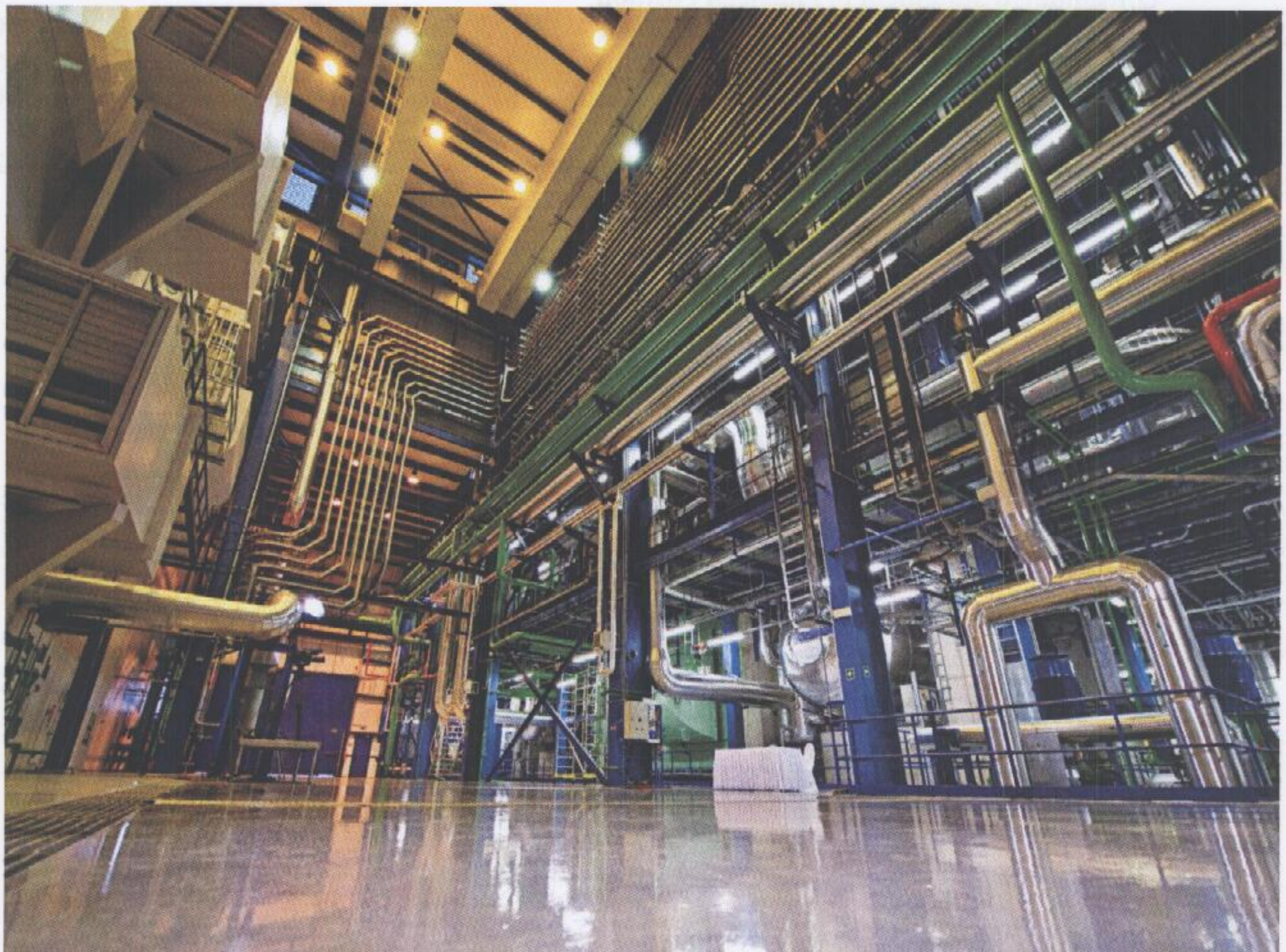
Latvenergo



Latvenergo
Consolidated Annual Report 2011

PREPARED IN ACCORDANCE WITH
THE INTERNATIONAL FINANCIAL REPORTING STANDARDS
AS ADOPTED BY EU

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Key Figures

		2007	2008	2009	2010	2011
Revenue	LVL'000	361,629	475,856	500,513	567,386	681,767
Including electricity sales	LVL'000	302,167	386,205	404,723	470,663	583,428
Heat sales	LVL'000	49,751	72,887	71,403	71,863	69,233
EBITDA [1]	LVL'000	89,819	107,052	144,885	207,240	180,729
EBITDA margin [2]		25%	22%	29%	37%	27%
Operating profit [3]	LVL'000	17,174	18,345	31,446	61,826	53,345
Operating margin [4]		5%	4%	6%	11%	8%
Net profit	LVL'000	7,507	7,328	19,556	44,325	43,778
Dividends	LVL'000	2,123	13,001	20,230	35,000	39,900
Net profit margin [5]		2%	2%	4%	8%	6%
Return on assets (ROA) [6]		0.8%	0.5%	1.2%	2.2%	1.9%
Return on equity (ROE) [7]		1.5%	0.9%	2.2%	4.0%	3.2%
Non-current assets at the end of the year	LVL'000	1,201,742	1,475,618	1,462,114	1,942,231	2,026,594
Total assets at the end of the year	LVL'000	1,315,958	1,680,567	1,699,491	2,279,266	2,288,004
Total equity at the end of the year	LVL'000	711,671	866,331	889,440	1,344,748	1,351,576
Borrowings from financial institutions at the end of the year	LVL'000	354,856	496,317	507,225	545,607	513,334
Cash flows from operating activities	LVL'000	125,410	84,419	138,174	160,563	180,399
Capital expenditure	LVL'000	221,886	197,311	104,506	127,539	198,723
Net debt [8]	LVL'000	315,682	392,767	352,287	311,342	404,458
Net debt/EBITDA ratio		3.5	3.7	2.4	1.5	2.3
Retail electricity sales	GWh	7,518	7,461	6,659	7,620	8,980
Electricity produced in power plants	GWh	4,128	4,567	4,871	5,869	5,285
Total amount of purchased electricity	GWh	3,981	3,478	3,145	3,028	4,466
Including purchased electricity from independent producers	GWh	564	637	636	693	759
The rest amount of purchased electricity	GWh	3,418	2,841	2,509	2,335	3,707
Aggregate heat sales	GWh	2,876	2,634	2,600	2,928	2,524
Number of employees at the end of the year		5,353	5,375	4,701	4,517	4,490
Moody's credit rating of the Parent Company		A2 (stable)	A3 (negative)	Baa3 (negative)	Baa3 (stable)	Baa3 (stable)

1) EBITDA – earnings before interest, income tax, share of result of associates, depreciation and amortisation, and impairment of intangible and fixed assets
2) EBITDA margin – EBITDA / revenue
3) Operating profit – earnings before income tax, finance income and costs
4) Operating margin – operating profit / revenue
5) Net profit margin – net profit / revenue
6) Return on assets (ROA) – net profit / average value of assets (assets at the beginning of the year + assets at the end of the year/2)
7) Return on equity (ROE) – net profit / average value of equity (equity at the beginning of the year + equity at the end of the year/2)
8) Net debt – borrowings from financial institutions at the end of the year minus cash and cash equivalents at the end of the year

Management Report

In 2011 Latvenergo Group is the largest electricity retailer in the Baltics

Latvenergo Group is the largest energy company in the Baltics - engaged in electricity and heat production as well as electricity trade. 2011 is the seventh reporting year for Latvenergo as a Group.

2011 Latvenergo Group's revenues are LVL 681.8 million, which is 20% more compared to 2010. Revenue growth was achieved mainly due to successful electricity retail market operations in the Baltics where the Group sold 8 980 GWh electricity - 18% more than in 2010 reaching the highest sales volume amount over the last years.

As a result of expansion of operations in Lithuania and Estonia in 2011 almost one fourth (13% in 2010) from the total Group's revenues are generated from operations outside Latvia. As a result of increase in sold electricity volumes, Latvenergo Group is the largest electricity retailer in the Baltic countries servicing one third of all Baltic clients.

The largest increase of electricity sold in 2011 is in Lithuania and Estonia where total sold volume amounts to 2 296 GWh, which exceeds 2010 results by more than 3 times (700 GWh), As a result our market share in Lithuania reached 18% (5% in 2010), while in Estonia – 7% (2% in 2010) from total consumption. Sold electricity volume in Latvia amounts to 6 685 GWh (6 920 GWh in 2010) covering 94% from total Latvian electricity consumption (95% in 2010).

In accordance to the provisions of Baltic Energy Market Interconnection Plan (BEMIP) which is also implemented in the local legislation of each Baltic country, electricity market liberalisation continued in 2011. Most substantial changes were introduced in Lithuania, where open market represents 56% of all electricity consumption (50% in Latvia, 30% in Estonia).

Latvenergo Group's share in the open Baltic electricity market is 47%

Latvenergo Group is actively pursuing market opening opportunities. During 2011 Latvenergo Group sold 5 330 GWh in unregulated Baltic electricity market, representing 47% from total market open to competition thus demonstrating successful operations in competitive environment.

In 2012 long term changes in the Baltic electricity market will continue including further price deregulation and joint electricity Exchange establishment in the Baltic countries. For 2012 Latvenergo Group has defined ambitious goals to strengthen position in the Baltics by considerably increasing number of clients. In 2012 new retail brand introduction and brand awareness activities are planned in addition to further deployment of on-line servicing and enhancement of billing options as well as preparations to enter Estonian small and medium enterprise and household market in 2013.

In 2011 Latvenergo Group's generated gross electricity volume amounted to 5 285 GWh in total or by 10% less than in 2010 when performance of Daugava hydro-power plants (hereinafter – Daugava HPP) was positively influenced by water throughput in the river Daugava.

Latvenergo Group is the largest Baltic renewable electricity producer in 2011

In 2011 Daugava HPP cascade delivered 2 823 GWh or 53% from total electricity produced by Latvenergo. As a result Latvenergo is the leading renewable electricity producer in the Baltics and one of the leaders of energy producers from renewable energy resources in whole Europe.

In addition to own produced electricity Latvenergo Group purchased 4 466 GWh electricity in 2011 (3 028 GWh in 2010) in Latvia, including 759 GWh from Latvian producers within framework of mandatory procurement (693 GWh in 2010).

All production facilities of Latvenergo Group will be renewed by 2013

Latvenergo Group's profit for 2011 was LVL 43.8 million (LVL 44.3 million in 2010), and dividends payable – LVL 39.9 million (LVL 35.0 million in 2010). During 2011 capital investments amounted to LVL 198.7 million and 57% of investments related to Rīgas TEC–2 energy generation unit reconstruction project that will commence operations in 2013. With completion of Rīgas TEC–2 energy unit in 2013 Latvenergo Group will be the only electricity producer in the Baltics that has renewed all production facilities.

Future investments in generation assets will relate to diversification of generation capacities as well as improving efficiency for the usage of renewable resource. Latvenergo will continue capital investment program to improve efficiency of Daugava HPP generation capacity to utilize the river Daugava resource more efficiently. It is planned to complete Daugava HPP generation unit upgrade by 2022 and total capital investments for this program will exceed LVL 100 million. Similarly, Latvenergo will explore options to develop new generation capacities in whole Baltic region as a major step towards electricity sales expansion.

Investments in the distribution network amounted to LVL 45.8 million in 2011

Important Latvenergo Group's business segment is electricity distribution. Revenues from distribution services in 2011 are LVL 179.5 million (LVL 161.9 million in 2010), while capital investments for distribution grid reconstruction and development increased to LVL 45.8 million (LVL 26.2 million in 2010). With the aim to decrease electricity supply interruptions, in 2011 capital investment program was started to rebuild overhead lines into cables. With an objective to improve reliability of distribution network and its technical parameters (frequency of outings, voltage measurements, technical conditions of electricity lines etc.) in 2012 it is planned to further increase capital investments in distribution network.

By investing distribution assets owned by Latvenergo AS in the equity of Sadales tīkls AS at the value of LVL 803.4 million in 2011 establishment of the distribution system operator as required by the market liberalization was finalized.

Requirements of Directive 2009/72/EC on unbundling of transmission system operator are fully satisfied

According to amendments to Electricity market Law, related to requirements of the European Parliament and the Council Directive as of 13th July of the 2009th Directive 2009/72/EC transmission operator needs to be separated from electricity generation, distribution and sale. At the end of 2011 the shares of transmission operator Augstsprieguma tīkls AS were sold to Ministry of Finance (process finalized at the beginning of 2012) and Latvijas elektriskie tīkli AS was established as an owner of the transmission system assets. With this business transfer, transmission system assets amounting to LVL 240.1 million previously owned by Latvenergo were invested in Latvijas elektriskie tīkli AS, and employees required for provision of services related to transmission system assets were taken over from Augstsprieguma tīkls AS.

Project *Kurzemes Ring* will improve security of electricity supply and ensure integration in Nordic market

In 2011 Latvenergo Group invested LVL 15.1 million into the transmission network. The most significant strategic project is 330 kV network development project *Kurzemes Ring* that is part of the international electricity infrastructure development project – *NordBalt* including construction of interconnection to Sweden by 2018 to improve security of electricity supply for whole Baltics. Capital investments related to the project reached LVL 4.7 million in 2011. Total project costs are estimated at LVL 140 million. Co-financing from EU Energy project for Economic recovery is received.

Cash flows from operations improves while sustaining good liquidity and stable capital structure

In 2011 Latvenergo Group's cash flows from the operating activities continued to improve and reached LVL 180.4 million (LVL 160.6 million in 2010). In overall cash flows from the operating activities for the last three years were sufficient to cover all capital investments for this period.

Latvenergo Group's loan and cash balance net value in 2011 was LVL 404.5 million (LVL 311.3 million for 2010). To optimize cash flow Latvenergo Group invested free cash flows in the state securities (LVL 60.4 million in 2011). Net debt ratio against earnings before taxes and depreciation (EBITDA) is 2.3 which according to financing practice considered as very good indicator.

