
Net gain from sale of current assets and other income	9,696	6,021	6,573	2,612
TOTAL other income	**149,950**	**6,656**	**147,502**	**3,115**

* information about compensation is disclosed in Note 23

8. Raw Materials and Consumables Used

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Electricity:				
Purchased electricity	124,521	148,453	27,094	48,083
Fair value loss / (income) on electricity forwards and futures (Note 21 c, III)	3,435	(6,515)	3,435	(6,515)
Electricity transmission services costs	71,044	72,584	845	1,009
	199,000	**214,522**	**31,374**	**42,577**
Energy resources costs	118,185	137,720	112,248	131,952
Raw materials, spare parts and maintenance costs	29,726	33,572	10,332	11,729
TOTAL raw materials and consumables used	**346,911**	**385,814**	**153,954**	**186,258**

9. Personnel Expenses

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Wages and salaries	74,453	71,848	31,233	29,375
Expenditure of employment termination	15,086	1,522	3,845	600
Pension costs – defined contribution plan	2,225	2,301	901	938
State social insurance contributions and other benefits defined in the Collective Agreement	18,574	17,887	7,685	7,200
Life insurance costs	3,131	2,670	1,228	1,052
Capitalised personnel expenses	(180)	(209)	–	–
TOTAL personnel expenses, including remuneration to the management	**113,289**	**96,019**	**44,892**	**39,165**
Including remuneration to the management:				
Wages and salaries	1,880	1,531	865	644
Expenditure of employment termination	206	22	–	–
Pension costs – defined contribution plan	30	36	–	7
State social insurance contributions and other benefits defined in the Collective Agreement	451	367	206	152
Life insurance costs	26	22	7	8
TOTAL remuneration to the management*	**2,593**	**1,978**	**1,078**	**811**

* remuneration to the Group's management includes remuneration to the members of the Management Boards of the Group entities, the Supervisory Board and the Supervisory body (Audit Committee) of the Parent Company. Remuneration to the Company's management includes remuneration to the members of the Company's Management Board, the Supervisory Board and the Supervisory body (Audit Committee)

	Group		Parent Company	
	2017	2016	2017	2016
Number of employees at the end of the year	3,908	4,131	1,431	1,472
Average number of employees during the year	4,075	4,176	1,467	1,478

10. Other Operating Expenses

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Selling expenses and customer services	6,210	7,524	4,817	5,590
Information technology maintenance	5,143	4,974	4,931	4,730
Transportation expenses	6,204	6,125	2,185	2,228
Environment protection and work safety	11,900	4,507	11,205	3,852
Real estate maintenance and utilities expenses	8,261	6,226	7,825	6,424
Telecommunications services	2,224	1,974	2,552	2,303
Electric power transit and capacity services	303	294	4	4
Real estate tax	1,086	1,091	1,074	1,073
Public utilities regulation fee	1,996	1,486	932	780
Subsidised energy tax (SET)*	15,087	14,847	14,859	14,650
Audit fee**	93	89	38	41
Other expenses	15,174	13,906	9,714	7,974
TOTAL other operating expenses	**73,681**	**63,043**	**60,136**	**49,649**

* subsidised energy tax according to the "Subsidised energy tax Law" has been introduced for a four–year period as of 1 January 2014 and applies to state support for generators of subsidised electricity (Note 2.17.)

** audit fee consists from audit of the Group's entities financial statements in the amount of EUR 85 thousand; Parent Company - EUR 30 thousand (2016: EUR 80 thousand; Parent Company - EUR 32 thousand)) and audit of The Group's Sustainability report and financial covenants - EUR 8 thousand (2016: EUR 9 thousand)

11. Finance Income and Costs

a) Finance income

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Interest income on bank accounts and deposits	16	45	17	40
Interest income on loans to subsidiaries	–	–	10,189	10,635
Interest income from held–to–maturity financial assets	1,085	1,414	1,085	1,414
Fair value gain on interest rate swaps (Note 21 c, II)	–	760	–	760
Net gain on issued debt securities (bonds)	120	83	120	83
Net gain from currency exchange rate fluctuations	22	26	22	26
TOTAL finance income	**1,243**	**2,328**	**11,433**	**12,958**

b) Finance costs

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Interest expense on borrowings	3,883	5,185	4,744	5,819
Interest expense on issued debt securities (bonds)	4,753	4,701	4,753	4,701
Interest expense on interest rate swaps	3,760	4,922	3,760	4,922
Net losses on redemption of held–to–maturity financial assets	50	58	50	58
Capitalised borrowing costs (Note 14 a)	(1,359)	(780)	(1,359)	(780)
Other finance costs	124	70	106	52
TOTAL finance costs	**11,211**	**14,156**	**12,054**	**14,772**

12. Income Tax

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Current income tax for the year	51,199	23,498	45,097	20,331
Deferred income tax relating to origination and reversal of temporary differences	(20,083)	(5,146)	(20,187)	(1,482)
Reversal of deferred tax	(129,023)	–	10,105	–
TOTAL income tax	**(97,907)**	**18,352**	**35,015**	**18,849**

The movement on the deferred income tax accounts

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Deferred tax liabilities at the beginning of the year	**315,759**	**273,987**	**126,260**	**127,899**
Attributable to re–measurement on defined post–employment benefit plan (Note 22 a)	–	(638)	–	(157)
Attributable to non–current assets revaluation reserve in equity (Note 20 a)	3,325	47,556	3,325	–
Income credited to the Statement of Profit or Loss	(20,083)	(5,146)	(20,187)	(1,482)
Deferred tax liabilities at the end of the year before reversal	**299,001**	**315,759**	**109,398**	**126,260**
Reversed to the Statement of Comprehensive Income	(169,978)	–	(119,503)	–
Reversed in the Statement of Profit or Loss	(129,023)	–	10,105	–
Deferred tax liabilities at the end of the year	**–**	**315,759**	**–**	**126,260**

Deferred income tax has been calculated from the following temporary differences between assets and liabilities values for financial reporting and tax purposes:

EUR'000

	Statement of Financial Position				Statement of Profit or Loss			
	Group		Parent Company		Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016	2017	2016	2017	2016
Deferred corporate income tax liabilities								
Accelerated depreciation for tax purposes	133,103	151,871	(8,403)	10,820	(18,768)	(6,947)	(19,223)	(2,726)
Attributable to non-current assets revaluation reserve	169,560	167,007	119,384	116,370	–	–	–	–
Attributable to re-measurement on defined post-employment benefit plan	–	(354)	(35)	(227)	–	–	–	–
Gross deferred corporate income tax liabilities	**302,663**	**318,524**	**110,946**	**126,963**	**(18,768)**	**(6,947)**	**(19,223)**	**(2,726)**
Deferred corporate income tax assets								
Tax loss carried forward	–	(226)	–	–	226	487	–	10
Accrued personnel expenses	(3,594)	(2,552)	(1,414)	(959)	(1,044)	207	(456)	153
Provisions for derivative financial instruments	78	594	78	594	(515)	1,091	(515)	1,091
Provisions for impaired inventories	(224)	(249)	(148)	(159)	25	(7)	11	(5)
Other provisions	(340)	(332)	(183)	(179)	(7)	23	(4)	(5)
Gross deferred corporate income tax assets	**(4,080)**	**(2,765)**	**(1,667)**	**(703)**	**(1,315)**	**1,801**	**(964)**	**1,244**
Net deferred corporate income tax liabilities before reversal	**298,583**	**315,759**	**109,279**	**126,260**	**–**	**–**	**–**	**–**
Net deferred corporate income tax income before reversal	**–**	**–**	**–**	**–**	**(20,083)**	**(5,146)**	**(20,187)**	**(1,482)**
Reversal of deferred tax*:								
In Statement of Profit or Loss	(129,023)	–	10,105	–	(129,023)	–	10,105	–
In reserves (Note 20 a)	(169,560)	–	(119,384)	–	–	–	–	–
Net deferred corporate income tax (liabilities)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Net income from deferred corporate income tax	**–**	**–**	**–**	**–**	**(149,106)**	**(5,146)**	**(10,082)**	**(1,482)**

* deferred tax liabilities for the year 2017 are reversed from the Statement of Profit or Loss and from reserves, as they have initially been recorded in the Statement of profit or loss and reserves, respectively, pursuant to amendments made to the tax legislation of the Republic of Latvia, which entered into force on 1 January 2018

Actual corporate income tax charge for the reporting year, if compared with theoretical calculations:

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Profit before tax	**224,114**	**148,945**	**185,906**	**156,290**
Tax at the applicable tax rate of 15%	33,617	22,342	27,886	23,444
Permanent differences:				
Received dividends from subsidiaries	–	–	(1,367)	(2,555)
Non-operating expenses	272	266	120	115
Other expenses	17,310	890	18,458	(673)
Deferred income tax relating to origination and reversal of temporary differences	(20,083)	(5,146)	(20,187)	(1,482)
Actual corporate income tax for the reporting year	**31,116**	**18,352**	**24,910**	**18,849**
Reversal of deferred tax	(129,023)	–	10,105	–
TOTAL income tax	**(97,907)**	**18,352**	**35,015**	**18,849**
Effective income tax rate	**13.9%**	**12.3%**	**13.4%**	**12.1%**

13. Intangible Assets

a) Intangible assets

EUR'000

	Group				Parent Company			
	Usage rights, licences	Soft-ware	Assets under devel-opment	TOTAL	Usage rights, licences	Soft-ware	Assets under devel-opment	TOTAL
As of 31 December 2015								
Cost	2,507	44,038	343	**46,888**	10,888	41,588	202	**52,678**
Accumulated amortisation	(1,859)	(30,624)	–	**(32,483)**	(3,182)	(29,650)	–	**(32,832)**
Net book amount	**648**	**13,414**	**343**	**14,405**	**7,706**	**11,938**	**202**	**19,846**
Year ended 31 December 2016								
Additions	–	966	2,737	**3,703**	1	758	1,933	**2,692**
Transfers	–	1,568	(1,568)	**–**	(48)	1,568	(1,568)	**(48)**
Disposals	(211)	–	–	**(211)**	(698)	–	–	**(698)**
Amortisation charge	–	(3,363)	–	**(3,363)**	–	(3,023)	–	**(3,023)**
Closing net book amount	**437**	**12,585**	**1,512**	**14,534**	**6,961**	**11,241**	**567**	**18,769**
As of 31 December 2016								
Cost	2,507	45,631	1,512	**49,650**	10,796	43,912	567	**55,275**
Accumulated amortisation	(2,070)	(33,046)	–	**(35,116)**	(3,835)	(32,671)	–	**(36,506)**
Net book amount	**437**	**12,585**	**1,512**	**14,534**	**6,961**	**11,241**	**567**	**18,769**
Year ended 31 December 2017								
Additions	–	468	2,120	**2,588**	–	468	2,063	**2,531**
Transfers	–	3,536	(3,536)	**–**	–	2,589	(2,589)	**–**
Disposals	(212)	–	–	**(212)**	(656)	–	–	**(656)**
Amortisation charge	–	(3 ,497)	–	**(3,497)**	–	(3,183)	–	**(3,183)**
Closing net book amount	**225**	**13,092**	**96**	**13,413**	**6,305**	**11,115**	**41**	**17,461**
As of 31 December 2017								
Cost	225	49,635	96	**49,956**	6,305	46,969	41	**53,315**
Accumulated amortisation	–	(36,543)	–	**(36,543)**	–	(35,854)	–	**(35,854)**
Net book amount	**225**	**13,092**	**96**	**13,413**	**6,305**	**11,115**	**41**	**17,461**

b) Greenhouse gas emission allowances

	Group		Parent Company	
	Number of allowances		Number of allowances	
	2017	2016	2017	2016
At the beginning of the year	**795,153**	**1,516,203**	**546,409**	**1,220,761**
Allowances allocated free of charge	314,160	364,488	295,942	343,330
Purchased allowances	–	117,400	–	117,400
Used allowances	(871,982)	(1,129,538)	(855,429)	(1,112,682)
Sold allowances	(30,700)	(73,400)	(700)	(22,400)
At the end of the year	**206,631**	**795,153**	**(13,778)**	**546,409**

Allowances are allocated free of charge in accordance with the law "On Pollution" and Directives of the Ministry of Environmental Protection and Regional Development of the Republic of Latvia and are recognised as off–balance sheet assets.

As of 31 December 2017 the number of allowances in the Group received in 2017 from the Government free of charge was 314,160 (31/12/2016: 364,488), the number of allowances Latvenergo AS received in 2017 from the Government free of charge was 295,942 (31/12/2016: 343,330). Therefore, their carrying amount as of 31 December 2017 was nil (31/12/2016: nil).

The fair value of greenhouse gas emission allowances as of 31 December 2017 for the Group was EUR 1,670 thousand (31/12/2016: EUR 5,208 thousand). Latvenergo AS has a shortage of allowance at the same date, a respective liability of EUR 112 thousand is recognised (31/12/2016 fair value of allowances: EUR 3,579 thousand). For estimation of the fair value of allowances was used fixed daily price in ICE (the Intercontinental Exchange) for European Union Allowances (EUA) on 29 December 2017 what was the last trade date in 2017 – 8.14 EUR/t (30/12/2016: 6.55 EUR/t).