Operations of Latvenergo Group are exposed to various risks. Most significant ones are financial risks, namely, foreign exchange rate risks, interest rate risks and price fluctuation risks. The main drivers of the Group's operations are price fluctuations in *NordPool* exchange, CO_2 emission allowance prices, EURIBOR rate and EUR exchange rate. According to the Group's risk management policies the Group is using derivative financial instruments to reduce open risk positions and limit impact on the Group's financial result due to changes in underlying market factors.

Latvenergo is recognised as the most valuable company in Latvia

In 2011 Latvenergo was recognised by Review of magazine Kapitāls, investment bankers firm IBS Prudentia and NASDAQ OMX Riga Stock exchange as the most valuable company in Latvia, similarly in 2012 review done by Dienas Bizness recognised Latvenergo as the third largest company by turnover in the Baltics and the largest Baltic energy company.

In 2011 seventeenth year in a row the knowledge quiz organized by Latvenergo Group eXperiments took place to facilitate in attractive way youth interest for physics, natural phenomena and safe electricity usage. In 2011 there were 220 teams participating from schools in Latvia.

Therefore we can conclude that successful operations of Latvenergo are result of targeted activities in the Baltic electricity market, well planned development of generation capacities and balanced grid development policy. We run our business by acknowledging of client needs, impact of our operations on environment, society and country. Successfully started development of Latvenergo Group will be continued in 2012.

Post balance sheet events

In accordance with the provisions of the agreement signed on 30 December 2011 between Latvenergo AS and Ministry of the Finance, and based on Augstsprieguma tīkls AS Shareholder's register entry on 2 January 2012, from 2 January 2012 the sole shareholder of Augstsprieguma tīkls AS is Latvian State represented by Ministry of the Finance.

There are no other post balance sheet events that would materially affect the financial position of the Group as at 31 December 2011.

Profit distribution

Fulfilling the requirements of the Law on state and municipality owned shares and companies, Regulations No. 1074 of the Cabinet of Ministers of Latvia dated 25 November 2010 On amendments of regulations No. 1471 dated 15 December 2009 On Procedure how the payable part of the profit for the use of the state's capital is determined and paid into the state's budget and the Law on state's budget for 2012, the Management Board of Latvenergo AS proposes to allocate LVL 39,900,000 to be paid out in dividends.

The distribution of profit for 2011 is subject to a resolution of Latvenergo AS Shareholders' meeting.

The Management Board of Latvenergo AS:

Āris Žīgurs
Chairman of the Board

Zane Kotāne

Uldis Bariss

Māris Kuņickis

Arnis Kurgs

22 May 2012

Consolidated Income Statement

	Notes	2011 LVL'000	2010 LVL'000
Revenue	5	681,767	567,386
Other income	6	4,175	2,674
Raw materials and consumables used	7	(408,192)	(273,590)
Personnel expenses	8	(61,572)	(56,136)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	12a, 13a	(127,384)	(145,414)
Other operating expenses	9	(35,449)	(33,094)
Operating profit		**53,345**	**61,826**
Finance income	10	3,047	5,513
Finance costs	10	(13,956)	(16,530)
Share of profit of associates	14	232	203
Profit before income tax		**42,668**	**51,012**
Income tax	11	564	(6,455)
Profit for the year from continuing operations		**43,232**	**44,557**
Discontinued operations (transmission system operator)			
Profit for the year from discontinued operations	30	546	(232)
Profit for the year		**43,778**	**44,325**
Profit attributable to:			
- Owners of the Parent Company		43,328	43,847
- Non-controlling interest		450	478

Consolidated Statement of Comprehensive Income

	Notes	2011 LVL'000	2010 LVL'000
Profit for the year		**43,778**	**44,325**
Other comprehensive income:			
Gains on revaluation of property, plant and equipment	19	81	425,248
(Losses)/gains on currency translation differences	19	(14)	8
Losses from change in hedge reserve	19	(4,335)	(375)
Other comprehensive (loss)/income for the year, net of tax		**(4,268)**	**424,881**
Total comprehensive income for the year		**39,510**	**469,206**
Attributable to:			
- Owners of the Parent Company		39,060	468,728
- Non-controlling interest		450	478

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:

Āris Žīgurs
Chairman

Zane Kotāne

Uldis Bariss

Māris Kuņickis

Arnis Kurgs

22 May 2012

Consolidated Statement of Financial Position

	Notes	31/12/2011 LVL'000	31/12/2010 LVL'000
ASSETS			
Non-current assets			
Intangible assets	12a	6,601	7,478
Property, plant and equipment	13a	1,999,502	1,928,810
Investment property	13c	-	382
Investments in associates	14	4,696	4,464
Other non-current receivables		95	172
Investments in held-to-maturity financial assets	28	15,670	-
Deferred income tax assets	11	30	925
Total non-current assets		**2,026,594**	**1,942,231**
Current assets			
Inventories	15	13,949	11,501
Trade receivables	16a	73,809	63,031
Other receivables	16b	17,611	21,882
Derivative financial instruments	24a	2,450	3,968
Investments in held-to-maturity financial assets	28	44,714	2,387
Cash and cash equivalents	17	108,877	234,266
Total current assets		**261,410**	**337,035**
TOTAL ASSETS		**2,288,004**	**2,279,266**
EQUITY			
Equity attributable to owners of the Parent Company			
Share capital	18	325,862	323,544
Non-current assets revaluation reserve	19	974,899	976,180
Hedge reserve	19	(8,247)	(3,912)
Other reserves	19	10,269	10
Retained earnings		45,773	46,356
		1,348,556	**1,342,178**
Non-controlling interest		**3,020**	**2,570**
Total equity		**1,351,576**	**1,344,748**
LIABILITIES			
Non-current liabilities			
Borrowings	20	462,888	506,756
Deferred income tax liabilities	11	172,425	187,635
Provisions for post-employment benefits	21a	7,734	7,321
Environmental provisions	21b	1,783	1,376
Derivative financial instruments	24a	10,629	7,088
Other liabilities and deferred income	22	94,815	94,889
Total non-current liabilities		**750,274**	**805,065**
Current liabilities			
Trade and other payables	23	121,214	82,356
Income tax payable		1,024	3,336
Borrowings	20	50,446	38,851
Derivative financial instruments	24a	13,134	4,408
Issued guarantees	26	336	502
Total current liabilities		**186,154**	**129,453**
TOTAL EQUITY AND LIABILITIES		**2,288,004**	**2,279,266**

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:

Āris Žīgurs
Chairman

Zane Kotāne

Uldis Bariss

Māris Kuņickis

Arnis Kurgs

22 May 2012

Consolidated Statement of Changes in Equity

	Notes	Share capital LVL'000	Reserves LVL'000	Retained earnings LVL'000	Total LVL'000	Non-controlling interest LVL'000	TOTAL LVL'000
		Attributable to owners of the Parent Company					
As at 31 December 2009		**317,653**	**549,354**	**20,782**	**887,789**	**1,651**	**889,440**
Increase in share capital	18	5,891	-	-	5,891	-	5,891
Dividends for 2009	19	-	-	(20,230)	(20,230)	-	(20,230)
Non-controlling interest arising on increase in subsidiary's share capital		-	-	-	-	441	441
Total contributions by and distributions to owners of the company, recognised directly in equity		**5,891**	**-**	**(20,230)**	**(14,399)**	**441**	**(13,898)**
Profit for the year		-	-	43,847	43,847	478	44,325
Other comprehensive income:							
Change in hedge reserve	19	-	(375)	-	(375)	-	(375)
Currency translation differences	19	-	8	-	8	-	8
Revaluation of property, plant and equipment	19	-	425,248	-	425,248	-	425,248
Disposal of revalued property, plant and equipment	19	-	(1,957)	1,957	-	-	-
Total other comprehensive income for the year		**-**	**422,924**	**1,957**	**424,881**	**-**	**424,881**
Total comprehensive income for the year		**-**	**422,924**	**45,804**	**468,728**	**478**	**469,206**
As at 31 December 2010	**18, 19**	**323,544**	**972,278**	**46,356**	**1,342,178**	**2,570**	**1,344,748**
Increase in share capital	18	2,318	-	-	2,318	-	2,318
Dividends for 2010	19	-	-	(35,000)	(35,000)	-	(35,000)
Transfer to reserves		-	10,257	(10,257)	-	-	-
Total contributions by and distributions to owners of the company, recognised directly in equity		**2,318**	**10,257**	**(45,257)**	**(32,682)**	**-**	**(32,682)**
Profit for the year		-	-	43,328	43,328	450	43,778
Other comprehensive income:							
Change in hedge reserve	19	-	(4,335)	-	(4,335)	-	(4,335)
Currency translation differences	19	-	2	(16)	(14)	-	(14)
Revaluation of property, plant and equipment	19	-	81		81	-	81
Disposal of revalued property, plant and equipment	19	-	(1,362)	1,362	-	-	-
Total other comprehensive income/(loss) for the year		**-**	**(5,614)**	**1,346**	**(4,268)**	**-**	**(4,268)**
Total comprehensive income/(loss) for the year		**-**	**(5,614)**	**44,674**	**39,060**	**450**	**39,510**
As at 31 December 2011	**18, 19**	**325,862**	**976,921**	**45,773**	**1,348,556**	**3,020**	**1,351,576**

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Cash Flows

	Notes	2011 LVL'000	2010 LVL'000
Cash flows from operating activities			
Profit before tax		42,668	51,012
Adjustments for:			
- Amortisation and depreciation	12a, 13a	115,622	119,056
- Impairment of non-current assets	13	11,762	26,357
- Loss from disposal of non-current assets		1,941	1,771
- Discontinued operations (transmission system operator)	30	546	(232)
- Investments accounting at equity method	14	(232)	(203)
- Interest expense	10	16,091	14,383
- Interest income	10	(2,776)	(5,351)
- Fair value losses / (gains) on derivative financial instruments	7, 10	9,284	(13,345)
- Changes in provisions	21	(413)	(152)
- (Gains) / losses on currency translation differences	10	748	1,142
(Increase) / decrease in inventories		(2,448)	1,542
Increase in receivables		(5,218)	(16,361)
Increase in payables, accrued expense, deferred income and other liabilities		22,863	1,649
Cash generated from operations		**210,438**	**181,268**
Interest paid		(15,424)	(14,889)
Interest received		1,459	5,352
Income tax paid		(16,074)	(11,168)
Net cash generated from operating activities		**180,399**	**160,563**
Cash flows from investing activities			
Proceeds from sale of intangible assets and PPE		-	301
Purchase of intangible assets and PPE		(182,301)	(107,812)
Proceeds on financing from EU funds		1,479	10,575
Purchase of the state treasury bills		(74,567)	(2,387)
Proceeds from redemption of the state treasury bills		17,180	-
Net cash used in investing activities		**(238,209)**	**(99,323)**
Cash flows from financing activities			
Proceeds from borrowings from credit institutions	20	4,357	60,041
Repayment of borrowings	20	(36,936)	(22,164)
Non-controlling interest's contribution to subsidiaries' share capital		-	441
Dividends paid		(35,000)	(20,230)
Net cash (used in) / generated from financing activities		**(67,579)**	**18,088**
Net (decrease) / increase in cash and cash equivalents		**(125,389)**	**79,328**
Cash and cash equivalents at the beginning of the year		234,266	154,938
Cash and cash equivalents at the end of the year	17	**108,877**	**234,266**

In 2011 property investment was committed in the amount of LVL 2,318 thousand by real estate investment in the Parent Company's share capital (2010: LVL 5,891 thousand).

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

1 CORPORATE INFORMATION

All of the shares of public limited company Latvenergo or Latvenergo AS (hereinafter – the Parent Company) are owned by the State of Latvia and are held by the Latvian Ministry of Economy. The registered address of the Company is 12 Pulkveža Brieža St., Riga, LV-1230, Latvia. Pursuant to the Latvian Energy Law, Latvenergo AS is designated as the business operations of national importance and, therefore, is not subject to privatisation.

The Parent Company is engaged in the production and sale of electrical power and heat, electricity trading, as well as provision of IT and telecommunication services in the territory of Latvia and the EU. The Parent Company is one of the largest corporate entities in Latvia.

2011 was the seventh reporting year with Latvenergo AS heading Latvenergo Group (hereinafter – the Group). The Group includes six subsidiaries:

	REGISTERED IN THE COMMERCIAL REGISTER	INTEREST HELD	BUSINESS ACTIVITY HELD
Augstsprieguma tīkls AS	01.09.2005	100%	Electricity transmission
Sadales tīkls AS	18.09.2006	100%	Electricity distribution
Latvenergo Kaubandus OÜ	27.06.2007	100%	Electricity trade operations in Estonia
Latvenergo Prekyba UAB	07.01.2008	100%	Electricity trade operations in Lithuania
Latvijas elektriskie tīkli AS	10.02.2011	100%	Operation and maintenance of transmission system assets
Liepājas enerģija SIA	06.07.2005	51%	Thermal energy generation, transmission, distribution and sale

The Parent Company's associate Nordic Energy Link AS carries out the functions of the operator of an interconnection power cable between Estonia and Finland.

The Parent Company's associate Pirmais Slēgtais Pensiju Fonds AS manages a defined-contribution corporate pension plan in Latvia.

Since 15 November 2010 until 14 August 2011, the Management Board of Latvenergo AS was comprised of the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Arnis Kurgs and Arnis Daugulis.

Reposing on Shareholder's resolution, Arnis Daugulis as at 14 August 2011 was excluded from the composition of the Management Board of Latvenergo AS, and since 15 August 2011 Zane Kotāne has been acting as a member of the Management Board of Latvenergo AS.

Since 15 August 2011 until the date of signing off this Annual Report, the Management Board of Latvenergo AS includes the following members: Āris Žīgurs (Chairman), Zane Kotāne, Uldis Bariss, Māris Kuņickis and Arnis Kurgs.

The Consolidated Financial Statements for year 2011 include the financial information in respect of the Parent Company and its all subsidiaries (hereinafter – the Group) for the annual period ending 31 December 2011 and comparative information for annual period ending 31 December 2010.

Latvenergo AS Management Board has approved for issue the Consolidated Financial Statements on 22 May 2012. The decision on approval of the Consolidated Financial Statements is made by Shareholder's meeting.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these Consolidated Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. Where it necessary comparatives are reclassified.