Received European Union Allowances (EUA) must be used until the end of 2020.

From greenhouse gas emission allowances purchased for the Group in 2017 are sold 30.7 thousand (2016: 73.4 thousand) and for the Latvenergo AS in 2017 are sold 0.7 thousand (2016: 22.4 thousand).

14. Property, Plant and Equipment

a) Property, plant and equipment

Net book amounts and movements of property, plant and equipment by groups, including groups of revalued categories (see Note 2.8.) are as follows:

EUR'000

	Group					Parent Company				
	Land, buildings and facilities	Technology equipment and machinery	Other PPE	Assets under construction and advance payments	Property, plant and equipment TOTAL	Land, buildings and facilities	Technology equipment and machinery	Other PPE	Assets under construction and advance payments	Property, plant and equipment TOTAL
As of 31 December 2015										
Cost or valuation	4,469,448	2,072,520	173,118	93,858	**6,808,944**	1,835,378	931,181	148,126	68,046	**2,982,731**
Accumulated depreciation and impairment	(2,455,220)	(1,149,878)	(121,484)	(6,106)	**(3,732,688)**	(976,255)	(546,822)	(109,102)	(5,882)	**(1,638,061)**
Net book amount	**2,014,228**	**922,642**	**51,634**	**87,752**	**3,076,256**	**859,123**	**384,359**	**39,024**	**62,164**	**1,344,670**
Year ended 31 December 2016										
Increase due PPE revaluation (Note 20 a)	303,933	12,954	154	–	**317,041**	–	–	–	–	**–**
Decrease due PPE revaluation	(25,816)	(9,909)	(49)	–	**(35,774)**	–	–	–	–	**–**
Additions	–	–	–	196,838	**196,838**	–	–	–	73,196	**73,196**
Invested in share capital (Note 19)*	177	7	–	–	**184**	177	7	–	–	**184**
Transfers	72,299	39,680	24,784	(136,763)	**–**	4,231	5,562	12,104	(21,849)	**48**
Reclassified to investment property	(214)	–	–	–	**(214)**	(195)	–	–	–	**(195)**
Disposals	(2,819)	(1,987)	(199)	(40)	**(5,045)**	(140)	(223)	(10)	(39)	**(412)**
Impairment charge	–	(10,140)	–	116	**(10,024)**	–	(10,140)	–	24	**(10,116)**
Depreciation	(89,432)	(79,609)	(14,424)	–	**(183,465)**	(27,879)	(45,604)	(11,374)	–	**(84,857)**
Closing net book amount	**2,272,356**	**873,638**	**61,900**	**147,903**	**3,355,797**	**835,317**	**333,961**	**39,744**	**113,496**	**1,322,518**
As of 31 December 2016										
Cost or valuation	4,615,210	2,059,129	186,442	153,893	**7,014,674**	1,833,638	925,505	150,827	119,354	**3,029,324**
Accumulated depreciation and impairment	(2,342,854)	(1,185,491)	(124,542)	(5,990)	**(3,658,877)**	(998,321)	(591,544)	(111,083)	(5,858)	**(1,706,806)**
Net book amount	**2,272,356**	**873,638**	**61,900**	**147,903**	**3,355,797**	**835,317**	**333,961**	**39,744**	**113,496**	**1,322,518**
Year ended 31 December 2017										
Increase/(decrease) due PPE revaluation (Note 20 a)	(23,337)	48,261	(2,757)	–	**22,167**	(23,337)	48,261	(2,757)	–	**22,167**
Decrease due PPE revaluation	(1,162)	(993)	(105)	–	**(2,260)**	(1,162)	(993)	(105)	–	**(2,260)**
Additions	–	–	–	241,220	**241,220**	–	–	–	84,373	**84,373**
Transfers	85,841	63,460	16,728	(166,029)	**–**	17,348	37,634	9,693	(64,675)	**–**
Reclassified to investment property	(1,182)	–	–	–	**(1,182)**	(1,059)	–	–	–	**(1,059)**
Reclassified from investment property	–	–	–	–	**–**	8,335	–	–	–	**8,335**
Disposals	(2,953)	(1,513)	(97)	(337)	**(4,900)**	(40)	(78)	(35)	(334)	**(487)**
Impairment charge	(261)	(116,799)	–	814	**(116,246)**	(261)	(116,799)	–	803	**(116,257)**
Depreciation	(85,710)	(82,906)	(16,995)	–	**(185,611)**	(23,815)	(50,217)	(11,844)	–	**(85,876)**
Closing net book amount	**2,243,592**	**783,148**	**58,674**	**223,571**	**3,308,985**	**811,326**	**251,769**	**34,696**	**133,663**	**1,231,454**
As of 31 December 2017										
Cost or valuation	4,567,205	2,313,351	199,880	228,748	**7,309,184**	1,769,280	1,184,339	157,609	138,718	**3,249,946**
Accumulated depreciation and impairment	(2,323,613)	(1,530,203)	(141,206)	(5,177)	**(4,000,199)**	(957,954)	(932,570)	(122,913)	(5,055)	**(2,018,492)**
Net book amount	**2,243,592**	**783,148**	**58,674**	**223,571**	**3,308,985**	**811,326**	**251,769**	**34,696**	**133,663**	**1,231,454**

* in December 2016, in accordance with the Directive No. 693 of the Cabinet of Ministers of the Republic of Latvia, dated 22 November 2016 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 184 thousand was invested in the share capital of Latvenergo AS

Impairment charge is included in the Statement of Profit or Loss under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

As of 31 December 2017 cost of fully depreciated PPE which are still in use for the Group amounted to EUR 237,692 thousand (31/12/2016: EUR 266,463 thousand) and for the Parent Company amounted to EUR 194,531 thousand (31/12/2016: EUR 242,479 thousand).

In 2017 the Group and the Parent Company has capitalised borrowing costs in the amount of EUR 1,359 thousand (2016: EUR 780 thousand) (see Note 11 b). Rate of capitalised borrowing costs was of 1.23% (2016: 1.29%).

Information about the pledged property, plant and equipment is disclosed in Note 21 b, l.

b) Investment property

Land or a building or part of a building held by the Group and the Parent Company as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business, after decision of the Group's or the Parent Company's management are initially recognised as investment properties at cost and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses (Note 2.7.).

EUR'000

	Group		Parent Company					
	Investment property		Investment properties for lease		Investment property held for sale		TOTAL Investment property	
	2017	2016	2017	2016	2017	2016	2017	2016
Net book amount at the beginning of the year	**563**	**696**	**72,335**	**71,041**	**498**	**522**	**72,833**	**71,563**
Additions	–	–	2,373	3,842	–	–	2,373	3,842
Reclassified to investment property held for capital appreciation	–	–	(125)	(167)	125	167	–	–
Reclassified from property, plant and equipment to investment property	1,182	214	–	178	1,059	17	1,059	195
Reclassified to property, plant and equipment	–	–	(8,335)	–	–	–	(8,335)	–
Disposal	(1)	(1)	(33)	(20)	(1)	–	(34)	(20)
Sold	(284)	(504)	–	–	(275)	(373)	(275)	(373)
Impairment charge	(685)	187	–	–	(685)	187	(685)	187
Depreciation	(22)	(29)	(2,108)	(2,539)	(21)	(22)	(2,129)	(2,561)
Net book amount at the end of the year	**753**	**563**	**64,107**	**72,335**	**700**	**498**	**64,807**	**72,833**

c) Property, plant and equipment revaluation

In 2016 the Group finished revaluation process with the revaluation of groups of distribution system facilities determining amounts of revalued assets as of 1 April 2016. Valuation have been done by independent certified valuator by applying the depreciated replacement cost model. Replacement cost for distribution system electrical lines is based on Sadales tīkls AS aggregate construction costs in 2015, by electricity lines type and region. As a result of revaluation in 2016 the carrying amounts of revalued distribution system property, plant and equipment increased by EUR 262,541 thousand.

In 2016 the Group accomplished revaluation process for property, plant and equipment of transmission system determining amounts of revalued assets as of 1 April 2016. Valuation have been done by independent certified valuator by applying the depreciated replacement cost model. To determine changes in initial replacement costs for transmission system assets were taken into consideration changes in cost of workforce and materials since revaluation of the assets in 2011, accordingly as well determining the ratio of workforce costs for each group. As a result of revaluation in 2016 the carrying amounts of revalued transmission system property, plant and equipment increased by EUR 18,726 thousand.

Revaluation on Latvenergo AS property, plant and equipment of Daugava hydropower plants had been determined as of 1 April 2017. Valuation have been done by independent certified valuator using the income method. Income method is based on the identification and analysis of generation capacity, forecasting of electricity trade prices, analysis of historical generation and operating expenses and forecast of future costs, capital expenditure, net cash flows, as well calculation of discount and capitalisation rates, based on market data.

As a result of revaluation in 2017 the carrying amounts of property, plant and equipment of Daugava hydropower plants increased by EUR 19,907 thousand. Increase of property, plant and equipment in the amount of EUR 22,167 thousand, less deferred income tax, is included in the equity as non-current assets revaluation reserve (see Note 20 a), while impairment charge due to property, plant and equipment revaluation in the amount of EUR 2,260 thousand – in the Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment.

The carrying amounts of revalued categories of property, plant and equipment groups (see Note 2.8.) at revalued amounts and their cost basis are as follows:

EUR'000

	Group				Parent Company			
	Revalued property, plant and equipment groups				Revalued property, plant and equipment groups			
	Revalued buildings and facilities	Revalued technology equipment and machinery	Revalued other equipment	TOTAL revalued PPE	Revalued buildings and facilities	Revalued technology equipment and machinery	Revalued other equipment	TOTAL revalued PPE
AT REVALUED AMOUNTS								
As of 31 December 2016								
Revalued	4,150,707	1,433,417	30,406	**5,614,530**	1,515,376	324,771	15,769	**1,855,916**
Accumulated depreciation	(2,205,076)	(815,208)	(18,084)	**(3,038,368)**	(907,067)	(229,374)	(9,647)	**(1,146,088)**
Revalued net book amount	**1,945,631**	**618,209**	**12,322**	**2,576,162**	**608,309**	**95,397**	**6,122**	**709,828**
As of 31 December 2017								
Revalued	4,087,589	1,673,602	37,908	**5,799,099**	1,424,022	568,670	21,921	**2,014,613**
Accumulated depreciation	(2,174,197)	(1,009,021)	(28,629)	**(3,211,847)**	(852,544)	(420,294)	(19,176)	**(1,292,014)**
Revalued net book amount	**1,913,392**	**664,581**	**9,279**	**2,587,252**	**571,478**	**148,376**	**2,745**	**722,599**
AT AMOUNTS STATED ON HISTORICAL COST BASIS								
As of 31 December 2016								
Cost	1,151,577	755,462	26,403	**1,933,442**	127,520	152,449	13,030	**292,999**
Accumulated depreciation	(324,536)	(347,718)	(16,092)	**(688,346)**	(42,065)	(113,718)	(9,822)	**(165,605)**
Net book amount	**827,041**	**407,744**	**10,311**	**1,245,096**	**85,455**	**38,731**	**3,208**	**127,394**
As of 31 December 2017								
Cost	1,200,277	785,849	33,994	**2,020,120**	129,353	169,405	13,096	**311,854**
Accumulated depreciation	(330,719)	(354,280)	(17,739)	**(702,738)**	(59,492)	(120,245)	(10,378)	**(190,115)**
Net book amount	**869 558**	**431 569**	**16 255**	**1 317 382**	**69 861**	**49 160**	**2 718**	**121 739**

* for revalued property, plant and equipment groups see Note 2.8.

d) Impairment

I) Riga combined heat and power plants (Riga CHPPs)

Impairment review performed for Riga CHPPs is based on value in use calculations. The cash–generating unit is defined as the assets of Riga CHPPs.

In October 2017, Latvenergo AS applied for a one-off compensation from the state, at the same time opting out of the receipt of 75% of the annual electrical capacity payments for cogeneration power plants Riga CHPP–1 and Riga CHPP–2 (Note 23). On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order which supports the reduction of the guaranteed support payments during the remaining support period for the installed capacity of Riga CHPPs. According to the order, Latvenergo AS obtained a government grant in the amount of EUR 454,413 thousand. The grant is divided into two parts, with the stipulation that EUR 140,000 thousand should be recognized as 'Other income' in the Group's and Latvenergo AS statement of profit or loss in 2017, while EUR 314,413 thousand should be recognized as deferred income in even distribution over the coming reporting periods and fulfilling obligations until the end of the support period.

As a result of the above transactions, additional impairment in the amount of EUR 116,799 thousand was recognised for Riga CHPPs in 2017. The recognised impairment charge is included in the Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

Value in use is determined by evaluating the future cash flows expected to be derived from an asset. Forecasted period is 2018 – 2028 and the terminal value appraisal, evaluated as a fraction of the balance sheet's assets value, is included. Revenue stream forecast mainly corresponds to the remaining intensity of electrical capacity payments and the support period till September 23, 2028, as it is set out in regulations by Cabinet of Ministers of the Republic of Latvia No. 221, dated 10 March 2009. The forecast of expenses is based on historical data, the budget approved by the management for 2018, the service maintenance agreements and assumed inflation. As a result of calculation, the future revenue stream is close to the amount of expenses – cash generating unit's value in use is insignificant. Nominal pre–tax discount rate used to determine value in use of cash–generating unit by discounting cash flows is 7.5% (2016: 7.8%).

The accumulated impairment as of 31 December 2017 amounted to EUR 220,709 thousand (31/12/2016: EUR 103,910 thousand). In 2016, additional impairment of EUR 10,140 thousand was recognised due to the forecasted tighter competition in the Riga heat market, which in turn have a negative impact on the cogeneration electricity output of the Riga CHPPs.

II) Distribution system assets (Group)

Impairment review based on value in use calculations is performed for electricity distribution system assets. As a result of impairment test there is no impairment loss to be recognised (2016: nil). The cash–generating unit is defined as all distribution system assets. Nominal pre–tax discount rate used to determine value in

use of cash–generating units by discounting cash flows is 5.3% (2016: 5.1%) as included in the electricity distribution system service tariff calculation methodology. Revenue stream forecasts are based on the tariff calculation methodology and assumptions related investment plans. The forecast of expenses and investments is based on historical data, the budgets approved by the management and assumed inflation. The growth rate used for the terminal value appraisal is in line with the assumed distributed electricity growth.

III) Transmission system assets (Group)

Impairment review based on value in use calculations is performed for electricity transmission system assets. As a result of impairment test there is no impairment loss to be recognised (2016: nil). The cash–generating unit is defined as all transmission system assets. Nominal pre–tax discount rate used to determine value in use of cash–generating units by discounting cash flows is 5.3% (2016: 5.1%) as included in electricity transmission system service tariff calculation methodology. Revenue stream forecasts are based on the tariff calculation methodology and assumptions related investment plans. The forecast of expenses and investments is based on historical data, the budgets approved by the management and assumed inflation. The growth rate used for the terminal value appraisal is in line with the assumed transmitted electricity growth.

IV) Daugava hydropower plants (HPPs)

Impairment review based on value in use calculations is performed for Daugava HPPs at the end of reporting period and there is no impairment loss to be recognised in addition to impairment already recognized as part of HPPs revaluation (Note 14 c). The cash–generating unit is defined as Daugava HPPs assets. Nominal pre–tax discount rate used to determine value in use of cash–generating units by discounting cash flows is 9.0%. Revenue stream forecasts are based on the most recent long-term forecasts of electricity prices and long-term output of electricity. The forecast of expenses and investments is based on historical data, the budget approved by the management for 2018 and assumed inflation. The growth rate used for the terminal value appraisal is in line with the assumed inflation.

e) Leases

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Rental income (the Group or the Parent Company is the lessor) (Note 6)	**45,779**	**47,233**	**15,922**	**15,432**
of which,				
Transmission system assets lease	43,911	45,371	–	–
Rental expense (the Group or the Parent Company is the lessee)	**1,577**	**1,274**	**1,267**	**1,296**

Future minimum lease receivables under non–cancellable operating lease contracts by due dates (the Group and the Company is the lessor)

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
– < 1 year	41,149	48,206	17,118	17,779
– 1–5 years	199,012	195,914	66,924	70,163
– > 5 years	244,546	240,732	93,694	98,228
TOTAL rental income	**484,707**	**484,852**	**177,736**	**186,170**

Transmission system assets had been leased out by the Group to Augstsprieguma tīkls AS under non–cancellable operating lease agreement.

Future minimum lease payments under non–cancellable operating lease contracts by due dates (the Group and the Parent Company is the lessee)

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
– < 1 year	1,628	1,420	1,418	1,350
– 1–5 years	6,512	6,018	5,672	6,453
– > 5 years	9,768	9,038	9,075	10,325
TOTAL rental expense	**17,908**	**16,476**	**16,165**	**18,128**

15. Non–Current Financial Investments

Name	Country of incor-poration	Business activity held	31/12/2017 Interest held,%	31/12/2017 EUR'000	31/12/2016 Interest held,%	31/12/2016 EUR'000
Subsidiaries (Parent Company):						
Latvijas elektriskie tīkli AS	Latvia	Lease of transmission system assets	100%	185,624	100%	185,624
Sadales tīkls AS	Latvia	Electricity distribution	100%	627,656	100%	627,656
Enerģijas publiskais tirgotājs AS	Latvia	Administration of mandatory electricity procurement process	100%	40	100%	40
Elektrum Eesti OÜ	Estonia	Electricity trade & gas	100%	35	100%	35
Elektrum Lietuva, UAB	Lithuania	Electricity trade	100%	98	100%	98
Liepājas enerģija SIA	Latvia	Thermal energy generation and trade in Liepaja, electricity generation	51%	3,556	51%	3,556
Other non–current financial investments (Group):				**817,009**		**817,009**
Pirmais Slēgtais Pensiju Fonds AS	Latvia	Management of pension plans	48.15%	37	48.15%	37
Rīgas siltums AS	Latvia	Thermal energy generation and trade in Riga, electricity generation	0.0051%	3	0.0051%	3
				40		**40**

The Group owns 48.15% of the shares of the closed pension fund Pirmais Slēgtais Pensiju Fonds AS (Latvenergo AS – 46.30%). However, the Group and the Parent Company is only a nominal shareholder as all risks and benefits arising from associate's activities will accrue to the employees who are members of the pension fund. Therefore, investment in Pirmais Slēgtais Pensiju Fonds AS is valued at cost.

a) Investments in subsidiaries (Parent Company)

Movement in investments in subsidiaries

EUR'000

	Parent Company	
	2017	2016
At the beginning of the year	**817,009**	**817,009**
At the end of the year	**817,009**	**817,009**

Share of profit of subsidiaries

EUR'000

	2017	2016
Dividends received		
Latvijas elektriskie tīkli AS	6,852	14,880
Sadales tīkls AS	3	–
Elektrum Lietuva, UAB	542	528
Elektrum Eesti OÜ	264	192
Liepājas enerģija SIA	1,450	1,433
	9,111	**17,033**

EUR'000

	Equity		Net profit / (loss) for the year		Carrying amount of interest from investment	
Name	**31/12/2017**	**31/12/2016**	**2017**	**2016**	**31/12/2017**	**31/12/2016**
Subsidiaries						
Latvijas elektriskie tīkli AS*	269,801	221,675	50,463	6,850	185,624	185,624
Sadales tīkls AS*	993,329	820,992	124,268	(79)	627,656	627,656
Enerģijas publiskais tirgotājs AS	40	40	–	–	40	40
Elektrum Eesti OÜ	904	936	232	264	35	35
Elektrum Lietuva, UAB	859	920	481	542	98	98
Liepājas enerģija SIA	16,413	14,458	4,799	3,159	3,556	3,556
	1,281,346	**1,059,021**	**180,243**	**10,736**	**817,009**	**817,009**

* re-measured according to applied IFRS after first time adoption of IFRS

b) Other non–current financial investments

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Other non–current financial investments				
Investment in Pirmais Slēgtais Pensiju Fonds AS	37	37	36	36
Investment in Rīgas siltums AS	3	3	3	3
	40	**40**	**39**	**39**

16. Inventories

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Raw materials and materials	16,547	17,438	1,583	1,267
Natural gas*	53,079	17,506	53,078	817
Other inventories	8,115	8,173	8,075	8,094
Prepayments for inventories	81	–	80	16,693
Allowance for raw materials and other inventories	(1,494)	(1,659)	(992)	(1,060)
TOTAL inventories	**76,328**	**41,458**	**61,824**	**25,811**

* on 3 April 2017, according to Energy Law, the natural gas market in Latvia was opened, inventories of purchased natural gas are used for production of electricity and heat, as well for trade to customers

Changes in the allowance for raw materials and materials at warehouses are included in the Statement of Profit or Loss position 'Raw materials and consumables used'.

Movement on the allowance for raw materials, spare parts and technological fuel

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**1,659**	**1,614**	**1,060**	**1,027**
Inventories written off	(62)	(87)	–	–
Charged to the Statement of Profit or Loss	(103)	132	(68)	33
At the end of the year	**1,494**	**1,659**	**992**	**1,060**

17. Receivables from Contracts with Customers and Other Receivables

a) Receivables from contracts with customers, net

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Receivables from contracts with customers:				
– Electricity, natural gas trade and related services customers	134,699	147,808	105,257	120,500
– Heating customers	10,922	11,629	8,851	9,530
– Other receivables from contracts with customers	8,610	7,588	4,155	3,086
– Subsidiaries	–	–	9,404	13,117
	154,231	**167,025**	**127,667**	**146,233**
Provisions for impaired receivables from contracts with customers:				
– Electricity, natural gas trade and related services customers	(45,561)	(44,801)	(44,472)	(43,674)
– Heating customers	(329)	(391)	(310)	(369)
– Other receivables from contracts with customers	(2,972)	(2,908)	(86)	(134)
	(48,862)	**(48,100)**	**(44,868)**	**(44,177)**
Receivables from contracts with customers, net:				
– Electricity, natural gas trade and related services customers	89,138	103,007	60,785	76,826
– Heating customers	10,593	11,238	8,541	9,161
– Other receivables from contracts with customers	5,638	4,680	4,069	2,952
– Subsidiaries	–	–	9,404	13,117
	105,369	**118,925**	**82,799**	**102,056**

There is no significant concentration of credit risk with respect to receivables from contracts with customers, as the Group and the Parent Company has a large number of customers except the major heating customer the net debt of which as of 31 December 2017 amounted to EUR 8,627 thousand (31/12/2016: EUR 9,040 thousand).

Electricity, natural gas trade and related services receivables grouped by past due days and calculated impairment loss

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Electricity, natural gas trade and related services receivables:				
– Fully performing receivables	70,290	92,450	46,956	69,766
Receivables past due but not impaired:				
– Receivables past due by 1–45 days	7,183	7,277	3,134	5,251
Impaired receivables:				
– Receivables past due by 46–90 days	743	1,608	657	1,402
– Receivables past due by 91–180 days	1,173	2,154	1,110	2,029
– Receivables past due by more than 181 days	17,623	15,988	16,780	15,136
– Individually impaired receivables with scheduled payments*	37,687	28,331	36,620	26,916
	134,699	**147,808**	**105,257**	**120,500**
Provisions for impaired electricity, natural gas trade and related services receivables:				
– Receivables past due by 46–90 days	(371)	(744)	(329)	(640)
– Receivables past due by 91–180 days	(880)	(1,480)	(833)	(1,387)
– Receivables past due by more than 181 days	(17,623)	(15,988)	(16,780)	(15,136)
– Individually impaired receivables with scheduled payments*	(26,687)	(26,589)	(26,530)	(26,511)
	(45,561)	**(44,801)**	**(44,472)**	**(43,674)**
Electricity, natural gas trade and related services receivables, net:				
– Fully performing receivables	70,290	92,450	46,956	69,766
Receivables past due but not impaired:				
– Receivables past due by 1–45 days	7,183	7,277	3,134	5,251
Net impaired receivables:				
– Receivables past due by 46–90 days	372	864	328	762
– Receivables past due by 91–180 days	293	674	277	642
– Individually impaired receivables with scheduled payments*	11,000	1,742	10,090	405
	89,138	**103,007**	**60,785**	**76,826**

* receivables under insolvency process and other individually impaired receivables

Heating and other receivables from contracts with customers grouped by past due days and calculated impairment loss

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Heating and other receivables from contracts with customers:				
– Fully performing receivables	16,029	15,606	12,549	11,997
Receivables past due but not impaired:				
– Receivables past due by 1–30 days	143	214	55	101
Impaired receivables:				
– Receivables past due by 31–90 days	118	199	12	31
– Receivables past due by more than 91 days	3,160	3,051	390	487
– Individually impaired receivables with scheduled payments*	82	147	–	–
	19,532	**19,217**	**13,006**	**12,616**
Provisions for impaired heating and other receivables from contracts with customers:				
– Receivables past due by 31–90 days	(59)	(101)	(6)	(16)
– Receivables past due by more than 91 days	(3,160)	(3,051)	(390)	(487)
– Individually impaired receivables with scheduled payments*	(82)	(147)	–	–
	(3,301)	**(3,299)**	**(396)**	**(503)**
Heating and other receivables from contracts with customers, net:				
– Fully performing receivables	16,029	15,606	12,549	11,997
Receivables past due but not impaired:				
– Receivables past due by 1–30 days	143	214	55	101
Net impaired receivables:				
– Receivables past due by 31–90 days	59	98	6	15
	16,231	**15,918**	**12,610**	**12,113**

* receivables under insolvency process and other individually impaired receivables

The Management has estimated allowances for impairment of receivables on the basis of aging of receivables from contracts with customers and by evaluating liquidity and history of previous payments of each significant debtor (see point 2.12). The carrying amount of receivables from contracts with customers, less allowances for impairment, is assumed to approximate their fair values.

The Management assumptions and methodology for estimation of recoverable amount of receivables from contracts with customers and evaluation of impairment risk are described in Note 4 b.