2.1. Basis of Preparation

The Consolidated Financial Statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union. Due to the European Union's endorsement procedure, the standards and interpretation not approved for use in the European Union are presented in this note as they may have impact on the Consolidated Financial Statements in the following periods if endorsed.

The Consolidated Financial Statements are prepared under the historical cost convention, as modified by the revaluation of land and buildings, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss as disclosed in accounting policies presented below.

All amounts shown in these Consolidated Financial Statements are presented in thousand of Latvian Lats (LVL), unless stated otherwise.

The preparation of the Consolidated 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 Parent Company 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 Consolidated Financial Statements are disclosed in Note 4.

In these Consolidated Financial Statements the Group has performed reclassification of some lines of the Consolidated Statement of Cash Flows of 2010 – 'Proceeds on financing from EU funds' in amount of LVL 10,575 thousand and 'Purchase of the state treasury bills' in amount of LVL 2,387 thousand were reclassified from cash flows from financing activities to cash flows from investing activities. The Group also has performed reclassification of some lines of the Consolidated Income Statement of 2010 – revenue from compensation of electric energy price margin in amount of LVL 4,324 thousand were reclassified from 'Revenue' to 'Raw materials and consumables used' and fair value loss on derivative financial instruments in amount of LVL 1,220 thousand was reclassified from 'Finance costs' to 'Finance income' to present the gain in net amount.

Adoption of new and revised standards and interpretations

Certain new IFRSs became effective for the Group from 1 January 2011.

- ***IAS 24 (revised), Related party disclosures***

This revised standard removes the requirement for government related entities to disclose details of all transactions with the government and other government-related entities and it clarifies and simplifies the definition of a related party.

Certain new standards and interpretations have been published that will become effective for the accounting periods beginning on or after 1 January 2012.

- ***Presentation of Items of Other Comprehensive Income – Amendment to IAS 1*** *(effective for annual periods beginning on or after 1 July 2012; not yet adopted by the EU)*

The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

- ***IFRS 9, Financial Instruments Part 1: Classification and Measurement*** *(effective for annual periods beginning on or after 1 January 2015; not yet endorsed by the EU)*

IFRS 9 issued in November 2009 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities, and in December 2011 to change its effective date and add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

- ***IFRS 10, Consolidated financial statements*** *(effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU)*

IFRS 10 replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the standard on its financial statements.

- ***IFRS 12, 'Disclosures of interests in other entities'*** *(effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU)*

IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including (i) significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, (ii) extended disclosures on share of non-controlling interests in group activities and cash flows, (iii) summarised financial information of subsidiaries with material non-controlling interests, and (iv) detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the impact of the standard on its financial statements.

- ***IFRS 13, 'Fair value measurement'** (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU)*

IFRS 13 aims to improve consistency and reduce complexity by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

2.2. Consolidation

(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. The existence of control is assumed when the Parent Company voting rights in the subsidiary is more than 50%.

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.

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 Consolidated Income Statement 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. Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in the income statement.

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

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group's Parent Company. 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 Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognized at cost. Under this method the Group's share of its associate's post-acquisition profits and losses is recognized in the Consolidated Income Statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in associate equals or exceeds its interest in associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

2.3. Foreign currency translation

(a) Functional and presentation currency

Items included in the Consolidated Financial Statements are measured using the currency of the primary economic environment in which the Group's entity operates ("the functional currency"). The Consolidated Financial Statements have been prepared in Latvian Lats (LVL), which is the Parent's functional and Group's presentation currency.

(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 Consolidated Income Statement.

(c) Consolidation of the Group's foreign companies

The results and financial position of all the Group's entities (none of which has the currency of a hyper-inflationary economy) that have functional currency different from the presentation currency are translated into the presentation currency as follows:

1) Assets and liabilities for each financial position presented are translated at the closing rate at the date of that financial position;
2) Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of transactions).

2.4. Intangible assets

(a) Licenses and software

Licenses and software are shown at historical cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of licenses and software over their estimated useful lives (5 years). Computer software development costs recognized as assets are amortised over their estimated useful lives, not exceeding a period of five years.

(b) Emission rights for greenhouse gases

Emission rights for greenhouse gases (or allowances) are recognised at purchase cost. Emission rights received from the Government free of charge is recognised at zero cost. Emission rights are recognised at cost when the Group is able to exercise the control, as at 31 December 2011 the number of allowances in the Group received from the Government free of charge was 1,107,445 (31/12/2010: 1,107,445). Therefore their carrying amount as at 31 December 2011 was nil (31/12/2010: nil). In case the quantity of emitted greenhouse gases exceeds the quantity of allowances allocated by the state free of charge, a provision is set up for the difference based on the market price of greenhouse gas emission allowances at the reporting period. Allowances are accounted for within 'Intangible assets'. As at 31 December 2011 the number of allowances in the Group purchased was 255,746 (31/12/2010: 280,000), see Note 12b. The forward agreements for purchase or sale of emission allowances for trade rather than for own uses in the Group are defined as derivatives (see points 2.18, 3.3. and Note 24. c).

2.5. Property, plant and equipment

All property, plant and equipment (PPE) are stated at historical cost or revalued amount (see Note 2.8) less accumulated depreciation and accumulated impairment loss.

The 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 recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of an item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance expenses are charged directly to the Consolidated Income Statement 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 are also capitalised and included in the Consolidated Income Statement 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, these components are depreciated as separate items. Homogenous items with similar useful lives are accounted for in groups.

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	Estimated useful life, years
Buildings and facilities, including	
• Hydropower plants, thermal power plants	15 – 80
• Electricity transmission lines	30 – 50
• Electricity distribution lines	20 – 30
Technology equipment and machinery, including	
• Hydropower plants	3 – 12
• Thermal power plants	3 – 10
• Transmission and distribution machinery and equipment	10
Other property, plant and equipment	2 – 5

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 (Note 2.7).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. Those are included in the Consolidated Income Statement.

If revalued property, plant and equipment have been sold, appropriate amounts are reclassified from revaluation reserve to retained earnings of previous accounting periods.

2.6. Leases

(a) The Group 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 Consolidated Income Statement on a straight-line basis over the period of the lease.

(b) The Group is the lessor

Assets leased out under operating leases are recorded within property, plant and equipment at historic cost less depreciation. 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 Consolidated Income Statement on a straight-line basis over the period of the lease.

2.7. Impairment of non-financial 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 recognized 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 pre-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 Consolidated Income Statement within amortisation, depreciation and impairment charge expenses for the assets that are accounted at amortised historical cost 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 impairment losses 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 at each reporting date. The reversal of impairment is recognised in the Consolidated Income Statement. Reversal of impairment loss for revalued assets is recognised in the Consolidated Income Statement to the extent that an impairment loss on the same revalued asset was previously recognised the income statement; the remaining reversals of impairment losses of revalued assets are recognised in Other Comprehensive Income.

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 fixed asset groups are revalued regularly but not less frequently than every five years:

- Hydropower plants' buildings and plants,
- Hydropower plants' machinery and technology equipment,
- Other fixed assets of hydropower plants,
- Electricity transmission system engineering structure,
- Electricity transmission lines,
- Electrical equipment and other fixed assets of electricity transmission system,
- Electricity distribution system engineering structure,
- Electricity distribution lines,
- Electrical equipment and other fixed assets of electricity distribution system.

Increase in the carrying amount arising on revaluation net of deferred tax is credited to the Consolidated Statement of Comprehensive Income as "Property, plant and equipment 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 Consolidated Income Statement. Any accumulated depreciation at the date of revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after the revaluation equals its revalued amount.

Property, plant and equipment revaluation reserve is decreased at the moment, when revalued asset has been eliminated or disposed.

Revaluation reserve cannot be distributed in dividends, used for indemnity, reinvested in share capital or other reserves, or used for other purposes.

2.9. Inventories

Inventories are stated at the lower of cost and 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.

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.

Amount of inventories as of the end of reporting period is verified during inventory.

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 has revaluation of the inventories been performed with purpose to identify obsolete and damaged inventories. Provisions 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 that haven't turned over during last 12 months are fully impaired,
b) 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%,
c) Inventories that haven't turned over during last 6 months are impaired in amount of 50%,
d) 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%,
e) Allowances are not calculated for the inventory of heating materials necessary to ensure uninterrupted operations of heat power plants,
f) Allowances are not calculated for scrap metal obtained in the process of fixed assets' dismantling and are accounted at net realisable value.

2.10. Trade and other receivables

Trade receivables are recognized initially at fair value and subsequently measured at amortised cost, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group 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.

An allowance for impairment of doubtful debts is calculated on the basis of trade receivables aging analysis according to estimates defined by the Group entities and the Parent Company's management, which are revised at least once a year. Allowances for electricity trade receivables are calculated for debts overdue 45 days, and, if the debt is overdue for more than 181 day, allowances are established at 100%. For other trade receivables allowances are calculated for debts overdue 31 day, and, if the date of payment is overdue for more than 91 day, allowances are established at 100% (see Note 16 a). Individual impairment assessments are performed for the debtors if their debt balance exceeds LVL 500 thousand and debt repayment schedule has been individually agreed. The level of allowance for such type of debtors is based on the individual risk assessment of insolvency probability.

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 Consolidated Income Statement within selling and customer services costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against selling and customer services costs in the Consolidated Income Statement.

2.11. Cash and cash equivalents

Cash and cash equivalents include cash in hand, at bank, and short-term deposits with original maturities of three months or less.

2.12. Dividend distribution

Dividend distribution to the Parent Company's shareholders is recognised as a liability in the Consolidated Financial Statements in the period in which the dividends are approved by the Parent Company's shareholders.

2.13. Pensions and employment benefits

(a) Pension obligations

The Group 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 50% of its share capital. A defined contribution plan is a pension plan under which the Group pays contributions into the plan. The Group 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 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 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 Consolidated 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.

Actuarial gains or losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Consolidated Income Statement in the period in which they arise. Past service costs are recognised immediately in the Consolidated Income Statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

2.14. Deferred income tax

Income tax is calculated in accordance with applicable tax regulations and is based on the taxable income reported for the taxation period.

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. However, the deferred income tax is not accounted if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. 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 realized or the deferred income tax liability settled.

Deferred income tax assets are recognized 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 utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Group controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

2.15. Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the Consolidated Income Statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability at least for 12 months after the end of reporting period. 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.

2.16. Provisions

Provisions are recognised when the Group 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 recognized for future operating losses.

Provisions are presented in the Consolidated 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 recognized 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 require 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 recognized as interest expense.

2.17. Grants

Property, plant and equipment received at nil consideration from other entities are accounted for as grants. Grants are recognised at fair value as deferred income and are credited to the Consolidated Income Statement on a straight-line basis over the expected lives of the related assets.

Financing provided by European Union funds

The Group ensures the management, application of internal controls and accounting for the Group'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 ensures separate accounting of financed projects with detailed income and expense, non-current investments and value added tax in the relevant positions of the Group's Consolidated Income Statement and Consolidated Statement of Financial Position.

2.18. Derivative financial instruments and hedging activities

The Group uses derivatives such as forward foreign exchange contracts, interest rate swaps, electricity swaps and CO_2 emission allowances forward contracts to hedge risks associated with currency exposures, 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 (Note 3.3.).

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

The Group designates certain derivatives as hedges of a particular risk associated with a recognised liability or highly probable forecast transactions denominated in foreign currency (cash flow hedge), other derivatives are accounted for at fair value through profit or loss.

The Group 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 also documents its assessment, both at hedge inception and on an ongoing 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. Those 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 Consolidated Income Statement.

Amounts accumulated in equity are recycled in the Consolidated Income Statement in the periods when the hedged item affects profit or loss.

The gain or loss relating to the ineffective portion of electricity swaps hedging variable electricity prices and interest rate swaps hedging variable rate borrowings is recognised in the Consolidated Income Statement.

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 Consolidated Income Statement.

(b) Financial assets at fair value through profit and loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short 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 with 12 months; otherwise, they are classified as non-current.

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 Consolidated Income Statement, are classified according to the purpose of the derivatives – gains/losses from electricity SWAP agreements and CO_2 forward 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'.

2.19. Revenue recognition

Revenue comprises the value of goods sold and services rendered in the ordinary course of the Group's activities. The Latvian regulatory authority (Public Utilities Commission) determines tariffs for electricity and heat. Revenue is measured at the fair value of the consideration received or receivable, net of value-added tax, estimated returns, rebates and discounts. Revenue is recognized as follows:

(a) Electricity sales

The Group records electricity sales to residential customers on the basis of reported meter readings. Where relevant, this includes an estimate of the electricity supplied between the date of the last meter reading and the year-end. Electricity sales to corporate customers are recognized on the basis of issued invoices according to meter readings of customers. Revenues from electricity sales to associated users are based on regulated tariffs approved by Public Utilities Commission, while revenues from market participants - on contractual prices included in electricity trade agreements. Revenues from trade of electricity in energy exchanges NordPool and BaltPool are based on the calculated market prices.

(b) Heat sales

The Group recognizes revenue from sales of thermal energy at the end of each month on the basis of the meter readings.

(c) Connection fees

When connecting to the electricity network, the clients must pay a connection fee that partly reimburses for the cost of infrastructure to be built to connect the client to the network. Connection fees are carried in the Consolidated Statement of Financial Position as deferred income and amortized to Consolidated Income Statement on a straight-line basis over the estimated customer relationship period.

(d) Sales of transmission and distribution services

Revenues from electricity transmission and distribution services are based on regulated tariffs that are subject to approval by the Public Utilities Commission. The Group recognizes revenue from sales of transmission and distribution services at the end of each month on the basis of the automatically made meter readings or customers' reported meter readings.

(e) Sales of IT & telecommunication services

Revenues derived from information technology services (internet connection services, data communication services), open electronic communication network and telecommunication services to corporative customers, business centres, network operators and households are recognised on the basis of invoices which are prepared for clients upon either usage of services listed in telecommunications billing system.

(f) Interest income

Interest income is recognized using the effective interest method. Interest income is recorded in the Consolidated Income Statement as "Finance income".

2.20. Related parties

The Parent Company is owned by the Latvian state. The Group's related parties are defined as companies in which the state has the control or significant influence, members of the Group companies Supervisory Board and the Management Board and key management personnel, their close relatives and companies in which they have a control or significant influence.

2.21. Non-current assets held for sale

The Group 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. Non-current assets held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

2.22. Share capital

The Group's share capital consists of ordinary shares.

2.23. Trade payables

The Group's trade payables are recognized initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

2.24. Investment property

Investment properties are land or a building or part of a building held by the Group 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. The investment properties are initially recognized 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.

2.25. Held-to-maturity investments

Held-to-maturity financial assets are non-derivative financial assets, quoted on an active market, with fixed or determinable payments and fixed maturities that the Group's

Management has the positive intention and ability to hold to maturity. If the Group 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 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 evaluates its intention and ability to hold such investments to maturity.

If the Group 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 recognized on trade date – the date on which the Group 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 Consolidated Income Statement in the period in which they arise.

2.26 Issued guarantees

Guarantees issued are initially recognised at fair value, which is usually equal to the premium received. Subsequently they are measured at the higher of the amount expected to be paid and the amount initially recognised less accumulated amortisation.

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group'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 overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by the Parent Company's Treasury department (the Group Treasury) according to 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 provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, and credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

Financial assets and liabilities by categories:

Assets as per statement of financial position as at 31/12/2011	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through profit or loss	Held-to-maturity assets
	LVL'000	LVL'000	LVL'000	LVL'000
Derivative financial instruments (Note 24)	-	2,345	105	-
Trade and other receivables (Note 16 a)	73,809	-	-	-
Other non-current receivables	95	-	-	-
Accrued income and other financial current receivables (Note 16 b)	7,595	-	-	-
Investments in held-to-maturity financial assets (Note 28)	-	-	-	60,384
Cash and cash equivalents (Note 17)	108,877	-	-	-
	190,376	2,345	105	60,384

Assets as per statement of financial position as at 31/12/2010	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through profit or loss	Held-to-maturity assets
	LVL'000	LVL'000	LVL'000	LVL'000
Derivative financial instruments (Note 24)	-	1,575	2,393	-
Trade and other receivables (Note 16 a)	63,031	-	-	-
Other non-current receivables	172	-	-	-
Accrued income and other financial current receivables (Note 16 b)	7,914	-	-	-
Investments in held-to-maturity financial assets (Note 28)	-	-	-	2,387
Cash and cash equivalents (Note 17)	234,266	-	-	-
	305,383	1,575	2,393	2,387

Liabilities as per statement of financial position as at 31/12/2011	Derivatives used for hedging	Other financial liabilities at amortised cost	Liabilities at fair value through the profit or loss
	LVL'000	LVL'000	LVL'000
Borrowings (Note 20)	-	513,334	-
Derivative financial instruments (Note 24)	10,592	-	13,171
Issued guarantees (Note 26)	-	-	336
Trade and other payables (Note 23)	-	78,161	-
	10,592	591,495	13,507

Liabilities as per statement of financial position as at 31/12/2010	Derivatives used for hedging	Other financial liabilities at amortised cost	Liabilities at fair value through the profit or loss
	LVL'000	LVL'000	LVL'000
Borrowings (Note 20)	-	545,607	-
Derivative financial instruments (Note 24)	5,487	-	6,009
Issued guarantees (Note 26)	-	-	502
Trade and other payables (Note 23)	-	51,934	-
	5,487	597,541	6,511

a) Market risk

I) Foreign exchange risk

The Group is exposed to currency risk primarily arising from settlements in foreign currencies for recognized assets and liabilities (mainly, borrowings), capital expenditures and imported electricity.

However, the peg of Lat to Euro at the beginning of the year 2005 resulted in limited EUR / LVL currency risk, as the Group had no any substantial liabilities in any other foreign currency except Euro. At 31 December 2011 the Group had none of their borrowings denominated in other currencies than the Euro (see Note 20).

Management has set up a Financial Risk Management policy inter alia to manage the Group's foreign currencies exchange risk against functional currency. To manage the Group's foreign currencies exchange risk arising from future transactions and recognized assets and liabilities, the Group uses forward contracts, transacted by the Group Treasury. Foreign currencies exchange risk arises when future transactions or recognized assets or liabilities are denominated in a currency that is not the Group's functional currency or Euro.

Except for the transactions described below the Group do not have any material balances of financial assets and liabilities denominated in currencies other than LVL and EUR. 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 2011 the Group had one committed capital expenditure project whose expected transactions in USD created significant currency risk and qualified as 'highly probable' forecast transactions for hedge accounting purposes (Note 24e).

The Parent Company has certain investments in associates and subsidiaries outside Latvia (Estonia and Lithuania); who are exposed to foreign currency risks. Currency exposure arising from the net assets of the Group's foreign operations in Estonia and Lithuania is limited as subsidiaries outside Latvia have insignificant amount of assets. Estonia has joined Euro zone, but Lithuania has fixed currency peg to Euro.

II) Cash flow and fair value interest rate risk

As the Group has no significant floating interest-bearing assets, the Group's financial income and operating cash flows are not substantially dependent on changes in market interest rates.

However, during 2011, if Euro and Lats 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 LVL 344 thousand higher or lower (2010: LVL 305 thousand).

The Group's cash flow interest rate risk mainly arises from long-term borrowings at variable rates. They expose the Group 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. To hedge a cash flow risk, the Group has entered into 15 interest rate swap agreements with the total notional amount EUR 343.6 million or LVL 241.5 million (2010: 15 interest rate swap agreements in total amount of EUR 348.2 million or LVL 244.7 million) (see Note 24b).

The Group 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 calculates the impact on profit and loss as well as on cash flows of a defined interest rate shift. For each simulation, the same interest rate shift is used for all currencies. The scenarios are run only for liabilities that represent the major interest-bearing positions.

Based on the various scenarios, the Group 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. As at 31 December 2011 47% of the Group's borrowings (31/12/2010: 43.4%) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration 2.13 years (2010: 2.3 years). Generally, the Group raises long-term borrowings at floating rates and swaps them into fixed rates that are lower than those available if the Group borrowed at fixed rates directly. Under the interest rate swaps, the Group 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.

During 2011, if interest rates on Euro denominated borrowings at floating base interest rate (after considering hedging effect) had been 50 basis points higher or lower with all other variables held constant, the Group's post-tax profit for the year would have been LVL 1,261 thousand lower or higher (2010: LVL 1,341 thousand).

The Group's 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.

At 31 December 2011, 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 LVL 4,112 thousand higher or lower (31/12/2010: LVL 4,286 thousand). Furthermore LVL 649 thousand (2010: LVL 795 thousand) would have been attributable to profit or loss and LVL 3,463 thousand (2010: LVL 3,491 thousand) to the Consolidated Statement of Changes in Equity 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 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 and CO_2 emission allowances. To hedge the risk the Parent Company has purchased electricity swap contracts and CO_2 emission allowance forward contracts that are used to hedge the risk related to changes in the price of electricity (Note 24 c) and CO_2 allowances (Note 24 d).

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 trade receivables is limited due to broad range of the Group's customers. The Group 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 16).

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 17), trade and other receivables (Note 16), nominal amounts of issued guarantees (Note 26) and investments in held-to-maturity financial assets (Note 28).

Assessment of maximum possible exposure to credit risk

	Note	31/12/2011 LVL'000	31/12/2010 LVL'000
Trade receivables	16 a	73,809	63,031
Accrued income	16 b	6,986	7,522
Other non-current financial receivables		95	172
Other current financial receivables	16 b	609	392
Cash and cash equivalents	17	108,877	234,266
Derivative financial instruments	24 a	2,450	3,968
Held-to-maturity financial assets	28	60,384	2,387
		253,210	**311,738**

Maximum credit risk related to the issued guaranties amounts to the outstanding loan balances as at the end of the year (see Note 26). 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 trade receivables two rating categories are used (see Note 16 a):

- 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:

	31/12/2011 LVL'000	31/12/2010 LVL'000
Investment level credit rating	96,499	202,767
No or non-investment level credit rating	12,378	31,499
	108,877	**234,266**

No credit limits were exceeded during the reporting period, and the Group entities' management does not expect any losses from non-performance by these counterparties.

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.

The Group entities' management is monitoring rolling forecasts of the Group's liquidity reserve, which comprises of undrawn borrowing facilities (see Note 20) and cash and cash equivalents (see Note 17).

The table below analyses the Group'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)

31/12/2011	Less than 1 year LVL'000	Between 1 and 2 years LVL'000	Between 3 and 5 years LVL'000	Over 5 years LVL'000	Total LVL'000
Borrowings	58,746	81,093	301,216	141,315	**582,370**
Derivative financial instruments	22,009	11,371	5,197	1,085	**39,662**
Issued guarantees	9,922	-	-	-	**9,922**
Trade and other payables*	78,161	-	-	-	**78,161**
	168,838	**92,464**	**306,413**	**142,400**	**710,115**

31/12/2010	Less than 1 year LVL'000	Between 1 and 2 years LVL'000	Between 3 and 5 years LVL'000	Over 5 years LVL'000	Total LVL'000
Borrowings	46,723	63,804	339,721	200,414	**650,662**
Derivative financial instruments	7,772	8,350	9,456	2,310	**27,888**
Issued guarantees	10,825	-	-	-	**10,825**
Trade and other payables*	51,934	-	-	-	**51,934**
	117,254	**72,154**	**349,177**	**202,724**	**741,309**

** 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 objectives when managing capital are to safeguard the Group'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 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 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 on 31 December 2011 and on 31 December 2010 was as follows:

	31/12/2011	31/12/2010
Total equity (LVL'000)	1,351,576	1,344,748
Total assets (LVL'000)	2,288,004	2,279,266
Outstanding financial guarantees issued (LVL'000)	9,922	10,825
Capital Ratio	**59%**	**59%**

3.3. Fair value estimation of financial instruments

The fair value of financial instruments is defined as the amount at which an instrument could be exchanged in a current transaction between financially uncommitted, knowledgeable, willing parties other than by forced or liquidation sale. 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 price used for financial assets held by the Group is the current bid price, i.e. interest rates by respective term and currency.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group use a variety of methods and make assumptions that are based on market conditions existing at each end of reporting period. Quoted market prices for similar instruments are used for long-term debt. Other techniques, such as 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. Those fair values are compared to counterparty's bank revaluation reports.

The fair value of electricity swap agreements is calculated as discounted difference between actual market and settlement prices multiplied by the volume of the agreement.

The fair value of CO_2 emission allowances for greenhouse gases forward contracts is calculated as discounted difference between actual market and settlement prices for CO_2 emission allowances multiplied by the volume of the forward contract.

The fair value of non-current borrowings with floating interest rates fixed by SWAP agreements for disclosure purposes is estimated by discounting their future contractual cash flows at the current market interest rates for similar financial instruments.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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 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 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 at 31 December 2011, the net book amount of property, plant and equipment of the Group totalled LVL 1,999 million (31 December 2010: LVL 1,929 million), and the depreciation charge of continuing operations for the reporting period was LVL 113 million (2010: LVL 116.7 million) (Note 13a). If depreciation rates were changed by 10%, the annual depreciation charge would change by LVL 11.3 million (2010: LVL 11.7 million).

II) Recoverable amount

When the events and circumstances indicate a potential impairment, the Group performs impairment tests for items of property, plant and equipment. 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. If discount rate used for the purposes of impairment charge calculation would be lower or higher by one percent point the current year's impairment charge on technological equipment would be by LVL 32.0 million higher or lower (2010: LVL 29.9 million). Impairment charges recognised during the current reporting year are disclosed in Note 13b.

III) Revaluation

External, certified valuers have performed revaluation of the Group'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 16, Property, plant and equipment,* based on current use of property, plant and equipment. As a result of valuation, depreciated replacement cost was determined for each asset. Depreciated replacement cost is calculated as land's instant market value at its current use, increased by the replacement cost of existing buildings and refinements on the said land plot and decreased by the depreciation expenses and other impairment losses. Results of revaluation are described in Note 13 a.

b) Recoverable amount of trade receivables

The estimated collectability of accounts receivable is assessed on an individual basis for each customer. 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 (Note 2.10). 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 16).

c) Fair value estimation for financial instruments

The following table presents the Group's financial assets and liabilities that are measured at fair value, by valuation method. The different levels have been defined as follows:

a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
b) 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),
c) Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

31/12/2011	Level 1	Level 2	Level 3	Total balance
Assets				
Financial assets at fair value through profit or loss:				
- Forward foreign exchange contracts (Note 24 e)	-	105	-	**105**
Electricity trading derivatives used for hedging (Note 24 c)	-	2,060	-	**2,060**
Forward foreign exchange contracts used for hedging (Note 24 e)	-	285	-	**285**
Total assets	**-**	**2,450**	**-**	**2,450**
Liabilities				
Financial liabilities at fair value through profit or loss:				
- Electricity trading derivatives (Note 24 c)	-	5,366	-	**5,366**
- CO_2 emission allowances forward contracts (Note 24 d)	-	4,597	-	**4,597**
- Interest rate derivatives (Note 24 b)	-	3,208	-	**3,208**
Electricity trading derivatives used for hedging (Note 24 c)	-	1,981	-	**1,981**
Interest rate derivatives used for hedging (Note 24 b)	-	8,611	-	**8,611**
Total liabilities	**-**	**23,763**	**-**	**23,763**

31/12/2010	Level 1	Level 2	Level 3	Total balance
Assets				
Financial assets at fair value through profit or loss:				
- Electricity trading derivatives (Note 24 c)	-	2,393	-	**2,393**
Interest rate derivatives used for hedging (Note 24 b)	-	1,011	-	**1,011**
Forward foreign exchange contracts used for hedging (Note 24 e)	-	564	-	**564**
Total assets	**-**	**3,968**	**-**	**3,968**
Liabilities				
Financial liabilities at fair value through profit or loss:				
- CO_2 emission allowances forward contracts (Note 24 d)	-	3,442	-	**3,442**
- Interest rate derivatives (Note 24 b)	-	2,567	-	**2,567**
Interest rate derivatives used for hedging (Note 24 b)	-	5,487	-	**5,487**
Total liabilities	**-**	**11,496**	**-**	**11,496**

d) Recognition of connection service fees

Connection and other service fees are recognised as income over the estimated customer relationship period, which is 20 years (see Note 22). The estimated customer relationship period is based on the Management's estimate. In the reporting period the Group's received connection fees totalled LVL 9.8 million (2010: LVL 12.4 million), and to the Consolidated Income Statement credited LVL 5.4 million (2010: LVL 5.2 million). If the estimated customer relationship period is reduced/increased by 25%, the annual income from connection service fees would increase/decrease by LVL 1.4 million (2010: LVL 1.3 million).

e) Evaluation of effectiveness of hedging instruments

The Group has concluded significant number of swap transactions 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 is recognized in the Consolidated Income Statement (Note 24).