Credit quality of receivables from contracts with customers

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Fully performing electricity, natural gas trade and related services receivables:				
– customers with no overdue receivables and not impaired	58,955	73,236	37,147	53,262
– customers with overdue receivables with impaired receivables	11,335	19,214	9,809	16,504
	70,290	**92,450**	**46,956**	**69,766**
Fully performing heating and other receivables:				
– customers with no overdue receivables	15,459	14,790	12,257	11,727
– customers with overdue receivables	570	816	292	270
	16,029	**15,606**	**12,549**	**11,997**

The basis for estimating the credit quality of fully performing receivables from contracts with customers not due yet and not written down are internal ratings by reference to earlier credit behaviour of clients.

Movements in provisions for impaired receivables from contracts with customers

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**48,100**	**46,089**	**44,177**	**43,422**
Receivables written off during the year as uncollectible	(1,710)	(1,511)	(1,343)	(1,294)
Allowance for impaired receivables	2,472	3,522	2,034	2,049
At the end of the year	**48,862**	**48,100**	**44,868**	**44,177**

The charge and release of allowance for impaired receivables from contracts with customers due to delayed payments have been recorded in the Statement of Profit or Loss position 'Other operating expenses' as selling expenses and customer services costs (Note 10).

b) Other receivables

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Other non–current receivables*	3,229	986	284	978
Total non–current receivables	**3,229**	**986**	**284**	**978**
Current financial receivables:				
Receivable of guaranteed fee for the installed electrical capacity of cogeneration power plants CHPP-1 and CHPP-2**	454,413	–	–	–
Unsettled revenue on mandatory procurement PSO fee recognised as assets ***	164,365	142,132	–	–
Receivables for lease	3,535	3,911	2,443	2,610
Other financial receivables from related parties	–	–	10,664	6,875
Other accrued income	3,572	1,024	872	1,024
Other current financial receivables	15,947	2,794	3,959	927
Total current financial receivables	**641,832**	**149,861**	**17,938**	**11,436**
Current non-financial receivables:				
Pre–tax and overpaid taxes	3,703	4,008	22	17
Other current receivables	1,226	1,164	119	150
Total current non-financial receivables	**4,929**	**5,172**	**141**	**167**
TOTAL current receivables	**646,761**	**155,033**	**18,079**	**11,603**
TOTAL other receivables	**649,990**	**156,019**	**18,363**	**12,581**

* other non–current receivables of the Group as of 31 December 2017 include financing for capital expenditure project "Construction of the 330 kV Kurzeme loks" in the amount of EUR 2,941 thousand

** on 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order on one–off compensation to Latvenergo AS on guaranteed support for the installed capacity of cogeneration power plants in the amount of EUR 454,413 thousand (see Note 23)

*** by applying agent principle unsettled revenue on mandatory procurement PSO fee is recognised as assets in net amount as difference between revenue from sale of electricity in Nord Pool power exchange by market price, received mandatory procurement PSO fees, received government grant for compensating the increase of mandatory procurement costs and costs of purchased electricity under the mandatory procurement from electricity generators who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants (over 4 MW)

None of the receivables are secured with pledges or otherwise. The carrying amounts of other receivables are assumed to approximate their fair values.

18. Cash and Cash Equivalents

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Cash at bank	233,624	176,626	230,476	173,843
Short–term bank deposits	–	7,000	–	7,000
Restricted cash and cash equivalents*	2,379	354	2,379	354
TOTAL cash and cash equivalents	**236,003**	**183,980**	**232,855**	**181,197**

* restricted cash and cash equivalents as of 31 December 2017 consist of the financial security for participating in NASDAQ OMX Commodities Exchange. Financial security is fully recoverable after termination of participation without any penalties, therefore restricted cash is considered as cash equivalent

In existing rate environment, cash at bank balances practically doesn`t earn any interests. Short–term deposits are placed for different periods between several days and three months depending on the immediate cash needs of the Group and the Parent Company and cash flow forecasts. During 2017 the average annual effective interest rate earned on short–term cash deposits was 0.175% (2016: 0.16%). See also Note 3.1.b.

The carrying amounts of cash and cash equivalents are assumed to be approximate to their fair values.

19. Share Capital

As of 31 December 2017, the registered share capital of the Latvenergo AS is EUR 1,288,715 thousand (31/12/2016: EUR 1,288,715 thousand) and consists of 1,288,715 thousand ordinary shares (31/12/2016: 1,288,715 thousand) with the nominal value of EUR 1 per share (31/12/2016: EUR 1 per share). All shares have been fully paid.

In 2017 there were no increase per share capital. In December 2016, in accordance with the Directive No. 693 of the Cabinet of Ministers of the Republic of Latvia, dated 22 November 2016 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 184 thousand was invested in the share capital of Latvenergo AS. The value of real estate was determined by independent certified valuation experts applying depreciated replacement cost model, based on construction or acquisition costs of similar assets.

20. Reserves, Dividends and Earnings Per Share

a) Reserves

EUR'000

	Note	Group					Parent Company		
		Non–current assets revaluation reserve	Hedge reserve	Currency translation	Other reserves	TOTAL	Non–current assets revaluation reserve	Hedge reserve	TOTAL
As of 31 December 2015		**681,742**	**(12,256)**	**97**	**13**	**669,596**	**662,035**	**(12,256)**	**649,779**
Increase of non–current assets revaluation reserve as a result of revaluation	14 a	317,041	–	–	–	**317,041**	–	–	**–**
Disposal of non–current assets revaluation reserve net of deferred tax		(4,854)	–	–	–	**(4,854)**	(2,606)	–	**(2,606)**
Deferred tax related to non–current assets revaluation reserve	12	(47,556)	–	–	–	**(47,556)**	–	–	**–**
Gains from fair value changes in derivative financial instruments	21 c, I	–	2,847	–	–	**2,847**	–	2,847	**2,847**
As of 31 December 2016		**946,373**	**(9,409)**	**97**	**13**	**937,074**	**659,429**	**(9,409)**	**650,020**
Increase of non–current assets revaluation reserve as a result of revaluation	14 a	22,167	–	–	–	**22,167**	22,167	–	**22,167**
Disposal of non–current assets revaluation reserve net of deferred tax		(4,377)	–	–	–	**(4,377)**	(1,762)	–	**(1,762)**
Deferred tax related to non–current assets revaluation reserve	12	(3,325)	–	–	–	**(3,325)**	(3,325)	–	**(3,325)**
Reversed deferred corporate income tax	12	169,560	–	–	–	**169,560**	119,384	–	**119,384**
Gains from fair value changes in derivative financial instruments	21 c, I	–	5,422	–	–	**5,422**	–	5,422	**5,422**
As of 31 December 2017		**1,130,398**	**(3,987)**	**97**	**13**	**1,126,521**	**795,893**	**(3,987)**	**791,906**

Non–current assets revaluation reserve, currency translation and hedge reserves cannot be distributed as dividends. Other reserves are maintained with the aim to maintain stability in the operations of the Group entities.

b) Dividends

The dividends declared to equity holders of the Parent Company for 2016 were EUR 90,142 thousand or EUR 0.06995 per share (2015: EUR 77,413 thousand or EUR 0.06008 per share) and to non–controlling interests – EUR 1,393 thousand or EUR 0.408 per share (2015: EUR 1,377 thousand or EUR 0.403 per share).

Fulfilling the requirements of the Article No. 41 of the law "On the State budget 2018" that determines the amount of dividends payable in the year 2018, the Management Board of Latvenergo AS proposes to pay out in dividends EUR 94.2 million, that consists from Latvenergo AS profit of 2017 in the amount of EUR 29.8 million and profit of 2016 in the amount of EUR 64.4 million, and the rest of Latvenergo AS profit of 2017 – EUR 121.1 million to leave undistributed as retained earnings with a purpose to take the decision on pay out as dividends simultaneously with the decision on the distribution of Latvenergo AS profit of 2018.

The distribution of net profit for the 2017 is subject to a resolution of the Latvenergo AS Shareholders Meeting.

c) Earnings per share

Basic earnings per share are calculated by dividing profit attributable to the equity holders of the Parent Company by the weighted average number of ordinary shares outstanding (Note 19). As there are no potential ordinary shares, diluted earnings per share are equal to basic earnings per share in all comparable periods.

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
Profit attributable to the equity holder of the Parent Company (in thousand EUR)	319,670	129,045	150,891	137,441
Weighted average number of shares (thousand)	1,288,715	1,288,623	–	–
Basic earnings per share (in euros)	0.250	0.100	0.117	0.107
Diluted earnings per share (in euros)	0.250	0.100	0.117	0.107

21. Financial Assets and Liabilities

a) Held-to-maturity financial assets

As of 31 December 2017 the entire Group's and the Parent Company's held–to–maturity financial assets were State Treasury bonds with 5 year and 10 year maturity, which were purchased with the purpose to invest liquidity reserve in the low risk financial instruments with higher yield. During 2017 in connection with the amortisation of held–to–maturity financial assets are recognised net losses in the amount of EUR 50 thousand (2016: EUR 58 thousand) (Note 11 b). All held–to–maturity financial assets are denominated in euros. The maximum exposure to credit risk at the reporting date is the carrying amount of held–to–maturity financial assets.

In 2017 the fair value of held–to–maturity financial assets is greater than the carrying amount by EUR 4,108 thousand (2016: EUR 4,991 thousand). The fair value of financial assets is calculated by discounting their future cash flows and using as discount factor the banks quoted prices of a corresponding financial instrument at the end of the reporting period.

Held–to–maturity financial assets carrying amount — EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Held–to–maturity financial assets:				
– current	–	3,520	–	3,520
– non–current	16,984	17,034	16,984	17,034
TOTAL held–to–maturity financial assets	**16,984**	**20,554**	**16,984**	**20,554**

b) Borrowings

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Non–current borrowings from financial institutions	583,313	500,215	574,764	492,286
Issued debt securities (bonds)	135,361	135,405	135,361	135,405
Total non–current borrowings	**718,674**	**635,620**	**710,125**	**627,691**
Current portion of non–current borrowings from financial institutions	105,931	82,762	102,522	78,222
Current portion of issued debt securities (bonds)	–	70,075	–	70,075
Current borrowings from financial institutions	–	744	–	–
Accrued interest on non–current borrowings	468	594	441	564
Accrued coupon interest on issued debt securities (bonds)	1,684	1,771	1,684	1,771
Total current borrowings	**108,083**	**155,946**	**104,647**	**150,632**
TOTAL borrowings	**826,757**	**791,566**	**814,772**	**778,323**

Movement in borrowings — EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**791,566**	**797,483**	**778,323**	**782,965**
Borrowings received	186,500	55,744	185,000	55,000
Borrowings repaid	(80,976)	(87,452)	(78,221)	(85,441)
Change in accrued interest on borrowings	(126)	15	(123)	23
Issued debt securities (bonds)	–	25,776	–	25,776
Repaid issued debt securities (bonds)	(70,000)	–	(70,000)	–
Changes in outstanding value of issued debt securities (bonds)	(207)	–	(207)	–
At the end of the year	**826,757**	**791,566**	**814,772**	**778,323**

Borrowings by categories of lenders — EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Foreign investment banks	426,102	394,917	426,102	394,917
Commercial banks	263,610	189,398	251,625	176,155
Issued debt securities (bonds)	137,045	207,251	137,045	207,251
TOTAL borrowings	**826,757**	**791,566**	**814,772**	**778,323**

Borrowings by maturity (excluding the effect of derivative financial instruments) — EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Fixed rate non–current and current borrowings:				
– < 1 year (current portion of non–current borrowings)	51,733	71,921	51,733	71,921
– 1–5 years	203,543	152,911	203,543	152,911
– > 5 years	–	100,676	–	100,676
Total fixed rate borrowings	**255,276**	**325,508**	**255,276**	**325,508**
Floating rate non–current and current borrowings:				
– < 1 year (current borrowings)	–	744	–	–
– < 1 year (current portion of non–current borrowings)	56,350	83,281	52,915	78,711
– 1–5 years	338,240	255,126	330,119	247,646
– > 5 years	176,891	126,907	176,462	126,458
Total floating rate borrowings	**571,481**	**466,058**	**559,496**	**452,815**
TOTAL borrowings	**826,757**	**791,566**	**814,772**	**778,323**

Borrowings by pricing period (considering the effect of derivative financial instruments)

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
– < 1 year	379,854	376,099	367,869	362,856
– 1–5 years	396,903	264,791	396,903	264,791
– > 5 years	50,000	150,676	50,000	150,676
TOTAL borrowings	**826,757**	**791,566**	**814,772**	**778,323**

As of 31 December 2017 and as of 31 December 2016 all of the Group's and the Parent Company's borrowings were denominated in euros.

The fair value of current and non–current borrowings with floating rates and twelve–month–fixed rates equals their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group and the Parent Company, and the effect of fair value revaluation is not significant.

I) Pledges

As of 31 December 2017 the Group's and the Parent Company's assets are not pledged to secure the borrowings, except the pledge on assets of Liepājas Enerģija SIA of maximum secured claims in the amount of EUR 32.3 million (31/12/2016: EUR 29 million) to secure its current and non–current borrowings. As of the end of the reporting year there has been pledged the property, plant and equipment in the net book amount of EUR 27 million and the claims on the receivables accounts in the amount of EUR 5.3 million (31/12/2016: EUR 26.6 million and EUR 2.4 million, respectively).

II) Un–drawn borrowing facilities

As of 31 December 2017 there are no un–drawn committed non–current credit facilities (31/12/2016: EUR 235 million).

As of 31 December 2017 the Group had entered into three overdraft agreements with total notional amount of EUR 34 million (31/12/2016: EUR 34.2 million) and in respect of those all conditions precedent had been met. At the end of the reporting year overdrafts were not used.

III) Weighted average effective interest rate

During the reporting year the weighted average effective interest rate (including interest rate swaps) on non–current borrowings was 1.73% (2016: 1.91%), weighted average effective interest rate for current borrowings was 0.87% (2016: 0.87%). At 31 December 2017 interest rates for non–current borrowings in euros were 3, 6 and 12 month EURIBOR+ 0.96% (31/12/2016: +1.13%) for the Group and 3, 6 and 12 month EURIBOR+ 0.95% (31/12/2016: +1.10%) for Latvenergo AS. At 31 December 2017 the total notional amount of interest rate swap agreements concluded by the Group amounts to EUR 193.4 million (31/12/2016: EUR 174.2 million) and the interest rate was fixed for the initial periods from 6 to 10 years.

IV) Bonds outstanding

The Parent Company (Latvenergo AS) 2013 issued bonds in the amount of EUR 35 million with maturity date – 22 May 2020 (ISIN code – LV0000801165) with the annual coupon rate of 2.8%. In 2015 and in 2016, Latvenergo AS issued green bonds in the total amount of EUR 100 million with the maturity date 10 June 2022 (ISIN code – LV0000801777) with the annual coupon rate of 1.9%. Five-year bonds issued in 2012 and 2013 in the amount of EUR 70 million (ISIN code – LV0000801090) have reached their maturity on 15 December 2017. Thus the total nominal amount of outstanding bonds amounts to EUR 135 million. All issued bonds are quoted in NASDAQ Baltic Stock Exchange. The issued debt securities (bonds) are measured at amortised cost at the end of reporting year.

As of 31 December 2017 the fair value of issued debt securities (bonds) exceeds their carrying amount by EUR 5,546 thousand (31/12/2016: EUR 6,523 thousand). The fair value of debt securities (bonds) issued is calculated by discounting their future cash flows and using the banks' quoted prices of the financial instruments at the end of the reporting year as discount factor.

c) Derivative financial instruments

I) Outstanding fair values of derivatives and their classification

In the table below outstanding fair values of derivatives are disclosed as follows:

EUR'000

		Group				Parent Company			
		31/12/2017		31/12/2016		31/12/2017		31/12/2016	
	Notes	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate swaps	21 c, II	(31)	8,061	–	11,563	(31)	8,061	–	11,563
Electricity forwards and futures	21 c, III	(4,588)	23	(6,134)	23	(4,588)	23	(6,134)	23
TOTAL outstanding fair values of derivatives		**(4,619)**	**8,084**	**(6,134)**	**11,586**	**(4,619)**	**8,084**	**(6,134)**	**11,586**

EUR'000

		Group				Parent Company			
		31/12/2017		31/12/2016		31/12/2017		31/12/2016	
	Notes	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Non–current		–	4,914	–	7,946	–	4,914	–	7,946
Current		(4,619)	3,170	(6,134)	3,640	(4,619)	3,170	(6,134)	3,640
TOTAL fair values of derivative financial instruments		**(4,619)**	**8,084**	**(6,134)**	**11,586**	**(4,619)**	**8,084**	**(6,134)**	**11,586**

(Gains) / losses on fair value changes as a result of realised hedge agreements EUR'000

	Notes	Group 2017	Group 2016	Parent Company 2017	Parent Company 2016
Included in the Statement of Profit or Loss					
Interest rate swaps	11 a	–	(760)	–	(760)
Electricity forwards and futures	8	3,435	(6,515)	3,435	(6,515)
		3,435	**(7,275)**	**3,435**	**(7,275)**
Included in the Statement of Other Comprehensive Income					
Interest rate swaps	20 a	(3,533)	(693)	(3,533)	(693)
Electricity forwards and futures	20 a	(1,889)	(2,154)	(1,889)	(2,154)
		(5,422)	**(2,847)**	**(5,422)**	**(2,847)**

According to IAS 1 a financial liability or asset that is not held for trading purposes should be presented as current or non–current on the basis of its settlement date. Derivatives that have a maturity of more than twelve months and are expected to be held for more than twelve months after the end of the reporting period have been classified as non–current assets or liabilities.

II) Interest rate swaps

As of 31 December 2017 the Group and the Parent Company had interest rate swap agreements with total notional amount of EUR 193.4 million (31/12/2016: EUR 174.2 million). Interest rate swaps are concluded with 6 to 10 year initial maturities and hedged floating rates are 6 month EURIBOR. As of 31 December 2017 fixed interest rates vary from 0.315% to 2.5775% (31/12/2016: from 0.7725% to 4.4925%).

At the end of the year all of outstanding interest rate swap agreements or agreements are designated to comply with hedge accounting and were re–measured prospectively and retrospectively to test whether they are effective within the hedging period (31/12/2016: 100% with notional amount of EUR 174.2 million). All contracts are designed as cash flow hedges. It was established that they are fully effective and therefore there is no ineffective portion to be recognised within profit or loss in the Statement of Profit or Loss.

Fair value changes of interest rate swaps EUR'000

	Group 2017 Assets	Group 2017 Liabilities	Group 2016 Assets	Group 2016 Liabilities	Parent Company 2017 Assets	Parent Company 2017 Liabilities	Parent Company 2016 Assets	Parent Company 2016 Liabilities
Outstanding fair value at the beginning of the year	**–**	**11,563**	**–**	**13,016**	**–**	**11,563**	**–**	**13,016**
Included in the Statement of Profit or Loss, net (Note 11 a)	–	–	–	(760)	–	–	–	(760)
Included in other comprehensive income (Note 20 a)	(31)	(3,502)	–	(693)	(31)	(3,502)	–	(693)
Outstanding fair value at the end of the year	**(31)**	**8,061**	–	**11,563**	**(31)**	**8,061**	–	**11,563**

The main interest rate hedging criteria stated in the Financial Risk Management policy is to ensure average fixed rate duration from 2 to 4 years and fixed rate portion at more than 35% of borrowings. As of 31 December 2017 54% (31/12/2016: 62%) of the Group's and 55% (2016: 63%) of the Parent Company's borrowings had fixed interest rates (taking into account the effect from the interest rate swaps), and average remaining time to interest re–pricing was 2.0 years (2016: 2.1 years) for the Group and 2.0 years (2016: 2.2 years) for the Parent Company.

III) Electricity forwards and futures

As of 31 December 2017 the Group and the Parent Company has entered into electricity forward and future contracts with total outstanding volume of 1,838,732 MWh (31/12/2016: 2,195,685 MWh) and notional value of EUR 29.0 million (31/12/2016: EUR 36.0 million). Electricity forward and future contracts are concluded for the maturities from one quarter to one year during the period from 1 January 2018 to 31 December 2019.

The Parent Company enters into electricity future contracts in the Nasdaq Commodities power exchange, as well as concludes electricity forward contracts with other counterparties. Electricity forward and future contracts are intended for hedging of the electricity price risk and are used for fixing the price of electricity purchased in the Nord Pool AS power exchange.

Electricity forward and future contracts with total outstanding volume of 1,829,972 MWh as of 31 December 2017 are designated to comply with hedge accounting treatment (31/12/2016: 1,626,285) and were re–measured prospectively and retrospectively to test whether they are effective within the hedging period. All contracts are designed as cash flow hedges. For the contracts which are ineffective fair value changes are recorded through profit or loss in the Statement of Profit or Loss (Note 8), and for fully effective contracts fair value gains are included in other comprehensive income (Note 20 a).

Fair value changes of electricity forward and future contracts EUR'000

	Group 2017 Assets	Group 2017 Liabilities	Group 2016 Assets	Group 2016 Liabilities	Parent Company 2017 Assets	Parent Company 2017 Liabilities	Parent Company 2016 Assets	Parent Company 2016 Liabilities
Outstanding fair value at the beginning of the year	**(6,134)**	**23**	**–**	**2,558**	**(6,134)**	**23**	**–**	**2,558**
Included in the Statement of Profit or Loss (Note 8)	3,435	–	(3,980)	(2,535)	3,435	–	(3,980)	(2,535)
Included in other comprehensive income (Note 20 a)	(1,889)	–	(2,154)	–	(1,889)	–	(2,154)	–
Outstanding fair value at the end of the year	**(4,588)**	**23**	**(6,134)**	**23**	**(4,588)**	**23**	**(6,134)**	**23**

d) Fair values and fair value measurement

In this Note are disclosed the fair value measurement hierarchy for the Group's and the Parent Company's assets and liabilities.

Quantitative disclosures of fair value measurement hierarchy for assets at the end of the year

EUR'000

		Group				Parent Company			
		Fair value measurement using				Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	TOTAL	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	TOTAL
Assets measured at fair value									
Revalued property, plant and equipment (Note 14 c)	31/12/2017	–	–	2,587,252	**2,587,252**	–	–	722,599	**722,599**
	31/12/2016	–	–	2,576,162	**2,576,162**	–	–	709,828	**709,828**
Derivative financial instruments, including:									
Electricity forwards and futures (Note 21 c, III)	31/12/2017	–	4,588	–	**4,588**	–	4,588	–	**4,588**
	31/12/2016	–	6,134	–	**6,134**	–	6,134	–	**6,134**
Interest rate swaps (Note 21 c, II)	31/12/2017	–	31	–	**31**	–	31	–	**31**
	31/12/2016	–	–	–	**–**	–	–	–	**–**
Assets for which fair values are disclosed									
Held–to–maturity financial assets (Note 21 a)	31/12/2017		21,092	–	**21,092**	–	21,092	–	**21,092**
	31/12/2016	–	25,545	–	**25,545**	–	25,545	–	**25,545**
Floating rate loans to subsidiaries (Note 25 e)	31/12/2017	–	–	–	**–**	–	103,928	–	**103,928**
	31/12/2016	–	–	–	**–**	–	100,872	–	**100,872**
Fixed rate loans to subsidiaries (Note 25 e)	31/12/2017	–	–	–	**–**	–	394,215	–	**394,215**
	31/12/2016	–	–	–	**–**	–	350,398	–	**350,398**

There have been no transfers for assets between Level 1, Level 2 and Level 3 during the reporting period.

Quantitative disclosures of fair value measurement hierarchy for liabilities at the end of the year

EUR'000

		Group				Parent Company			
		Fair value measurement using				Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	TOTAL	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	TOTAL
Liabilities measured at fair value									
Derivative financial instruments, including:									
Interest rate swaps (Note 21 c, II)	31/12/2017	–	8,061	–	**8,061**	–	8,061	–	**8,061**
	31/12/2016	–	11,563	–	**11,563**	–	11,563	–	**11,563**
Electricity forwards and futures (Note 21 c, III)	31/12/2017		23	–	**23**	–	23	–	**23**
	31/12/2016	–	23	–	**23**	–	23	–	**23**
Liabilities for which fair values are disclosed									
Issued debt securities (bonds) (Note 21 b, IV)	31/12/2017	–	142,591	–	**142,591**	–	142,591	–	**142,591**
	31/12/2016	–	213,774	–	**213,774**	–	213,774	–	**213,774**
Floating rate borrowings (Note 21 b)	31/12/2017	–	689,712	–	**689,712**	–	677,727	–	**677,727**
	31/12/2016	–	584,315	–	**584,315**	–	571,072	–	**571,072**
Fixed rate borrowings (Note 21 b)	31/12/2017	–	–	–	**–**	–	–	–	**–**
	31/12/2016	–	–	–	**–**	–	–	–	**–**

There have been no transfers for liabilities between Level 1, Level 2 and Level 3 during the reporting period.

The fair value hierarchy for the Group's and the Parent Company's financial instruments that are measured at fair value, by using specific valuation methods, is disclosed in Note 4 c.

Set out below, is a comparison by class of the carrying amounts and fair value of the Group's and the Parent Company's financial instruments, other than those with carrying amounts which approximates their fair values:

EUR'000

	Group				Parent Company			
	Carrying amount		Fair value		Carrying amount		Fair value	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Financial assets								
Held–to–maturity financial assets	16,984	20,554	21,092	25,545	16,984	20,554	21,092	25,545
Derivative financial instruments not designated for hedging, including:								
– electricity forwards and futures	545	3,980	545	3,980	545	3,980	545	3,980
Derivative financial instruments used for hedging, including:								
– electricity forwards and futures	4,043	2,154	4,043	2,154	4,043	2,154	4,043	2,154
– interest rate swaps	31	–	31	–	31	–	31	–
Financial liabilities								
Interest–bearing liabilities, including:								
– issued debt securities (bonds)	137,045	207,251	142,591	213,774	137,045	207,251	142,591	213,774
– floating rate borrowings	689,712	584,315	689,712	584,315	677,727	571,072	677,727	571,072
– fixed rate borrowings	–	–	–	–	–	–	–	–
Derivative financial instruments not designated for hedging, including:								
– electricity forwards and futures	23	23	23	23	23	23	23	23
– interest rate swaps	–	–	–	–	–	–	–	–
Derivative financial instruments used for hedging, including:								
– interest rate swaps	8,061	11,563	8,061	11,563	8,061	11,563	8,061	11,563

The management assessed that cash and short–term deposits, receivables, trade payables, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short–term maturities of these instruments. The fair value of the financial assets and liabilities 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.