5 REVENUE

	2011 LVL'000	2010 LVL'000
Electricity sales	583,428	470,663
- including sales to corporate customers	457,119	338,886
- residential customers	126,309	131,777
Sales of network services	9,664	6,074
	593,092	**476,737**
Heat sales	69,233	71,863
Revenue from lease of assets	393	97
Other services	19,049	18,689
Total revenue:	**681,767**	**567,386**

6 OTHER INCOME

	2011 LVL'000	2010 LVL'000
(Loss)/gain from sale of assets held for sale and PPE	(68)	221
Gain from sale of current assets and other income	2 943	2,452
Interest income on treasury bills	1,300	1
Total other income:	**4,175**	**2,674**

7 RAW MATERIALS AND CONSUMABLES USED

	2011 LVL'000	2010 LVL'000
Electricity:		
Imported from the Baltic countries	138,373	60,974
Purchased from producers in Latvia	65,439	56,590
Imported from other countries	38,481	24,025
Fair value loss / (income) on electricity swaps (Note 24 b)	7,759	(12,651)
	250,052	**128,938**
Fuel expense	127,673	121,335
Fair value (income) / loss on CO_2 emission allowances forward contracts (Note 24 c)	1,155	(532)
Raw materials, spare parts and maintenance costs	29,312	23,849
Total raw materials and consumables used:	**408,192**	**273,590**

8 PERSONNEL EXPENSES

	2011 LVL'000	2010 LVL'000
Wages and salaries	45,896	42,443
Expenditure of employment termination	2,028	1,055
Pension costs – defined contribution plan	2,102	1,991
State social insurance contributions and other benefits defined in the Collective Agreement	11,546	10,647
Total personnel expenses:	**61,572**	**56,136**

	2011 LVL'000	2010 LVL'000
Including remuneration to the management:		
Wages and salaries	710	606
Expenditure of employment termination	9	8
Pension costs – defined contribution plan	26	31
State social insurance contributions and other benefits defined in the Collective Agreement	181	151
Total remuneration to the management:	**926**	**796**

	2011	2010
Number of employees at the end of the year	4,490	4,517
Average number of employees during the year	4,518	4,594

Remuneration to the management includes remuneration to the members of the Management Boards of the Group entities.

In accordance with the directions of the Cabinet of Ministers of Latvia No. 1199 dated 28 December 2010: "On distribution of the obligatory state social insurance contribution rate for 2011" 73% from the obligatory state social insurance contributions are used for financing the state fixed contribution pension scheme (2010: 65%).

9 OTHER OPERATING EXPENSES

	2011 LVL'000	2010 LVL'000
Selling expenses and customer service costs	5,843	3,604
Information technology maintenance expenses	2,192	2,206
Transportation expenses	5,608	4,558
Environment protection and work safety expenses	3,181	2,599
Rent, maintenance and utilities costs	3,944	4,627
Electric power transit and capacity services costs	3,750	4,300
Loss from disposal of property, plant and equipment	1,583	1,969
Real estate tax	704	756
Telecommunications expenses	1,437	1,754
Public utilities regulation fee	80	955
Other expenses	7,127	5,766
Total other operating expenses:	**35,449**	**33,094**

10 FINANCE INCOME AND COSTS

Finance income

	2011 LVL'000	2010 LVL'000
Interest income on bank accounts and deposits	2,776	5,351
Fair value gain on interest rate swaps (Note 24 b)	-	21
Fair value gain on forward foreign currencies exchange contracts (Note 24 e)	105	-
Fair value gain on issued guarantees (Note 26)	166	141
Total finance income:	**3,047**	**5,513**

Finance costs

	2011 LVL'000	2010 LVL'000
Interest expense on borrowings	12,025	9,023
Interest expense on interest rate swaps	4,065	5,360
Other finance costs	64	1,671
Fair value loss on interest rate swaps (Note 24 b)	641	-
Net foreign exchange losses	748	1,142
Capitalized interest expense and currency translation	(3,587)	(666)
Total finance costs:	**13,956**	**16,530**

11 INCOME TAX

	2011 LVL'000	2010 LVL'000
Current tax	13,730	11,551
Deferred tax	(14,294)	(5,096)
Total income tax:	**(564)**	**6,455**

The tax on the Group's profit before tax differs from the theoretical amount that would arise if using the tax rate applicable to profits of the Group as follows:

	2011 LVL'000	2010 LVL'000
Profit before tax	**42,668**	**51,012**
Corporate income tax at the statutory rate 15%	6,400	7,652
Gain on deferred income tax asset value	-	(7)
Expense not deductible for tax purpose	1,058	915
(Income)/loss not subject to tax	(245)	830
Gain on discontinuing operations	(123)	(35)
Accelerated depreciation of newly constructed technological equipment	(7,654)	(2,900)
Total income tax:	**(564)**	**6,455**

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same taxation authority. The offset amounts are as follows:

	31/12/2011 LVL'000	31/12/2010 LVL'000
Deferred income tax liabilities:		
- Deferred tax liabilities to be recovered after more than 1 year	172,087	185,124
- Deferred tax liabilities to be recovered within 1 year	4,636	4,310
Deferred income tax assets:		
- Deferred tax assets to be recovered after more than 1 year	(1,849)	(1,811)
- Deferred tax assets to be recovered within 1 year	(2,479)	(913)
Total deferred income tax assets	**(30)**	**(925)**
Total deferred income tax liabilities	**172,425**	**187,635**

The movement on the deferred income tax accounts is as follows:

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**186,710**	**117,108**
Income credited to the Consolidated Income Statement	(14,294)	(5,096)
Attributable to non-current assets revaluation reserve in equity (Note 19)	(81)	74,698
Attributable to discontinuing operations	60	-
Deferred tax asset at the end of the year	**(30)**	**(925)**
Deferred tax liabilities at the end of the year	**172,425**	**187,635**

Deferred income tax has been calculated from the following temporary differences between assets and liabilities values for financial reporting and tax purposes:

	2011 LVL'000	2010 LVL'000
Deferred tax liabilities:		
	Accelerated tax depreciation	
At the beginning of the year	**189,434**	**121,810**
Income credited to the Consolidated Income Statement	(15,897)	(7,074)
Attributable to discontinuing operations	(104)	-
Attributable to non-current assets revaluation reserve in equity	(81)	74,698
At the end of the year	**173,352**	**189,434**
Deferred tax assets:		
	Accruals/provisions	
At the beginning of the year	**(2,724)**	**(4,702)**
Expense charged to the Consolidated Income Statement	1,603	1,978
Attributable to discontinuing operations	164	-
At the end of the year	**(957)**	**(2,724)**

12 INTANGIBLE ASSETS

12 a) Intangible assets

	Licenses LVL'000	Software LVL'000	Assets under construction LVL'000	Total LVL'000
At 31 December 2009				
Cost	1,750	17,206	33	18,989
Accumulated amortisation	(420)	(10,377)	-	(10,797)
Net book amount	**1,330**	**6,829**	**33**	**8,192**
Year ended 31 December 2010				
Opening net book amount	1,330	6,829	33	8,192
Additions	-	1,626	47	1,673
Disposals	-	(1)	-	(1)
Amortisation charge	(147)	(2,239)	-	(2,386)
Closing net book amount	**1,183**	**6,215**	**80**	**7,478**
At 31 December 2010				
Cost	1,750	18,793	80	20,623
Accumulated amortisation	(567)	(12,578)	-	(13,145)
Net book amount	**1,183**	**6,215**	**80**	**7,478**
Year ended 31 December 2011				
Opening net book amount	1,183	6,215	80	7,478
Additions	-	1,290	417	1,707
Amortisation charge	(148)	(2,436)	-	(2,584)
Closing net book amount	**1,035**	**5,069**	**497**	**6,601**
At 31 December 2011				
Cost	1,750	19,940	497	22,187
Accumulated amortisation	(715)	(14,871)	-	(15,586)
Net book amount	**1,035**	**5,069**	**497**	**6,601**

12 b) Emission allowances:

	2011 Number of allowances	2010 Number of allowances
At the beginning of the year	**483,309**	**459,097**
Allocated allowances*	1,107,445	1,107,445
Purchased allowances	255,746	280,000
Used allowances	(1,184,626)	(1,268,233)
Sales of allowances	(109,315)	(95,000)
At the end of the year	**552,559**	**483,309**

*Allowances are allocated free of charge in accordance with the law "On Pollution" and Directives of the Ministry of Environmental Protection and Regional Development and are recognised at zero cost.

13 PROPERTY, PLANT AND EQUIPMENT

13 a) Property, plant and equipment

	Revalued buildings and facilities					Revalued technology equipment, machinery				
	Daugava hydropower plants' buildings and facilities	Trans-mission system buildings and facilities	Distri-bution system buildings and facilities	Non-revalued buildings and facilities	Land and buildings, total	Daugava hydropower plants' technology equipment, machinery	Trans-mission system technology equipment, machinery	Distri-bution system technology equipment, machinery	Non-revalued technology equipment, machinery	Technology equipment and machinery, total
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000
At 31 December 2009										
Cost or valuation	1,041,449	302,528	352,204	204,713	**1,900,894**	147,044	250,075	166,099	209,029	**772,247**
Accumulated depreciation and impairment	(577,363)	(188,329)	(102,335)	(40,871)	**(908,898)**	(101,694)	(126,038)	(81,087)	(77,136)	**(385,955)**
Net book amount	464,086	114,199	249,869	163,842	991,996	43,350	124,037	85,012	131,893	386,292
Year ended 31 December 2010										
Opening net book amount	464,086	114,199	249,869	163,842	**991,996**	45,350	124,037	85,012	131,893	**386,292**
Revaluation of PPE	-	-	349,863	-	**349,863**	-	-	149,777	-	**149,777**
Additions	542	8,582	17,819	14,652	**41,595**	11,819	4,495	8,766	8,239	**33,319**
Transfers	-	(1,552)	4,501	1,995	**4,944**	-	-	(4,538)	(242)	**(4,780)**
Disposals	-	(700)	(265)	(175)	**(1,140)**	(78)	(406)	(298)	(5)	**(787)**
Impairment charge*	-	-	(2,276)	(850)	**(3,126)**	-	-	(5,144)	(17,223)	**(22,367)**
Depreciation	(9,252)	(6,204)	(36,419)	(6,466)	**(58,341)**	(11,560)	(9,869)	(14,245)	(12,709)	**(48,383)**
Closing net book amount	455,376	114,325	583,092	172,998	1,325,791	45,531	118,257	219,330	109,953	493,071
At 31 December 2010										
Cost or valuation	1,041,991	305,217	1,261,427	223,733	**2,832,368**	156,685	252,433	468,911	216,984	**1,095,013**
Accumulated depreciation and impairment	(586,615)	(190,892)	(678,335)	(50,735)	**(1,506,577)**	(111,154)	(134,176)	(249,581)	(107,031)	**(601,942)**
Net book amount	455,376	114,325	583,092	172,998	1,325,791	45,531	118,257	219,330	109,953	493,071
Year ended 31 December 2011										
Opening net book amount	455,376	114,325	583,092	172,998	**1,325,791**	45,531	118,257	219,330	109,953	**493,071**
Additions	2,957	1,863	30,127	6,896	**41,843**	2,886	3,197	11,456	5,678	**23,217**
Transfers	-	-	-	(60)	**(60)**	-	-	-	53	**53**
Disposals	-	(148)	(315)	(420)	**(883)**	-	(58)	(525)	(16)	**(599)**
Impairment charge*	-	-	-	414	**414**	-	-	-	(11,899)	**(11,899)**
Depreciation	(9,284)	(6,169)	(36,503)	(6,222)	**(58,178)**	(10,056)	(9,671)	(13,869)	(11,906)	**(45,502)**
Closing net book amount	449,049	109,871	576,401	173,606	1,308,927	38,361	111,725	216,392	91,863	458,341
At 31 December 2011										
Cost or valuation	1,041,813	306,387	1,290,528	230,364	**2,869,092**	158,771	252,794	478,154	220,049	**1,109,768**
Accumulated depreciation and impairment	(592,764)	(196,516)	(714,127)	(56,758)	**(1,560,165)**	(120,410)	(141,069)	(261,762)	(128,186)	**(651,427)**
Net book amount	449,049	109,871	576,401	173,606	1,308,927	38,361	111,725	216,392	91,863	458,341

	Revalued other fixed assets						
	Daugava hydropower plants' other fixed assets LVL'000	Transmission system other fixed assets LVL'000	Distribution system other fixed assets LVL'000	Non-revalued other fixed assets LVL'000	Other fixed assets, total LVL'000	Assets under construction LVL'000	Property, plant and equipment, total LVL'000
At 31 December 2009							
Cost or valuation	7,477	3,299	2,065	84,864	**97,705**	43,193	**2,814,039**
Accumulated depreciation and impairment	(3,053)	(2,066)	(1,374)	(60,652)	**(67,145)**	(3,997)	**(1,365,995)**
Net book amount	**4,424**	**1,233**	**691**	**24,212**	**30,560**	**39,196**	**1,448,044**
Year ended 31 December 2010							
Opening net book amount	4,424	1,233	691	24,212	**30,560**	39,196	**1,448,044**
Revaluation of PPE	-	-	306	-	**306**	-	**499,946**
Additions	-	61	141	4,612	**4,814**	46,138	**125,866**
Transfers	-	-	521	(632)	**(111)**	-	**53**
Disposals	-	(8)	(1)	(63)	**(72)**	(73)	**(2,072)**
Impairment charge*	-	-	(76)	-	**(76)**	(788)	**(26,357)**
Depreciation	(313)	(605)	(173)	(8,855)	**(9,946)**	-	**(116,670)**
Closing net book amount	**4,111**	**681**	**1,409**	**19,274**	**25,475**	**84,473**	**1,928,810**
At 31 December 2010							
Cost or valuation	7,477	3,309	4,135	81,629	**96,550**	89,193	**4,113,124**
Accumulated depreciation and impairment	(3,366)	(2,628)	(2,726)	(62,355)	**(71,075)**	(4,720)	**(2,184,314)**
Net book amount	**4,111**	**681**	**1,409**	**19,274**	**25,475**	**84,473**	**1,928,810**
Year ended 31 December 2011							
Opening net book amount	4,111	681	1,409	19,274	**25,475**	84,473	**1,928,810**
Additions	-	154	307	7,175	**7,636**	124,320	**197,016**
Transfers	-	-	-	7	**7**	-	**-**
Disposals	-	-	-	(11)	**(11)**	(37)	**(1,530)**
Impairment charge*	-	-	-	-	**-**	(277)	**(11,762)**
Depreciation	(309)	(551)	(273)	(8,219)	**(9,352)**	-	**(113,032)**
Closing net book amount	**3,802**	**284**	**1,443**	**18,226**	**23,755**	**208,479**	**1,999,502**
At 31 December 2011							
Cost or valuation	7,477	3,318	4,359	81,648	**96,802**	213,475	**4,289,137**
Accumulated depreciation and impairment	(3,675)	(3,034)	(2,916)	(63,422)	**(73,047)**	(4,996)	**(2,289,635)**
Net book amount	**3,802**	**284**	**1,443**	**18,226**	**23,755**	**208,479**	**1,999,502**

* Impairment charge is included in the Consolidated Income Statement under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

In 2011 the Group has capitalised borrowing expenses in amount of LVL 3,097 thousand (2010: LVL 666 thousand) at a rate of 2.26% (2010: 1.69%).