The following methods and assumptions were used to estimate the fair values:

a) The fair values of borrowings with floating interest rates are equal their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group and the Parent Company;

b) The borrowings with fixed interest rates had the fixed repayment period and the financial instrument is not traded in the active market; the financial instrument, which is not traded in the active market, the fair value is measured, using valuation techniques. The Group and the Parent Company uses various methods and models and make assumptions, which are based on the market conditions regarding the interest rates and other market conditions, existing at the end of reporting period. The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by the Group`s and the Parent Company's credit risk margin;

c) The Group and the Parent Company enters into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. The derivative financial instruments are determined by using various valuation methods and models with market observable inputs. The models incorporate the credit quality of counterparties, foreign exchange spot and forward rates; the fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments. The fair value of electricity forward and future contracts is calculated as discounted difference between actual market and settlement prices for the volume set in the agreements. If counterparty is a bank, calculated fair values of financial instruments are compared to bank's revaluation reports and the bank's calculated fair values of the financial instruments are used in the financial reports;

d) The fair value of the bonds issued and held–to–maturity financial assets are calculated, based on the bank's quoted prices of the financial instruments at the end of the reporting period.

22. Provisions

a) Provisions for post–employment benefits

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**16,428**	**13,619**	**6,733**	**5,445**
Current service cost	1,392	1,011	572	457
Interest cost	304	204	124	82
Post–employment benefits paid	(943)	(1,352)	(465)	(298)
(Gains) / losses as a result of changes in actuarial assumptions less of deferred income tax	(3,460)	2,946	(1,053)	1,047
At the end of the year	**13,721**	**16,428**	**5,911**	**6,733**

Total charged / (credited) provisions are included in the Statement of Profit or Loss position 'Personnel expenses' within state social insurance contributions and other benefits defined in the Collective agreement (Note 9), while gains / (losses) as a result on re–measurement on defined post–employment benefit plan net of deferred income tax are included in the Statement of Other Comprehensive Income, according to *IAS 19 Employee Benefits*:

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**16,428**	**13,619**	**6,733**	**5,445**
(Credited) / charged to the Statement of Other Comprehensive Income less of deferred income tax	(3,460)	2,946	(1,053)	1,047
Deferred income tax on re–measurement on defined post–employment benefit plan (Note 12)	–	(638)	–	(157)
Charged to the Statement of Profit or Loss	753	501	231	398
At the end of the year	**13,721**	**16,428**	**5,911**	**6,733**

Weighted average discount rate used for discounting benefit obligations was 1.85% (2016: 1.50%), considering the market yields on government bonds at the end of the reporting year. The Group's Collective Agreement provides indexation of employees' wages at least at the level of inflation. Long–term inflation determined at the level of 3.0% (2016: 3.0%) when calculating long–term post–employment benefits. In calculation of these liabilities also the probability, determined on the basis of previous experience, of retirement in different employees' aging groups was also considered.

A quantitative sensitivity analysis for significant assumptions on provisions for post–employment benefits as of the end of the year is as shown below:

EUR'000

		Group						Parent Company					
	Date of valuation	Discount rate		Future salary changes		Retirement probability changes		Discount rate		Future salary changes		Retirement probability changes	
		1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease
Impact on provisions for post–employment benefits	31/12/2017	1,508	(1,246)	1,468	(1,240)	1,634	(1,360)	594	(488)	578	(486)	644	(533)
	31/12/2016	1,945	(1,590)	1,886	(1,577)	2,071	(1,709)	752	(611)	728	(606)	800	(656)

The sensitivity analysis above has been determined based on a method that extrapolates the impact on defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

b) Termination benefits

Termination benefits paid out in 2017 are included in the Statement of Profit or Loss position 'Personnel expenses' within expenditure of employment termination (Note 9), while termination benefits and projected future liability values for years 2018 to 2022 is recognised as a liability in the Statement of Financial Position and as accrued costs within expenditure of employment termination (Note 9):

EUR'000

	Group	Parent Company
	2017	2017
At the beginning of the year	**–**	**–**
Termination benefits paid	(3,974)	(407)
Provisions for current termination benefits	7,364	1,310
Provisions for non–current termination benefits	5,925	1,704
At the end of the year	**9,315**	**2,607**

According to defined development directions per Strategy of Latvenergo Group for the period 2017-2022 approved the Strategic Development and Efficiency Programme. Provisions for employees' termination benefits are recognised on a basis of Strategic Development and Efficiency Programme of Latvenergo Group for the period in which it is planned to implement the efficiency program (including Latvenergo AS and Sadales tīkls AS efficiency activities), by which it is intended to reduce gradually the number of employees by 2022.

Assumptions used in calculation of termination benefits are as follow – average employee earnings at the time of termination - average earnings per year, with projected increase (salary indexation) in the following years by 3.0% for Latvenergo AS and by 2.5% for Sadales tīkls AS, average employee length of service at the time of termination, the State Social Insurance Contributions rate is 24.09% in 2018 and in subsequent years.

The amount of provisions at the end of reporting year is estimated in accordance with the estimated future liability value as of 31 December 2017, using the fixed discount rate of 1.093% as adopted by the Latvenergo Group. The discount rate is comprised of a 5-year EUROSWAP rate of 0.314% and a corporate risk premium of 0.779% (determined on the basis of interest rate on Latvenergo AS issued bonds yield spreads above the market rate).

A quantitative sensitivity analysis for significant assumptions used for calculation of termination benefits as of the end of the year is as shown below:

EUR'000

		Group						Parent Company					
	Date of valuation	Discount rate		Future salary changes		Average employee length of service		Discount rate		Future salary changes		Average employee length of service	
		1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease
Impact on provisions for termination benefits	31/12/2017	(134)	138	261	(254)	53	(53)	(68)	71	69	(67)	15	(15)

c) Environmental provisions

EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**2,215**	**2,365**	**1,191**	**1,160**
Charged to the Statement of Profit or Loss	49	(150)	29	31
At the end of the year	**2,264**	**2,215**	**1,220**	**1,191**

The environmental provision in the amount of EUR 2,264 thousand (31/12/2016: EUR 2,215 thousand) for the Group represents the estimated cost for Latvenergo AS of cleaning up Riga TEC–1 combined heat and power plant ash–fields in accordance with the requests made by the regional Environmental Authority of Riga and feasibility study on this project in the amount of EUR 1,220 thousand (31/12/2016: EUR 1,191 thousand) and Liepājas Enerģija SIA provision for the environmental recovery measures in the amount of EUR 1,044 thousand (31/12/2016: EUR 1,024 thousand). The amount of the provisions is calculated taking into account the construction cost index (data from the Central Statistical Bureau of the Republic of Latvia).

23. Other Liabilities and Deferred Income

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
I) Non-current deferred income				
a) from contracts from customers				
Deferred income from connection fees	142,132	141,817	–	–
	142,132	**141,817**	**–**	**–**
b) from lease				
Deferred income from connection fees	4,319	4,787	–	–
Other deferred income	18,056	3,483	423	444
	22,375	**8,270**	**423**	**444**
c) other				
Deferred income on grant for the installed electrical capacity of CHPPs	285,109	–	285,109	–
Effective allowable load (distribution service) IFRS 15	–	–	–	–
Deferred income on financing from European Union funds	43,159	45,013	270	304
Deferred income from plant and equipment received free of charge	283	307	283	307
	328,551	**45,320**	**285,662**	**611**
TOTAL non-current liabilities and deferred income	**493,058**	**195,407**	**286,085**	**1,055**

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
II) Current deferred income				
a) from contracts from customers				
Deferred income from connection fees	12,247	11,605	–	–
Deferred income from use of allowed effective electrical load (distribution system services)	253	–	–	–
	12,500	**11,605**		
b) from lease				
Deferred income from connection fees	449	449	–	–
	449	**449**	**–**	**–**
c) other				
Other deferred income	121	57	20	20
Deferred income on grant for the installed electrical capacity of CHPPs	29,304	–	29,304	–
Deferred income on financing from European Union funds	1,854	1,911	34	39
	31,279	**1,968**	**29,358**	**59**
TOTAL current liabilities and deferred income	**44,228**	**14,022**	**29,358**	**59**
TOTAL other liabilities and deferred income	**537,286**	**209,429**	**315,443**	**1,114**

Movement in other liabilities and deferred income (non–current and current part) EUR'000

	Group		Parent Company	
	2017	2016	2017	2016
At the beginning of the year	**209,429**	**209,860**	**1,114**	**1,192**
Deferred non–current income	14,707	2,249	–	–
Received fees	12,848	11,097	–	–
Received income from grant for the installed electrical capacity of CHPPs	314,413	–	314,413	–
Credited to the Statement of Profit or Loss (Note 6 "Other revenue")	(14,111)	(13,777)	(84)	(78)
At the end of the year	**537,286**	**209,429**	**315,443**	**1,114**

Deferred income on grant for the installed electrical capacity of CHPPs

In October 2017, the Parent Company applied for a one-off compensation from the state, at the same time opting out of the receipt of 75% of the guaranteed annual payments for installed electrical capacity in combined heat and power plant Riga CHPP-1 and Riga CHPP-2. The one-off compensation is calculated as 75% of the discounted future guaranteed payments for installed electrical capacity. On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order on one–off compensation to Latvenergo AS on guaranteed support for the installed capacity of cogeneration power plants, therefore the Parent Company obtained a government grant in the amount of EUR 454,413 thousand.

The grant is divided into two parts and recognised in accordance with accounting policy stated in Note 2.20 a:

1) an unconditional grant in amount of EUR 140,000 thousand recognised as 'Other income' (Note 7) in the Group's and the Parent Company's statement of profit or loss in 2017

2) a conditional grant in amount of EUR 314,413 thousand recognised as deferred income in the Group's and the Parent Company's statement of financial position and to be allocated to income on a straight-line basis until fulfilling obligation till the end of the support period – September 23, 2028

Following the order No. 685 of the Cabinet of Ministers of the Republic of Latvia on 28 November 2017 a trilateral agreement was concluded between Republic of Latvia (represented by Ministry of Economics), the Parent Company and its subsidiary Enerģijas publiskais tirgotājs AS (public trader) on settlement of the one–off compensation. Accordingly, public trader has recognised receivable from state for one-off compensation in the amount of EUR 454,413 thousand. This balance is recognized as government grant receivable in Group financial statements (Note 17). For Enerģijas publiskais tirgotājs AS to ensure financing of compensation, the Parent Company has concluded agreement on loan issue in amount equal to the grant receivable (see Note 25 f).

The compensation is financed by applying the rights of the state as the Shareholder of the Parent Company to carry out a share capital reduction of the Parent Company. As disclosed in Note 27, after the reporting year, in March 2018, the Parent Company has decreased its share capital in amount of EUR 454,413 thousand. Further in March 2018 the Parent Company settled its liability towards Ministry of Economics for the capital release by netting of the balance with the respective grant receivable from the state in accordance with the trilateral agreement. In accordance with the provisions of the same agreement, the Parent Company netted balances with public trader on the same date (see Note 27).

24. Trade and Other Payables

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Financial liabilities:				
Payables for materials and services	75,395	54,366	68,820	66,805
Payables for electricity and natural gas	21,094	20,275	933	465
Accrued expenses	10,093	7,315	4,722	3,452
Other financial current payables	9,160	6,599	4,866	475
Total financial liabilities	**115,742**	**88,555**	**79,341**	**71,197**
Non–financial liabilities:				
State social security contributions and other taxes	15,919	12,536	9,025	5,583
Advances received	11,784	12,845	4,993	7,205
Other current payables	3,627	3,881	1,330	1,584
Total non–financial liabilities	**31,330**	**29,262**	**15,348**	**14,372**
TOTAL trade and other current payables	**147,072**	**117,817**	**94,689**	**85,569**

The carrying amounts of trade and other payables are assumed to approximate their fair values.

25. Related Party Transactions

The Parent Company and, indirectly, its subsidiaries are controlled by the Latvian state. Related parties of the Latvenergo Group and the Parent Company are Shareholder of the Parent Company who controls or who has significant influence over the Parent Company in accepting operating business decisions, members of Latvenergo Group entities' management boards, members of the Supervisory board of the Parent Company, members of Supervisory body of the Parent Company – the Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence.

Trading transactions taking place under normal business activities with the Latvian government including its departments and agencies and transactions between state–controlled entities and providers of public utilities are excluded from the scope of related party disclosures. Quantification of transactions with those related parties is impossible due to broad range of the Latvenergo Group's and the Parent Company's customers.

a) Income and expenses from transactions with subsidiaries (Parent Company) EUR'000

	Parent Company	
	2017	2016
Income:		
– Subsidiaries	155,338	172,522
	155,338	**172,522**
Expenses:		
– Subsidiaries	344,038	360,421
	344,038	**360,421**
including expenses from transactions with subsidiaries recognised in net amount through profit or loss:		
– Sadales tīkls AS	332,172	346,753
– Enerģijas publiskais tirgotājs AS	520	534
	332,692	**347,287**

b) Balances at the end of the period arising from sales/purchases of goods and services EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Prepayments for inventories:				
– Subsidiaries (Note 16)*	–	–	–	16,682
	–	**–**	**–**	**16,682**
Receivables from related parties:				
– Subsidiaries (Note 17 a)	–	–	17,435	14,851
	–	**–**	**17,435**	**14,851**
Payables to related parties:				
– Subsidiaries	–	–	30,994	33,267
– Other related parties**	281	236	88	98
	281	**236**	**31,082**	**33,365**

* advance payment for subsidiary - Elektrum Eesti OÜ
** Pirmais Slēgtais Pensiju fonds AS

c) Accrued income raised from transactions with related parties

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
– For goods sold / services received from subsidiaries (Note 17 a)	–	–	3,199	5,581
– For interest received from subsidiaries (Note 17 a)	–	–	1,875	2,170
	–	**–**	**5,074**	**7,751**

d) Accrued expenses raised from transactions with related parties

EUR'000

	Group		Parent Company	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016
– For purchased goods / received services from subsidiaries	–	–	1,176	826
	–	**–**	**1,176**	**826**

The Group and the Parent Company has not incurred write–offs of trade payables and receivables from transactions with related parties, as all debts are recoverable.

Receivables and payables with related parties are current balances for services and goods. None of the amounts at the end of the reporting year are secured.

Remuneration to the Latvenergo Group's management includes remuneration to the members of the Management Boards the Group entities, the Supervisory Board and the Supervisory body (Audit Committee) of the Parent Company. Remuneration to the Company's management includes remuneration to the members of the Company's Management Board, the Supervisory Board and the Supervisory body (Audit Committee). Information disclosed in Note 9.

Dividend payments to Shareholder of the Parent Company and share capital contributions are disclosed in Note 20 b and Note 19, respectively.

e) Non–current loans to related parties (Parent Company)

Concluded non–current borrowing agreements with Latvijas elektriskie tīkli AS:

EUR'000

Agreement conclusion date	Principal amount of the loan	Interest rate	Maturity date
01/04/2011	97,467	6 months EURIBOR + fixed rate	01/04/2025
03/09/2013	44,109	fixed rate	10/09/2023
10/06/2016*	156,500	fixed rate	10/06/2027
TOTAL	**298,076**		

* as of 31 December 2017 within the loan agreement issued loan have been disbursed in the amount of EUR 45,000 thousand with the maturity date on 10 June 2027 for issued loan in 2017 in amount of EUR 30,000 thousand and with the maturity date on 10 June 2026 for disbursed loan in 2016 in the amount of EUR 15,000 thousand

Total outstanding amount of non–current loans with Latvijas elektriskie tīkli AS as of 31 December 2017 amounted to EUR 93,883 thousand (31/12/2016: EUR 75,229 thousand), including current portion of the loan repayable in 2018 – EUR 8,490 thousand (31/12/2016: EUR 12,931 thousand). As of 31 December 2017 for 17% (31/12/2016: 29%) of the loans issued to Latvijas elektriskie tīkli AS was set floating interest rate, which was influenced by 6 months EURIBOR interbank rate fluctuations. During 2017 the effective average interest rate of non–current loans was 2.36% (2016: 2.69%). Non–current loans are not secured with a pledge or otherwise.

Non–current loans to Latvijas elektriskie tīkli AS by maturity

EUR'000

	Parent Company	
	31/12/2017	31/12/2016
Non–current loan:		
– < 1 year	8,490	12,931
– 1 – 5 years	64,790	30,866
– > 5 years	20,603	31,432
	93,883	**75,229**

Concluded non–current borrowing agreements with Sadales tīkls AS

EUR'000

Agreement conclusion date	Principal amount of the loan	Interest rate	Maturity date
29/09/2011	316,271	6 months EURIBOR + fixed rate	01/09/2025
06/02/2013	42,686	fixed rate	10/09/2022
18/09/2013	42,686	fixed rate	10/08/2023
29/10/2014	90,000	fixed rate	10/09/2024
20/10/2015	90,000	fixed rate	21/10/2025
22/08/2016	60,000	fixed rate	22/08/2026
22/08/2016	50,000	fixed rate	14/06/2027
TOTAL	**691,643**		

Total outstanding amount of non–current loans with Sadales tīkls AS as of 31 December 2017 amounted to EUR 363,497 thousand (31/12/2016: EUR 362,376 thousand), including current portion of the loan repayable in 2018 – EUR 50,915 thousand (31/12/2016: EUR 48,880 thousand). As of 31 December 2017 for 16% of the loans issued to subsidiary (31/12/2016: 21%) was set floating interest rate, which was influenced by 6 months EURIBOR interbank rate fluctuations. During 2017 the effective average interest rate of non–current loans was 1.84% (2016: 1.96%). Non–current loans are not secured with a pledge or otherwise.

Non–current loans to Sadales tīkls AS by maturity

EUR'000

	Parent Company	
	31/12/2017	31/12/2016
Non–current loan:		
– < 1 year	50,915	48,880
– 1 – 5 years	238,425	220,023
– > 5 years	74,157	93,473
	363,497	**362,376**

f) Current loans to related parties (Parent Company)

Financial transactions between related parties have been carried out by using current loans with a target to effectively and centrally manage Latvenergo Group companies' financial resources, using Group accounts. In the reporting period Latvenergo AS issued loans to subsidiaries in accordance with mutually concluded agreement 'On provision of mutual financial resources'. In 2017 the effective average interest rate was 0.52% (2016: 0.55%).

In the reporting period Enerģijas publiskais tirgotājs AS received current loan from Latvenergo AS in accordance with mutually concluded agreement 'On provision of mutual financial resources', using Group accounts.

On 31 March 2017 an agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS for issue of the current loan in amount of EUR 200,000 thousand to ensure Enerģijas publiskais tirgotājs AS financial resources for the fulfilment of public supplier duties and mandatory procurement process administration. Loan annual interest rate is fixed at 1.000% (2016: 1.000%). Maturity date of the loan is 31 March 2018. Latvenergo AS issued and Enerģijas publiskais tirgotājs AS accepted loan or its part at the end of each month, reassigned Enerģijas publiskais tirgotājs AS current loan liabilities from Latvenergo AS at the end of last calendar day of the current calendar month. As of 31 December 2017 issued, but unpaid net amount of current loan is EUR 150,231 thousand (31/12/2016: EUR 129,936 thousand).

On 29 November 2017 an agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS for issue a short term loan in amount of EUR 454,413 thousand. Loan amount equals to the government grant receivable (Note 23) and loan is intended to ensure Enerģijas publiskais tirgotājs AS financial resources for financing of one-off compensation (see Note 23). The maturity of the loan is 11 April 2018 and the loan is settled subsequently to the reporting year by using the funds generated through capital release of Latvenergo AS (Note 27).

Non–current and current loans to related parties

EUR'000

	Parent Company	
	31/12/2017	31/12/2016
Non–current loans to subsidiaries		
Sadales tīkls AS	312,582	313,497
Latvijas elektriskie tīkli AS	85,394	63,883
Total non–current loans	**397,976**	**377,380**
Current portion of non–current loans		
Sadales tīkls AS	50,914	48,880
Latvijas elektriskie tīkli AS	8,490	11,345
Current loans to subsidiaries		
Latvijas elektriskie tīkli AS	1,294	3,678
Sadales tīkls AS	28,157	41,651
Elektrum Eesti OÜ	5,134	5,046
Elektrum Lietuva, UAB	2,172	4,788
Enerģijas publiskais tirgotājs AS	604,644	129,936
Total current loans	**700,805**	**245,324**
TOTAL loans to subsidiaries	**1,098,781**	**622,704**

Movement in loans

EUR'000

	Parent Company	
	31/12/2017	31/12/2016
At the beginning of the year	**622,704**	**624,577**
Issued current loans (net)	536,302	78,446
Repaid non–current loans	(60,225)	(80,319)
At the end of the year	**1,098,781**	**622,704**

Interest received from related parties

EUR'000

	Parent Company	
	2017	2016
Interest received	1,682	1,408
	1,682	**1,408**

g) Current borrowings from related parties (Parent Company)

Financial transactions between related parties have been carried out by using current loans with a target to effectively and centrally manage Latvenergo Group companies' financial resources, using Group accounts. In the reporting period Latvenergo AS has received borrowings from subsidiaries in accordance with mutually concluded agreement 'On provision of mutual financial resources'. In 2017 the effective average interest rate was 0.52% (2016: 0.55%). At the end of the reporting year Latvenergo AS has no borrowings from related parties (31/12/2016: nil).

EUR'000

	Parent Company	
	2017	2016
Interest paid	41	51
	41	**51**

26. Capital Commitments and Contingent Liabilities

As of 31 December 2017 the Group had commitments amounting to EUR 225.6 million (31/12/2016: EUR 264.7 million) and the Parent Company had commitments amounting to EUR 105.2 million (31/12/2016: EUR 150.1 million) for capital expenditure contracted but not delivered at the end of the reporting period.

Latvenergo AS has concluded contracts with PJSC Power Machines for reconstruction of Pļavinas HPP's hydroelectric units HA1 and HA3 and reconstruction of Ķeguma HPP's hydroelectric units HA5, HA6 and HA7 until the year 2020 with the total amount of contracts EUR 78.0 million. Contingent liabilities contracted but not fulfilled at the end of the balance sheet date are amounted to EUR 28.2 million.

On 26 January 2018 U.S. Department of Treasury Office of Foreign Assets Control (hereinafter – OFAC) published a statement on persons subjected to sanctions of USA, according to this statement PJSC Power Machines is under abovementioned sanctions. As a result the end of the project could be extended, because both contracting parties has no possibilities to make mutual payments. On 9 March 2018 Latvenergo AS was submitted the application to OFAC with a request for a licence to continue the contract

obligations with Power Machines to complete the reconstruction of the Pļavinas HPP's and Ķeguma HPP's hydroelectric units. Due to negative decision made by OFAC there is possibility of mutual future claims, but the outcome cannot be determined at the moment.

In 2017 Latvenergo AS has issued support letters to its subsidiaries Enerģijas publiskais tirgotājs AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS acknowledging that its position as shareholders is to ensure that subsidiaries are managed so that they have sufficient financial resources and are able to carry their operations and settle their obligations.

27. Events after the Reporting Year

On 29 March 2018, an agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS on prolongation of borrowing from Latvenergo AS in amount till EUR 150 million by one year till 31 March 2019.

In March 2018 International credit rating agency Moody's has affirmed the credit rating of Latvenergo AS – Baa2, stable. The rating has been unchangeably stable for several years, confirming consistency within operations and financial soundness of the company.

In accordance with the Shareholder's decision of 24 November 2017, change in share capital of Latvenergo AS is registered on 20 March 2018. Share capital of Latvenergo AS is reduced by EUR 454,413 thousand and is related to the order by the Cabinet of Ministers on 21 November 2017 on the decrease of the intensity of support by 75% of the future state commitments to Latvenergo AS regarding its cogeneration power plants Riga TEC-1 and Riga TEC-2 (CHPPs) in exchange to a one-off compensation in the amount of EUR 454,413 thousand (Note 23). The compensation is financed by the funds generated through capital release of Latvenergo AS.

Further on 26 March 2018 the Parent Company settled its liability towards Ministry of Economics for the capital release by netting of the balance with the respective grant receivable from the state in accordance with the trilateral agreement. In accordance with the provisions of the same agreement, the Parent Company netted balances with public trader on the same date. As a result of this process, mandatory procurement public service obligation fee (MP PSO fee) has been reduced – as of 1 January 2018, the fee is 25.79 EUR/MWh, by 1 EUR/MWh compared to the former 26.79 EUR/MWh. Further MP PSO fee reduction is currently one of the issues under consideration by the government of Latvia.

There have been no other significant events subsequent to the end of the reporting year that might have a material effect on the Financial Statements for the year ended 31 December 2017.

_____
Āris Žīgurs
Chairman of the Management Board

_____
Guntars Baļčūns
Member of the Management Board

_____
Uldis Bariss
Member of the Management Board

_____
Māris Kuņickis
Member of the Management Board

_____
Liāna Ķeldere
Accounting director of Latvenergo AS

17 April 2018

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Latvenergo AS

Opinion

We have audited the accompanying consolidated financial statements of Latvenergo AS and its subsidiaries (the Group) and the accompanying financial statements of Latvenergo AS (the Parent Company) set out on pages 92 to 146 of the accompanying Annual Report, which comprise the statements of financial position as at 31 December 2017, and the statements of profit or loss, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements of the Group and the Parent Company give a true and fair view of the financial position of the Group and the Parent Company as at 31 December 2017, and of their financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

Basis for opinion

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 *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Group and the Parent Company in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the independence requirements included in the Law on Audit Services of Republic of Latvia that are relevant to our audit of the financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with the Law on Audit Services of Republic of Latvia and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Building a better working world

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the Group and the Parent Company of the current period. These matters were addressed in the context of our audit of the financial statements of the Group and the Parent Company as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements of the Group and the Parent Company. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements of the Group and the Parent Company.