Property, plant and equipment revaluation

Latvenergo AS revalued assets of Daugava hydropower plants as at 1 January 2007, transmission system assets as at 1 January 2008 and distribution system assets as at 1 January 2010. Valuation have been done by external certified valuators by applying the depreciated replacement cost model, which provides, that the assets value comprises replacement or renewal costs of similar asset at the date of revaluation less the accumulated depreciation. Construction or purchase costs of similar assets are used to estimate the renewal costs of the assets. As at 1 January 2011 transmission system assets and distribution system assets were evaluated for property investment in subsidiaries share capital (*Latvijas elektriskie tīkli AS* and *Sadales tīkls* AS respectively). As at the end of the reporting period carrying value of the hydropower plants, transmission system assets and distribution system assets approximates its fair value (in 2010 the increase in revalued distribution system assets' carrying amount of LVL 499,946 thousand, net of deferred tax, was charged to non-current assets revaluation reserve under the comprehensive income and the decrease in the carrying amount of assets, as a result of a distribution system assets revaluation in the amount of LVL 7,496 thousand in the Consolidated Income Statement under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment').

The carrying amounts of revalued property, plant and equipment of Daugava hydropower plants, transmission and distribution system assets at revalued amounts and their cost basis are as follows:

	Revalued property, plant and equipment categories			
	Buildings and facilities LVL'000	Technology equipment and machinery LVL'000	Other fixed assets LVL'000	Total LVL'000
	At revalued amounts			
At 31 December 2010				
Revalued	2,608,635	878,029	14,921	3,501,585
Accumulated depreciation	(1,455,842)	(494,911)	(8,720)	(1,959,473)
Revalued net book amount	**1,152,793**	**383,118**	**6,201**	**1,542,112**
At 31 December 2011				
Revalued	2,638,728	889,719	15,154	3,543,601
Accumulated depreciation	(1,503,407)	(523,241)	(9,625)	(2,036,273)
Revalued net book amount	**1,135,321**	**366,478**	**5,529**	**1,507,328**
	At amounts stated on historical cost basis			
At 31 December 2010				
Cost	496,062	374,573	10,951	881,586
Accumulated depreciation	(153,748)	(184,264)	(8,483)	(346,495)
Net book amount	**342,314**	**190,309**	**2,468**	**535,091**
At 31 December 2011				
Cost	530,900	396,426	13,740	941,066
Accumulated depreciation	(165,019)	(197,067)	(11,045)	(373,131)
Net book amount	**365,881**	**199,359**	**2,695**	**567,935**

13 b) Impairment

Impairment review performed in accordance with *IAS 36 Impairment of Assets* resulted in an impairment charge on technological equipment and machinery of the Riga TEC-2 combined heat and power plant (carried in non-revalued technology equipment and machinery) based on value in use calculations. The accumulated impairment as at 31 December 2011 amounted to LVL 50,381 thousand (31/12/2010: LVL 38,358 thousand). The cash-generating unit is defined as the assets of Riga TEC-2 plant. Additional impairment is due to Riga TEC-2 technological equipment and machinery planned to be partly discontinued after 2013. Nominal pre-tax discount rate for the future cash flows has diminished from 8.5% in 2010 to 8.4% in 2011. Impairment review was performed also for other assets that are not substantial in the context of these Consolidated Financial Statements. For sensitivity analysis see Note 4 a, II.

13 c) Investment properties (buildings):

	Augstsprieguma tīkls AS buildings LVL'000
Year ended 31 December 2010	
Opening net book amount	436
Reclassified to property, plant and equipment	(53)
Depreciation	(1)
Closing net book amount	**382**
At 31 December 2010	
Cost	454
Accumulated depreciation	(72)
Net book amount	**382**
Year ended 31 December 2011	
Opening net book amount	382
Disposals	(376)
Depreciation	(6)
Closing net book amount	-
At 31 December 2011	
Cost	78
Accumulated depreciation	(78)
Net book amount	-

14 INVESTMENTS IN ASSOCIATES AND OTHER INVESTMENTS

	2011 LVL'000	**2010** LVL'000
At the beginning of the year	**4,464**	**4,261**
Share of profit	232	203
At the end of the year	**4,696**	**4,464**

The table below discloses the Group's share of profit from investments in significant associates and summarised financial information on the amounts of assets, liabilities and net sales of these entities.

Name	Assets LVL'000	Liabilities LVL'000	Net sales LVL'000	Share of profit LVL'000
As of 31 December 2010				
Nordic Energy Link AS *	63,152	45,378	10,504	203
	63,152	**45,378**	**10,504**	**203**
As of 31 December 2011				
Nordic Energy Link AS *	60,063	41,399	9,706	232
	60,063	**41,399**	**9,706**	**232**

** Audited financial data of associate for financial year ending 31 December 2011 and comparative figures for financial year ending 31 December 2010.*

Participating interest in subsidiaries and associates:

Name	Country of incorporation	Business activity held	Interest held, % 31/12/2011	31/12/2010
Subsidiaries:				
Latvijas elektriskie tīkli AS	Latvia	Transmission system assets operation	100%	-
Augstsprieguma tīkls AS *	Latvia	Transmission	-	100%
Sadales tīkls AS	Latvia	Distribution	100%	100%
Latvenergo Kaubandus OÜ	Estonia	Electricity trading	100%	100%
Latvenergo Prekyba UAB	Lithuania	Electricity trading	100%	100%
Liepājas enerģija SIA	Latvia	Heating	51%	51%
Associates:				
Nordic Energy Link AS	Estonia	Transmission	25%	25%
Pirmais Slēgtais Pensiju Fonds AS	Latvia	Management of pension plans	50%	50%

** As at 31 December 2011 following the regulation No. 635 of the Cabinet of Ministers of Latvia dated 5 December 2011 "On purchase of shares and the shareholder of Augstsprieguma tīkls AS" and according to the agreement "On purchase of shares" dated 30 December 2011 the investments in subsidiary undertaking Augstsprieguma tīkls AS is disposed off (see Note 30)*

The Group owns 50% of the shares of the closed pension fund *Pirmais Slēgtais Pensiju Fonds AS*. However, the Group is only a nominal shareholder as all risks and benefits arising from associate's activities will accrue to the Group's employees who are members of the pension fund. Therefore, investment in *Pirmais Slēgtais Pensiju Fonds AS* is valued at cost and not consolidated.

15 INVENTORIES

	31/12/2011 LVL'000	31/12/2010 LVL'000
Raw materials and spare parts	12,532	9,807
Technological fuel	4,143	4,124
Advance payments for inventories	16	29
Allowance for raw materials, spare parts, technological fuel	(2,742)	(2,459)
	13,949	**11,501**

Changes in the allowance for raw materials and spare parts are included in the Consolidated Income Statement position 'Raw materials and consumables used'.

Movement on the allowance for raw materials, spare parts and technological fuel:

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**2,459**	**1,768**
Inventories written off	(44)	(1,026)
Charged to the Consolidated Income Statement	327	1,717
At the end of the year	**2,742**	**2,459**

16 TRADE RECEIVABLES AND OTHER CURRENT RECEIVABLES

16 a) Trade receivables, net

	31/12/2011 LVL'000	31/12/2010 LVL'000
Receivables		
- Electricity customers	66,101	48,494
- Heating customers	12,324	16,816
- Other trade receivables	5,101	5,939
	83,526	**71,249**
Provision for impairment of receivables		
- Electricity customers	(8,320)	(6,809)
- Heating customers	(292)	(394)
- Other trade receivables	(1,105)	(1,015)
	(9,717)	**(8,218)**
Receivables, net		
- Electricity customers	57,781	41,685
- Heating customers	12,032	16,422
- Other trade receivables	3,996	4,924
	73,809	**63,031**

There is no significant concentration of credit risk with respect to trade receivables, as the Group has a large number of customers.

Electricity receivables grouped by past due days and calculated impairment loss:

	31/12/2011 LVL'000	31/12/2010 LVL'000
Electricity receivables:		
Fully performing receivables	44,151	37,870
Receivables past due but not impaired:		
- Receivables past due by 1-45 days	4,826	3,339
Impaired receivables:		
- Receivables past due by 46-90 days	702	602
- Receivables past due by 91-180 days	909	703
- Receivables past due by more than 181 day	7,034	5,980
- Individually impaired receivables with scheduled payments*	8,479	-
	66,101	**48,494**
Provision for impaired electricity receivables:		
- Receivables past due by 46-90 days	(351)	(301)
- Receivables past due by 91-180 days	(683)	(528)
- Receivables past due by more than 181 day	(7,034)	(5,980)
- Individually impaired receivables with scheduled payments*	(252)	-
	(8,320)	**(6,809)**
Electricity receivables, net		
Fully performing receivables	44,151	37,870
Receivables past due but not impaired:		
- Receivables past due by 1-45 days	4,826	3,339
Net impaired receivables:		
- Receivables past due by 46-90 days	351	301
- Receivables past due by 91-180 days	226	175
- Individually impaired receivables with scheduled payments*	8,227	-
	57,781	**41,685**

* - individually impaired receivables are electricity receivables with debt amount exceeding LVL 500 thousand and with the agreement for gradual debt repayment; the required impairment level for individually impaired receivables is determined and based on the debtor's risk assessment and estimated probability of debtor's default (see Note 2.10)

Heating and other receivables grouped by past due days and calculated impairment loss:

	31/12/2011 LVL'000	31/12/2010 LVL'000
Heating and other trade receivables:		
Fully performing receivables	15,697	20,820
Receivables past due but not impaired:		
- Receivables past due by 1-30 days	258	404
Impaired receivables:		
- Receivables past due by 31-90 days	142	242
- Receivables past due by more than 91 day	1,328	1,289
	17,425	**22,755**
Provision for impaired heating and other trade receivables:		
- Receivables past due by 31-90 days	(69)	(120)
- Receivables past due by more than 91 day	(1,328)	(1,289)
	(1,397)	**(1,409)**
Heating and other trade receivables, net		
Fully performing receivables	15,697	20,820
Receivables past due but not impaired:		
- Receivables past due by 1-30 days	258	404
Net impaired receivables:		
- Receivables past due by 31-90 days	73	122
	16,028	**21,346**

The Group's Management has estimated provisions for impairment of receivables on the basis of aging of trade receivables and by evaluating liquidity and history of previous payments of each significant debtor (see Note 2.10). The carrying amount of trade receivables, less provision for impairment, is assumed to approximate their fair values.

The Group's Management assumptions and methodology for estimation of recoverable amount of trade receivables and evaluation of impairment risk are described in Note 4 b).

	31/12/2011 LVL'000	31/12/2010 LVL'000
Fully performing electricity receivables:		
- customers with no overdue receivables	36,908	32,745
- customers with overdue receivables	7,243	5,125
	44,151	**37,870**
Fully performing heating and other receivables:		
- customers with no overdue receivables	15,209	17,627
- customers with overdue receivables	488	3,193
Total fully performing trade receivables	**15,697**	**20,820**

The basis for estimating the credit quality of fully performing trade receivables not due yet and not written down are internal ratings by reference to earlier credit behaviour of clients.

Movements in allowances for impairment of trade receivables are as follows:

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**8,218**	**6,137**
Receivables written off during the year as uncollectible	(575)	(288)
Allowance for impaired receivables	2,074	2,369
At the end of the year	**9,717**	**8,218**

The charge and release of allowance for impaired trade receivables due to delayed payments have been recorded in the Consolidated Income Statement position 'Other operating expenses' as selling expenses and customer services costs (Note 9).

16 b) Other current receivables

	31/12/2011 LVL'000	31/12/2010 LVL'000
Accrued income	6,986	7,522
Pre-tax and overpaid taxes	9,029	13,520
Deferred expenses	571	364
Other financial current receivables	609	392
Other non-financial current receivables	416	84
	17,611	**21,882**

None of the receivables are secured with pledges or otherwise. The carrying amounts of other receivables are assumed to approximate their fair values.

17 CASH AND CASH EQUIVALENTS

	31/12/2011 LVL'000	31/12/2010 LVL'000
Cash at bank and on hand	77,969	52,399
Short-term bank deposits	30,908	181,867
	108,877	**234,266**

Cash at bank earns daily interest mostly based on floating interbank deposit rates. Short-term deposits are placed for different periods between several days and three months depending on the immediate cash needs of the Group and cash flow forecasts. During 2011 the average annual effective interest rate earned on short-term cash deposits was 1.53% (2010: 3.49%). See also Note 3.1.b).