Key audit matter	How we addressed the key audit matter
Revenue recognition from contracts with customers (the Group and the Parent Company)	
The Group and the Parent Company in 2017 have recognized in the statement of profit or loss revenue from contracts with customers amounting to 879 344 thousand EUR and 482 658 thousand EUR, respectively, as disclosed in Note 6. During the financial year the Group and the Parent Company have early adopted IFRS 15: Revenue from contracts with customers. The early adoption of this accounting standard has not materially affected how the Group and the Parent Company recognises revenue, as disclosed in Note 2.29. However, there are significant judgements made by management in determining the appropriate basis of revenue recognition including recognition of revenue from connection service fees to the distribution system, as outlined in Note 4. d). Accurate revenue recognition is inherently more complex in the energy sector when compared to some other industries due to the large number of the customers, including both residential and corporate customers, and various pricing arrangements included in the range of products and services provided to different groups.	In relation to revenue recognition we performed the following procedures, among others: • we gained an understanding of the revenue recognition and measurement for electricity supply, electricity services and distribution system services revenue streams; • we tested a sample of IT dependent manual controls implemented over revenue recognition and measurement for electricity supply, electricity services and distribution system services revenue streams; • we tested relevant IT system controls over revenue recording, calculation of amounts billed to the Group's and Parent Company's customers and matching of cash receipts to the customers' accounts; • we obtained external customer confirmations for selected largest customers regarding heat sales stream amounts recognized by the Group and the Company; • we performed analytical review procedures by forming an expectation of revenue based on the key performance indicators, including taking into consideration the number and composition of the Group's and Parent Company's customers, electricity supply volumes, changes in electricity prices and also comparing the results of our analysis against the prior reporting period and

Key audit matter	How we addressed the key audit matter
Given the variety of contractual terms with the customers, as well as different revenue streams and product types included in each stream, revenue recognition is considered to be relatively complex and requires, among other things, continual operating effectiveness of controls over the various categories of revenue streams. Revenue recognition was significant to our audit due to the materiality of revenue to the financial statements, potential impact from IFRS 15 early adoption and the variety of products and price components included in revenue.	• we tested a sample of revenue transactions near the financial year-end for their recognition in the appropriate accounting period. In relation to IFRS 15 early adoption our procedures included the following: • we have obtained and reviewed IFRS 15 impact assessment prepared by the management; • we reviewed IFRS 15 implementation by comparing it with the requirements in IFRS 15 and related guidance. We have involved our IFRS specialists to assist us with the assessment of the judgements made by the management; • we checked the calculation of the restated comparative figures; • we have tested contracts on a sample basis and reviewed management's IFRS 15 analysis to assess whether performance obligations in the sales contracts have been appropriately identified and whether revenue related to the different performance obligations is recognized in accordance with IFRS 15 requirements. We also assessed the adequacy of the revenue related disclosures contained in Note 2.29., Note 5. and Note 6. In addition, we evaluated the sufficiency of disclosures made regarding significant judgements made by the management in relation to revenue recognition (Note 4. d)).
Revaluation of Daugava hydropower plants (HPPs) (the Group and the Parent Company)	
Property, plant and equipment (PPE), as disclosed in Note 2.6., is carried at historical cost or revalued amounts less accumulated depreciation and accumulated impairment loss. As per accounting policy outlined in Note 2.8. certain groups of PPE are revalued regularly but not less frequently than every five years.	We involved our valuation specialists to assess the revaluation model, assumptions and methods used by the management in the revaluation. We discussed the revaluation model with the management and the external appraiser. We also tested the data used in the revaluation models on sample basis to the source data. We evaluated the recognition and measurement of the results of the revaluation as presented in the financial statements Note 14 c) and compared the accounting treatment applied to the

Key audit matter	How we addressed the key audit matter
During the financial year HPPs recognized by the Parent Company were revalued by applying the income approach model (Note 14. c)). The management used an external appraisal to carry out the revaluation of this PPE group with the revaluation date of 1 April 2017. In the Group's and Parent Company's financial statements, as a result of upward revaluation of HPPs as at the revaluation date a gross revaluation reserve of 22 167 thousand EUR (excluding the effect of deferred income tax) was recognized in equity and the result of downward revaluation of 2 260 thousand EUR was charged to the statements of profit or loss in the year 2017. Revaluation of this PPE group involves significant estimates and assumptions, such as the selection of appropriate valuation method, estimation of remaining useful lifetime and condition of PPE items, market knowledge and data on the historical transactions provided by the management to the external experts. This matter is one of the most significance to the audit given the size and complexity of the revaluation and the importance of the disclosures relating to the assumptions used in the revaluation.	requirements of IFRS. For a sample of revalued PPE items, we tested the accounting treatment on the individual transaction level in the Group's accounting system. Finally, we also evaluated the disclosures relating to the revaluation model, revaluation outcome and the assumptions used as disclosed in Note 4. a) III) and in Note 14. c).
Impairment assessment of property, plant and equipment (the Group and the Parent Company)	
As at 31 December 2017, the Group and the Parent Company have recognized PPE amounting to 3 308 985 thousand EUR and 1 231 454 thousand EUR, respectively, as reported in the statements of the financial position and disclosed in Note 14 a). The Group performed impairment tests based on the value in use estimation for distribution system assets, transmission system assets. In addition, the Parent Company performed impairment tests for certain HPPs (combined impairment test for Riga, Plavinu and Keguma HPPs) and assets of Riga Combined Heat and Power Plant. Each of the above in the judgement of the management represents a separate cash generating unit (CGU).	For all four CGU impairment tests we involved our valuation specialists to assist us with the assessment of the impairment test models, discount rates applied in each model and other significant management assumptions as described. We discussed with the management the appropriateness of the information and data used in the impairment tests. We compared the most significant inputs to the source data. We also compared the amounts used by the management in the cash flow forecasts with the historical results and compared the estimated cash flows with the long term budgets approved by the management.

Key audit matter	How we addressed the key audit matter
An additional impairment of charge of 116 799 thousand EUR was recorded in the statements of profit or loss of the Group and the Parent Company for Riga Combined Heat and Power Plant CGU in the year 2017, while for other CGU's no impairment charge has been recognized as a result of the impairment tests (Note 14. d)). In relation to the impairment tests for the assets of the distribution and transmission systems significant assumptions used by the management include the selection of discount rate, pricing forecast for major revenue streams, which are contingent on regulatory pre-approvals, assumptions related to capital investment plans, as well as terminal value calculation. HPPs impairment test is based on significant assumptions in relation to the selection of discount rate, electricity price and operating expenses forecasts, as well as terminal value calculation. Riga Combined Heat and Power Plant CGU impairment test is based on significant assumptions in relation to the selection of discount rate, variable revenue stream forecast in view of legislation regulating the cogeneration unit capacity component payments and the terminal value calculation. Impairment test was significant to our audit as it involves significant management judgements applied in the cash flow forecasts.	Finally, we evaluated the adequacy of the disclosures in relation to the impairment tests and the outcome of these tests as disclosed in Note 4. a) II) and in Note 14. d).
Government grant in relation to Riga Combined Heat and Power Plant (the Group and the Parent Company)	
In October 2017 the Cabinet of Ministers of the Republic of Latvia issued a ruling, which granted an option for qualifying electricity producers receiving guaranteed payments for installed electric capacity to apply for a one-off compensation from the state. The purpose of the compensation is to provide an option to receive a government grant in exchange for a decrease in the intensity of the state support in amount equal to 75% of the discounted future guaranteed payments, while the remaining 25% would be paid by the state to the qualifying producer as per the previous regulation.	We discussed the transaction with the management and gained an understanding of its rationale and legal basis. Our audit procedures also included, among others, a detailed review of the related legislation and the Cabinet of Ministers rulings. We also evaluated the contents of the relevant agreements, documents and data provided to us by the Parent Company's management.

Key audit matter	How we addressed the key audit matter
The Parent Company is the owner of two qualifying plants under the Riga Combined Heat and Power Plant and is eligible to receive the guaranteed payments for installed electric capacity until October 2028. It applied and was granted the compensation for these plants by the state in November 2017. Total government grant receivable in accordance with the Cabinet of Ministers ruling amounts to 454 413 thousand EUR, as disclosed in Note 23. The ruling states that the compensation is granted in two parts as: 1) an unconditional grant, giving immediate financial support in 2017, and amounting to 140 000 thousand EUR. The respective amount is recognized in the Group's and Parent Company's statements of profit or loss as income in 2017 (Note 7); 2) a conditional grant, which is granted in return for future compliance with the conditions attached to the operating activities of Riga Combined Heat and Power Plant until October 2028, amounting to 314 413 thousand EUR. This amount as at 31 December 2017 is recognized in the Group's and Parent Company's statement of financial position as deferred income (Note 23) and in future years is to be allocated to income on a straight-line basis till October 2028. In accordance with the above Cabinet of Ministers ruling and related legislation, the government grant shall be settled by the Ministry of Economics, which is also representing the state as the sole shareholder of the Parent Company. In order to settle the government grant, the Parent Company, its subsidiary Enerģijas publiskais tirgotājs AS (who is an agent in this transaction) and Ministry of Economics entered a trilateral agreement in November 2017. In accordance with the provisions of the agreement and related Parent Company's shareholder resolution the government grant will be settled with a share capital reduction of the Parent Company equal to the government grant amount. As a result, subsequent to financial year-end the Parent Company has decreased its share capital in the amount of 454 413 thousand EUR. The Parent Company further settled its liability towards the Ministry of Economics for the share capital reduction via a netting of the balance with the respective grant receivable from the shareholder in accordance with the trilateral agreement (Note 27). The above transactions are unusual and material to the Group's and Parent Company's financial statements, therefore were significant to our audit.	We evaluated the accounting treatment as described and compared to the amounts stipulated in the related rulings and agreements. We further evaluated the requirements set out in IAS 20: Accounting for Government Grants and Disclosure of Government Assistance, compared IAS 20 requirements with the amounts recorded in the accounting system and disclosures made in the financial statements. Our procedures also included a review of events after the financial year. We evaluated the disclosures made in Note 27 by obtaining the relevant documents related to the share capital decrease and mutual netting of balances, as described. Finally, we also assessed the sufficiency of the related disclosures included in Note 7, Note 23 and Note 27, as well as the related accounting policy included in Note 2.20.

Reporting on other information

Management is responsible for the other information. The other information comprises:

- the Management Report, as set out on pages 86 to 91 of the accompanying Annual Report;
- the Statement of Corporate Governance, as set out in a separate statement provided by the Parent Company's management and available on the Parent Company's website http://www.latvenergo.lv section *Investors*,
- the Non-financial Statement, as included in the Management Report set out on page 89 of the accompanying Annual Report.

but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except as described 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 financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the 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 Group and the Parent Company and their environment obtained in the course of our audit, 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

We have other reporting responsibilities in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Management Report, the Statement of Corporate Governance and the Non-Financial Statement. These additional reporting responsibilities are beyond those required under the ISAs.

Our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Law on the Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

Based solely on the work undertaken in the course of our audit, in our opinion:

- the information given in the Management Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Management Report has been prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

In accordance with the Law on Audit Services of the Republic of Latvia with respect to the Statement of Corporate Governance, our responsibility is to consider whether the Statement of Corporate Governance includes the information required in Article 56^2 paragraph three of the Financial Instruments Market Law.

In our opinion, the Statement of Corporate Governance includes the information required Article 56^2 paragraph three of the Financial Instruments Market Law.

Furthermore, in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Non-financial Statement our responsibility is to report whether the Company has prepared the Non-financial Statement and whether the Non-financial Statement is included in the Management Report or prepared as a separate element of the Annual Report or is included in the consolidated Non-financial Statement of the Company's parent company.

We hereby report that the Group has prepared a Consolidated Non-financial Statement, and it is included in the Management Report.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with the International Financial Reporting Standards 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 financial statements, management is responsible for assessing the Group's and the Parent Company'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 Group and the Parent Company or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's 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 financial statements.

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

- Identify and assess the risks of material misstatement of the 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 Group's and the Parent Company'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 Group's and the Parent Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the 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 auditor's report. However, future events or conditions may cause the Group and the Parent Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves 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 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 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.

Other reporting responsibilities and confirmations required by the legislation of the Republic of Latvia and European Union when providing audit services to public interest entities

We were first appointed as auditors of the Group and the Parent Company on 1 June 2011 by Latvenergo AS shareholder. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 6 years.

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We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Parent Company;
- as stipulated in paragraph 37^6 of the Law on Audit Services of the Republic of Latvia we have not provided to the Group and the Parent Company the prohibited non-audit services (NASs) referred to in EU Regulation (EU) No 537/2014. We also remained independent of the audited entity in conducting the audit.

The responsible certified auditor on the audit resulting in this independent auditors' report is Diāna Krišjāne.

ERNST & YOUNG BALTIC SIA
License No. 17

Diāna Krišjāne
Chairperson of the Board
Latvian Certified Auditor
Certificate No. 124

Riga, 17 April 2018