The carrying amounts of cash and cash equivalents are assumed to approximate their fair values.

18 SHARE CAPITAL

As at 31 December 2011, the registered share capital of the Parent Company is LVL 325,862 thousand (31/12/2010: 323,544 thousand) and consists of 325,862 thousand (31/12/2010: 323,544 thousand) ordinary shares with the nominal value of LVL 1 per share (31/12/2010: LVL 1 per share). All shares are fully paid up.

In November 2011, in accordance with the Cabinet of Ministers Directive No. 543 dated 20 October 2011: "On the Investment of the State's property units in the Share Capital of *Latvenergo AS*" and Directives No. 568 and No. 569 dated 2 November 2011: "On the Investment of the State's property units in the Share Capital of *Latvenergo AS*", real estate in the amount of LVL 2,318 thousand was invested in the Parent Company's share capital (2010: real estate in the amount of LVL 5,891 thousand). The value of real estate was determined by external certified valuation experts applying amortised cost model, based on purchase costs of similar assets. Increase in the share capital was approved by the Parent Company's Shareholders' meeting on 9 November 2011 and registered with the Commercial Register of Latvia on 14 November 2011.

19 RESERVES AND DIVIDENDS

As at 31 December 2011, the Group's reserves in the amount of LVL 976,921 thousand (31/12/2010: LVL 972,278 thousand) consist of the property, plant and equipment revaluation reserve, hedge reserve, currency translation reserve and other reserves. The Group cannot distribute the property, plant and equipment revaluation, currency translation and hedge reserves. Other reserves are maintained with the aim to maintain stability in the operations of the Group entities. Other reserves can be distributed by a resolution of the shareholders.

	Non-current assets revaluation reserve LVL'000	Hedge reserve LVL'000	Trans-lation LVL'000	Other reserves LVL'000	TOTAL LVL'000
As at 31 December 2009	**552,889**	**(3,537)**	-	**2**	**549,354**
Revaluation of property, plant and equipment (PPE) (Note 13a)	499,946	-	-	-	**499,946**
Disposal of non-current assets revaluation reserve (Note 13a)	(1,957)	-	-	-	**(1,957)**
Deferred tax related to PPE revaluation reserve (Note 11)	(74,698)	-	-	-	**(74,698)**
Currency translation differences	-	-	8	-	**8**
Loss from fair value changes in derivative financial instruments (Note 24 a)	-	(375)	-	-	**(375)**
As at 31 December 2010	**976,180**	**(3,912)**	**8**	**2**	**972,278**
Transfer from previous year profit	-	-	-	10,257	**10,257**
Disposal of non-current assets revaluation reserve (Note 13a)	(1,362)	-	-	-	**(1,362)**
Deferred tax related to PPE revaluation reserve (Note 11)	81	-	-	-	**81**
Currency translation differences	-	-	2	-	**2**
Loss from fair value changes in derivative financial instruments (Note 24 a)	-	(4,335)	-	-	**(4,335)**
As at 31 December 2011	**974,899**	**(8,247)**	**10**	**10,259**	**976,921**

The dividends paid in 2011 were LVL 35,000 thousand (LVL 0.107 per share) and in 2010 - LVL 20,230 thousand (LVL 0.064 per share).

The distribution of net profit for the 2011 is subject to a resolution of the Parent Company's Shareholder's meeting.

20 BORROWINGS

	31/12/2011 LVL'000	31/12/2010 LVL'000
Non-current borrowings	**462,888**	**506,756**
Current portion of non-current borrowings	48,226	36,935
Accrued interest on non-current borrowings	2,220	1,916
Total current borrowings	**50,446**	**38,851**
Total borrowings	**513,334**	**545,607**

Movement in borrowings:

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**545,607**	**507,225**
Borrowings received	4,357	60,041
Borrowings repaid	(36,936)	(22,164)
Accrued interest on borrowings	306	505
At the end of the year	**513,334**	**545,607**

Borrowings by categories of lenders:

	31/12/2011 LVL'000	31/12/2010 LVL'000
Foreign investment banks	316,860	334,517
Foreign commercial banks	36,038	40,229
Financial institutions registered in the Republic of Latvia	160,436	170,861
Total borrowings	**513,334**	**545,607**

Borrowings by maturity:

	31/12/2011 LVL'000	31/12/2010 LVL'000
Fixed rate non-current borrowings:		
- < 1 year (current portion of non-current borrowings)	291	292
- 1- 5 years	984	1,124
- > 5 years	-	141
Total fixed rate borrowings	**1,275**	**1,557**
Floating rate borrowings:		
- < 1 year (current portion of non-current borrowings)	50,155	38,559
- 1- 5 years	341,189	333,613
- > 5 years	120,715	171,878
Total floating rate borrowings	**512,059**	**544,050**
Total borrowings	**513,334**	**545,607**

Borrowings by pricing period (considering the effect of derivative financial instruments):

	31/12/2011 LVL'000	31/12/2010 LVL'000
- < 1 year	270,560	309,836
- 1– 5 years	186,550	185,029
- > 5 years	56,224	50,742
Total borrowings:	**513,334**	**545,607**

At 31 December 2011 and at 31 December 2010 the Group had none of their borrowings denominated in other currencies than Euro.

The fair value of current and non-current borrowings with floating 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 effect of fair value revaluation is not significant. The fair value of current and non-current borrowings with fixed rates (excluding the effect of derivative financial instruments) exceeds their carrying amounts by LVL 26.2 thousand (2010: LVL 143.68 thousand). The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by average market margin. The average interest rate for discounting cash flows of non-current borrowings was 5.185% (2010: 2.99%).

a) Pledges

The Group's assets are not pledged to secure the borrowings, except the pledge assets of *Liepājas Enerģija SIA* of maximum secured claims in the amount of LVL 14.8 million (31/12/2010: LVL 13.4 million) to secure its current and non-current borrowings. There has been pledged the property, plant and equipment in the amount of LVL 12.8 million and the claims on the receivables accounts in the amount of LVL 2.0 million (31/12/2010: LVL 10.7 million and LVL 2.7 million, respectively).

b) Un-drawn borrowing facilities

As at 31 December 2011 the undrawn portion of committed non-current credit facilities amounts to LVL 257.5 million (31/12/2010: LVL 253 million).

At 31 December 2011 the Group had available LVL 17.57 million (31/12/2010: LVL 17.57 million) of undrawn committed short-term borrowing facilities in respect of which all conditions precedent had been met.

c) Weighted average effective interest rate

During the reporting year the weighted average effective interest rate on non-current borrowings was 2.27% (2010: 1.70%), weighted average effective interest rate for current borrowings was 2.44% (2010: 1.949%). At 31 December 2011 interest rates for non-current borrowings in Euro were 3 and 6 month EURIBOR+0.451% (31/12/2010: +0.453%). At 31 December 2011 fifteen interest rate swap agreements were concluded by the Group for the total notional amount of EUR 343.6 million or LVL 241.5 million (31/12/2010: fifteen interest rate swap agreements EUR 348.2 million or LVL 244.7 million) and the interest rate was fixed for the periods from 3 to 10 years (see Note 24).

21 PROVISIONS

21 a) Provisions for post-employment benefits

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**7,321**	**7,473**
Current service cost	283	309
Interest cost	422	360
Post-employment benefits paid	(353)	(440)
Losses/(gains) as a result of changes in actuarial assumptions	61	(381)
At the end of the year	**7,734**	**7,321**

Total charged/credited provisions are included in the Consolidated Income Statement position 'Personnel expenses' within state social insurance contributions and other benefits defined in the Collective agreement (see Note 8):

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**7,321**	**7,473**
Charged/(credited) to the Consolidated Income Statement	413	(152)
At the end of the year	**7,734**	**7,321**

Discount rate used for discounting benefit obligations was 6.15% (2010: 5.53%), 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% (2010: 2.7%) 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.

21 b) Environmental provisions

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**1,376**	**1,376**
Charged to the Consolidated Income Statement	407	-
At the end of the year	**1,783**	**1,376**

The environmental provision in the amount of LVL 1,783 thousand (2010: LVL 1,376 thousand) represents the estimated cost 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 LVL 1,028 thousand (2010: LVL 1,376 thousand) and SIA "Liepājas Enerģija" provision for the environmental recovery measures in the amount of LVL 755 thousand (2010: LVL 0). The amount of the provisions is calculated taking into account the construction cost index (data from the Central Statistical Bureau).

22 OTHER LIABILITIES AND DEFERRED INCOME

	31/12/2011 LVL'000	31/12/2010 LVL'000
Deferred non-current income from connection fees	87,181	82,688
Deferred income from plant and equipment received free of charge and financing from EU funds	366	234
Other non-financial liabilities	7,268	11,967
Total other liabilities and deferred income:	**94,815**	**94,889**

Movement in deferred connection fees (non-current portion):

	2011 LVL'000	2010 LVL'000
At the beginning of the year	**87,901**	**80,699**
Received	9,753	12,415
Credited to the Consolidated Income Statement	(5,377)	(5,213)
At the end of the year	**92,277**	**87,901**

23 TRADE AND OTHER PAYABLES

	31/12/2011 LVL'000	31/12/2010 LVL'000
Financial liabilities:		
Payables for materials and services	56,672	30,034
Payables for electricity	14,962	15,169
Accrued expenses	5,621	6,274
Other financial current payables	906	457
Total financial liabilities	**78,161**	**51,934**
Non-financial liabilities:		
Value added tax payable	14,305	15,320
State social security contributions and other taxes	6,482	2,467
Advances received	8,701	5,702
Deferred income from connection fees	5,095	5,213
Other non-financial current payables	8,470	1,720
Total non-financial liabilities	**43,053**	**30,422**
Total trade and other current payables:	**121,214**	**82,356**

The carrying amounts of trade and other payables are assumed to approximate their fair values.

24 DERIVATIVE FINANCIAL INSTRUMENTS

24 a) Outstanding fair values of derivatives and their classification

In the table below outstanding fair values of derivatives are disclosed as follows:

	Note	31/12/2011 LVL'000		31/12/2010 LVL'000	
		Assets	**Liabilities**	**Assets**	**Liabilities**
Interest rate swaps	24 b)	-	11,819	(1,011)	8,054
Electricity swaps	24 c)	(2,060)	7,347	(2,393)	-
CO_2 emissions allowances forward contracts	24 d)	-	4,597	-	3,442
Forward foreign currencies exchange contracts	24 e)	(390)	-	(564)	-
Total outstanding fair values of derivatives:		**(2,450)**	**23,763**	**(3,968)**	**11,496**

	31/12/2011 LVL'000		31/12/2010 LVL'000	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Non-current	-	10,629	-	7,088
Current	(2,450)	13,134	(3,968)	4,408
Total:	**(2,450)**	**23,763**	**(3,968)**	**11,496**

In the table below are disclosed (gains) / losses on fair value changes as a result of realized hedge agreements:

	Note	Included in the Consolidated Income Statement		Included in other comprehensive income		Included in accrued liabilities	
		2011	2010	2011	2010	2011	2010
Interest rate swaps – hedging derivatives	19	-	-	4,135	939	-	-
Interest rate swaps – trading derivatives	10	641	(21)	-	-	-	-
Electricity swaps – hedging derivatives	19	-	-	(79)	-	-	-
Electricity swaps – trading derivatives	7	7,759	(12,651)	-	-	-	-
CO_2 emissions allowances forward contracts	7	1,155	(532)	-	-	-	608
Forward foreign currencies exchange contracts – hedging derivatives	19	-	-	279	(564)	-	-
Forward foreign currencies exchange contracts – trading derivatives	10	(105)	-	-	-	-	-
Total:		9,450	(13,204)	4,335	375	-	608

According to amendments 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. The Group implemented the above-mentioned amendments to *IAS 1* in the Consolidated Financial Statements from 2008. 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.

24 b) Interest rate swaps

As at 31 December 2011 the Group had fifteen interest rate swap agreements with total notional amount of EUR 343.6 million or LVL 241.5 million (31/12/2010: EUR 348.2 million or LVL 244.7 million). Interest rate swaps are agreed with 3 to 10 year maturities and hedged floating rates are 3 and 6 month EURIBOR. At 31 December 2011 fixed interest rates vary from 2.3835% to 4.4925% (31/12/2010: from 2.3835% to 4.4925%).

Twelve of all outstanding interest rate swap 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. 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 recognized within profit or loss in the Consolidated Income Statement.

In the table below fair value changes of interest rate swaps are disclosed:

	2011 LVL'000		2010 LVL'000	
	Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year	(1,011)	8,054	(145)	6,270
Included in the Consolidated Income Statement, net (Note 10)	-	641	-	(21)
Included in other comprehensive income (Note 19)	1,011	3,124	(866)	1,805
Outstanding fair value at the end of the year	-	11,819	(1,011)	8,054

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 at 31 December 2011 47% (31/12/2010: 43.4%) of the Group'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 2.13 years (2010: 2.3 years).

24 c) Electricity swaps

As at 31 December 2011 the Group has entered into 125 (31/12/2010: 85) electricity swap contracts with total outstanding volume of 4 418 243 MWh (31/12/2010: 3 007 701 MWh) and notional value of EUR 198 million or LVL 139.2 million (2010: EUR 152 million or LVL 106.8 million). Electricity swaps are signed for the maturities from one month to one year during the period from 1 January 2012 to 31 December 2014.

Electricity swap contracts are agreed through financial counterparties and by using the Nordic energy exchange *Nord Pool Spot* pricing according to the Group's Financial Risk Management Policy for hedging purposes. All purchased swap contracts were contracts with fixed amount of electricity and price in Euros.

As at 31 December 2011 57 (31/12/2010: 0) electricity swap contracts are designated to comply with hedge accounting treatment 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. As there was no ineffectiveness to be recorded through profit or loss in the Consolidated Income Statement, then fair value gains or losses are recognized in the hedging reserve in 'Other comprehensive income' (Note 19).

In the table below fair value changes of electricity swaps are disclosed:

	2011 LVL'000		2010 LVL'000	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Outstanding fair value at the beginning of the year	**(2,393)**	**-**	**-**	**10,258**
Included in the Consolidated Income Statement (Note 7)	2,393	5,366	(2,393)	(10,258)
Included in other comprehensive income (Note 19)	(2,060)	1,981	-	-
Outstanding fair value at the end of the year	**(2,060)**	**7,347**	**(2,393)**	**-**

24 d) CO_2 emissions allowances forward contracts

As at 31 December 2011 the Group has entered into 24 forward contracts of CO_2 emission allowances purchase or sale (31/12/2010: 25) which included 9 purchase contracts of European Union Allowances, hereinafter – EUAs (31/12/2010: 9), 13 purchase contracts of Certified Emission Reductions, hereinafter – CERs (31/12/2010: 12) and 2 sale contracts of CERs (31/12/2010: 4), with the total fair value of EUR 9.6 million or LVL 6.7 million (31/12/2010: EUR 9.4 million or LVL 6.6 million).

As at 31 December 2011 total amount of allocated and procured CO_2 emission allowances for the current allocation period till the end of 2012 is sufficient to offset expected emissions. Over the European Union Emissions Trading System Phase II the Parent Company has fully used the allowed option to procure and offset 10% of allocated EUAs with cheaper CERs. As a result of EUAs and CERs purchase and sale contracts measurement at fair value as at 31 December 2011, the Group has recognised the liabilities in the amount of EUR 5,816 thousand or LVL 4,088 thousand (31/12/2010: EUR 3,612 thousand or LVL 2,538 thousand) for EUAs contracts and EUR 726 thousand or LVL 510 thousand (31/12/2010: EUR 1,286 thousand or LVL 904 thousand) for CERs contracts.

In 2011 CO_2 emissions allowances forward contracts fair value changes are included in the Consolidated Income Statement in the amount of EUR 1,645 thousand or LVL 1,155 thousand (see Note 7) (31/12/2010: EUR 757 thousand or LVL 532 thousand).

In the table below fair value changes of CO_2 emission allowances forward contracts are disclosed:

	2011 LVL'000	2010 LVL'000
	Liabilities	Liabilities
Outstanding fair value at the beginning of the year	**3,442**	**3,366**
Included in accrued liabilities	-	608
Included in the Consolidated Income Statement (Note 7)	1,155	(532)
Outstanding fair value at the end of the year	**4,597**	**3,442**

24 e) Forward foreign currencies exchange contracts

As at 31 December 2011 the Group has entered into EUR/USD and LVL/EUR forward foreign currencies exchange contracts. The notional principal amounts of the outstanding forward foreign currencies exchange contracts as at 31 December 2011 were USD 9.4 million or LVL 5.1 million (31/12/2010: USD 35.8 million or LVL 19.2 million) EUR/USD currency pair and EUR 42.0 million or LVL 29.5 million (31/12/2010: 0) LVL/EUR currency pair.

The hedged highly probable forecasted USD currency transactions are expected to occur at various dates during the next 21 months. Fair value gains and losses on EUR/USD forward foreign currencies exchange contracts as at 31 December 2011 are recognized in the hedging reserve in 'Other comprehensive income' (Note 19) as they qualify under *IAS 39* requirements of hedge accounting.

All outstanding EUR/USD forward foreign currencies exchange contracts at 31 December 2011 were designed as cash flow hedges for USD transactions of Riga TEC-2 combined heat and power plant second power generation unit reconstruction contract. As it was not possible to use LVL/USD forward foreign currencies exchange contracts due to limited maturities and availability, then instead the EUR/USD forward foreign currencies exchange contracts were used to employ the existing peg between Latvian lats and Euros.

There was no ineffectiveness to be recorded through profit or loss in the Consolidated Income Statement from EUR/USD forward foreign currencies exchange contracts. The maximum exposure to credit risk at the reporting date is the fair value of the derivative assets in the Consolidated Statement of Financial Position.

Agreed LVL/EUR forward foreign currencies exchange contracts will be settled at various dates during the next 4 months. Fair value gains and losses on LVL/EUR forward foreign currencies exchange contracts as at 31 December 2011 are recognized through profit or loss in the Consolidated Income Statement (Note 10).

In the table below fair value changes of forward foreign currencies exchange contracts are disclosed:

	2011 LVL'000	2010 LVL'000
	Assets	Assets
Outstanding fair value at the beginning of the year	**(564)**	**-**
Included in the Consolidated Income Statement (Note 10)	(105)	-
Included in other comprehensive income (Note 19)	279	(564)
Outstanding fair value at the end of the year	**(390)**	**(564)**

25 RELATED PARTY TRANSACTIONS

The Parent Company and, indirectly, the other Group entities are controlled by the Latvian state. Related parties, other than subsidiaries and associates, are those companies in which the State exercises control or has significant influence.

The following transactions were carried out with related parties:

	2011 LVL'000	2010 LVL'000
a) Sales of goods:		
- Associates (electricity sales)	2,448	103
- Other related parties (heat sales)	59,363	60,536
Total sales of goods to related parties:	**61,811**	**60,639**
b) Sales of services:		
- Associates	626	13,659
- Other related parties	682	800
Total sales of services to related parties:	**1,308**	**14,459**
c) Purchases of goods:		
- Associates (electricity purchases)	407	335
- Other related parties (heat purchases)	10,037	10,723
Total purchases of goods from related parties:	**10,444**	**11,058**
d) Purchases of services:		
- Associates	2,277	3,090
- Other related parties	1,493	1,655
Total purchases of services from related parties:	**3,770**	**4,745**

	31/12/2011 LVL'000	31/12/2010 LVL'000
e) Balances at the end of the year arising from sales:		
Trade receivables from:		
- Associates	432	28
- Other related parties	10,000	13,699
Total trade receivables from related parties:	**10,432**	**13,727**
f) Balances at the end of the year arising from purchases:		
Trade payables to:		
- Associates	309	138
- Other related parties	1,530	2,013
Total trade payables to related parties:	**1,839**	**2,151**
g) Accrued liabilities due to related party transactions:		
- Other related parties	68	78
	68	**78**

The Group has not created any provisions or incurred write-offs from transactions with related parties, as all debts are recoverable.

The transactions disclosed above do not include sales of electricity in the ordinary course of business of the Group due to a very large volume of those transactions and the fact that these transactions are performed at tariffs regulated by the Latvian Regulatory authority (Public Utilities Commission) applicable to other similar customers.

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 key management personnel that is defined as Members of the Management Boards of the Group entities is disclosed in Note 8.

26 ISSUED GUARANTEES

	31/12/2011 LVL'000	31/12/2010 LVL'000
Outstanding issued guarantees by the Group to guarantee obligations to third parties:		
Guarantee on behalf of *Nordic Energy Link AS*	9,922	10,825
Total outstanding issued guarantees by the Group to guarantee obligations to third parties:	**9,922**	**10,825**

Guarantee on behalf of *Nordic Energy Link AS* was provided for receiving long-term loan facility. The outstanding amount of the issued guarantee on behalf of *Nordic Energy Link AS* (validity term – December 15, 2014) is LVL 9,922 thousand (31/12/2010: LVL 10,825 thousand). The fair value of guarantee is LVL 335.6 thousand (31/12/2010: LVL 502 thousand). The fair value calculations are based on the estimated amount of service fee receivable discounted at EUR swap rates increased by average market margin of loans with respective maturities. During 2011 the average interest rate for discounting cash flow was 4.55% (2010: 2.57%).

27 CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As of 31 December 2011 the Parent Company had commitments amounting to LVL 323.9 million (31/12/2010: LVL 221.7 million) for capital expenditure contracted but not delivered at the end of the reporting period.

The tax authorities may at any time inspect the books and records within 3 years subsequent to the reported tax year, and may impose additional tax assessments and penalties. The Group's and the Parent Company's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

28 HELD-TO-MATURITY FINANCIAL ASSETS

There were no gains or losses realized on the disposal of held-to-maturity financial assets in 2011 (2010: nil). All held-to-maturity financial assets are denominated in the LVL. The maximum exposure to credit risk at the reporting date is the carrying amount of held-to-maturity financial assets.

As at 31 December 2011 the entire Group's held-to-maturity financial assets were State Treasury bills with 6 months and 12 months maturity, and the 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. The outstanding amortised value of held-to-maturity financial assets are assumed to approximate their fair values.

	2011 LVL'000		2010 LVL'000	
Outstanding amortised value:	**Current**	**Non-current**	**Current**	**Non-current**
Held-to-maturity financial assets	44,714	15,670	2,387	-

29 EVENTS AFTER THE REPORTING PERIOD

Following to the Share Purchase Agreement concluded 30 December 2011 between Latvenergo AS and Republic of Latvia in person of Ministry of Finance and according to the entry in the Shareholders' Register of Augstsprieguma tīkls AS, dated 2 January 2012, since 2 January 2012 Augstsprieguma tīkls AS has been fully owned by Republic of Latvia in person of Ministry of Finance.

There have been no other significant events subsequent to the end of the reporting year that might have a material effect on the Group's Consolidated Financial Statements for the year ended 31 December 2011.

30 DISCONTINUED OPERATIONS

Following the regulation No. 635 of the Cabinet of Ministers of Latvia dated 5 December 2011 "On purchase of shares and the shareholder of *Augstsprieguma tīkls AS*" and according to the agreement "On purchase of shares" dated 30 December 2011 the investments in subsidiary undertaking Augstsprieguma tīkls AS is disposed off. The sales transaction was completed on January 2012. *Augstsprieguma tīkls AS* was engaged in provision of the electricity transmission services within the Group.

The Group retained its transmission assets, but will lease them out to *Augstsprieguma tīkls AS* who will continue providing electricity transmission services with those assets. Accordingly, the Group will continue purchasing transmission services from this entity, and will lease its assets and provide other necessary services to the entity necessary to the latter for providing these services. In 2011, such transactions represented intra-group transactions and were therefore eliminated; the major transactions comprised: purchase of transmission services in the amount of LVL 57,740 thousand, lease of transmission assets in the amount of LVL 22,813 thousand, and sales of electricity and other services in the amount of LVL 32,096 thousand.

Financial information disclosed below on discontinued operations includes result, net assets and cash flows of discontinued transmission business segment:

Income Statement

	2011 LVL'000	2010 LVL'000
Revenue	3,804	2,980
Other income	342	43
Raw materials and consumables used	(520)	(279)
Personnel expense	(1,751)	(1,557)
Other operating expenses	(1,058)	(1,419)
Operating profit / (loss)	**817**	**(232)**
Profit / (loss) before tax	**817**	**(232)**
Income tax	(271)	-
Profit for the year	**546**	**(232)**

Assets and liabilities of discontinued operations

	31/12/2011 LVL'000	31/12/2010 LVL'000
ASSETS		
Current assets	1,826	662
TOTAL:	**1,826**	**662**
LIABILITIES		
Provisions	127	96
Trade payables and other current liabilities	3,004	1,619
TOTAL:	**3,131**	**1,715**

Cash flows of discontinued operations

In 2011 operating cash flows of the discontinued transmission business segment amounts to LVL 998 thousand and investing cash outflows amounts to LVL 9 thousand.

31 FINANCIAL INFORMATION ON THE PARENT COMPANY

Financial information disclosed on the Parent Company includes the primary separate Financial Statements of the Parent Company, the disclosure of which is required by the Accounting Act of Latvia. The primary Financial Statements of the Parent Company have been prepared using the same accounting policies that have been used in the preparation of the Consolidated Financial Statements. Investments in subsidiaries are reported at cost less any impairment charge in the separate Financial Statements of the Parent Company.

Income Statement

	2011 LVL'000	2010 LVL'000
Revenue	700,914	650 374
Other income	2,327	2 322
Income on transfer of operating segment	577,989	-
Raw materials and consumables used	(325,818)	(241 331)
Personnel expense	(21,454)	(19,400)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	(101,140)	(142,867)
Other operating expenses	(168,995)	(189,165)
Operating profit	**663,823**	**59,933**
Income from investments in subsidiaries	725	-
Finance costs, net	(6,879)	(10,929)
Profit before tax	**657,669**	**49,004**
Income tax	295	(6,399)
Profit for the year	**657,964**	**42,605**

Statement of Financial Position

	31/12/2011 LVL'000	31/12/2010 LVL'000
ASSETS		
Intangible assets	8,065	7,452
Property, plant and equipment	952,048	1,915,907
Financial investment	884,390	6,487
Total non-current assets	**1,844,503**	**1,929,846**
Inventories	4,697	4,779
Receivables	145,251	99,886
Derivative financial instruments	2,450	3,968
Held-to-maturity assets	44,715	2,387
Cash and cash equivalents	101,841	229,457
Total current assets	**298,954**	**340,477**
TOTAL ASSETS	**2,143,457**	**2,270,323**
EQUITY		
Share capital	325,862	323,544
Non-current assets revaluation reserve	411,959	978,137
Hedge reserve	(8,246)	(3,912)
Other reserves	9,562	-
Retained earnings	657,964	42,605
Total equity	**1,397,101**	**1,340,374**
LIABILITIES		
Provisions	3,918	4,014
Borrowings	454,783	500,127
Deferred income tax liabilities	74,896	187,635
Derivative financial instruments	10,629	7,088
Other non-current liabilities	3,932	92,448
Total non-current liabilities	**548,158**	**791,312**
Borrowings	60,642	40,232
Trade and other payables	97,220	65,270
Derivative financial instruments	13,470	4,910
Other current liabilities	26,866	28,225
Total current liabilities	**198,198**	**138,637**
TOTAL EQUITY AND LIABILITIES	**2,143,457**	**2,270,323**

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Translation from Latvian original*

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of Latvenergo AS

Report on the Consolidated Financial Statements

We have audited the accompanying financial statements of Latvenergo AS and its subsidiaries ("the Group"), set out on pages 8 to 60 of the accompanying annual report which comprise the consolidated statement of financial position as of 31 December 2011 and the consolidated income statement and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

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Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

We have read the Management Report for 2011 set out on pages 4 to 7 of the accompanying annual report for 2011 and did not identify material inconsistencies between the financial information contained in the Management Report and that contained in the consolidated financial statements for 2011.

PricewaterhouseCoopers SIA
Certified audit company
Licence No. 5

Ilandra Lejiņa
Certified auditor in charge
Certificate No. 168

Member of the Board

Riga, Latvia
22 May 2012

* This version of our report is a translation from the original, which was prepared in Latvian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.