

Translation from Latvian Original

**JOINT STOCK COMPANY “LATVIJAS GĀZE”**  
**ANNUAL ACCOUNTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2005**

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**ANNUAL ACCOUNTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2005**

**DIRECTORS AND AUDITORS**

Names and positions of the Council members	<p>Kiril Seleznov (Кирил Селезнев) – Chairman of the Council</p> <p>Juris Savickis – Deputy Chairman of the Council</p> <p>Stephan Kamphues – Deputy Chairman of the Council</p> <p>Eike Benke – Member of the Council</p> <p>Reiner Lehmann – Member of the Council</p> <p>Matthias Keuchel – Member of the Council</p> <p>Uwe Fip – Member of the Council</p> <p>Jelena Karpel (Елена Карпель) – Member of the Council</p> <p>Igor Nazarov (Игорь Назаров) – Member of the Council</p> <p>Vlada Rusakova (Влада Русакова) – Member of the Council</p> <p>Aleksandr Krasnenkov (Александр Красненков) – Member of the Council</p>
Names and positions of the Board members	<p>Adrians Dāvis – Chairman of the Board</p> <p>Aleksandrs Mihejevs (Александр Михеев) – Member of the Board, Deputy Chairman of the Board</p> <p>Frank Siebert – Member of the Board, Deputy Chairman of the Board</p> <p>Anda Ulpe – Member of the Board</p> <p>Gints Freibergs – Member of the Board</p>
Financial Year	1 January – 31 December 2005
Name and address of the auditor and responsible certified auditor	<p>PricewaterhouseCoopers SIA</p> <p>Audit company licence No. 5</p> <p>Kr. Valdemāra Street 19</p> <p>Riga, LV-1010</p> <p>Latvia</p> <p>Responsible certified auditor:</p> <p>Juris Lapshe</p> <p>Certified auditor</p> <p>Certificate No. 116</p>

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**ANNUAL ACCOUNTS**  
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**Report of the Board**

**1. Performance of the Company in the reporting year**

In the year 2005, the Joint Stock Company "Latvijas Gāze" (hereinafter the Company) retained its position in the fuel market. In the reporting year, the Company devoted major attention to the fulfilment of the Investment program and to increase of safety of gas supply network operation, as well as to supply natural gas to the consumers in the amounts and quality as specified in the contracts.

In the reporting period 1 664,44 mio nm<sup>3</sup> of natural gas have been delivered to the consumers. In comparison to the year 2004, the volume of natural gas sales has increased by 2,7%. The increase was ensured by gasification of Rēzekne city and new connections in accordance with investment contracts.

The financial results of the Company were influenced by rapid increase of price of oil products in the World. In order to hasten the adjustment of gas price towards the price of oil products in Rotterdam market, amendments to the natural gas supply agreement became effective as of January 1, 2005, according to which the purchase price of natural gas was determined by a formula taking into account the actual heavy fuel oil quotation. The formula anticipated gradual increase of the price up to 60% during three years at heavy fuel oil quotation 200 USD/t. Since the actual heavy fuel oil quotation during 2005 significantly exceeded the highest quotation specified in the agreement in December 2005, new amendments to the natural gas supply agreement were signed, removing the heavy fuel oil quotation ceiling specified in the agreement as of January 1, 2006.

On the basis of the changes of the gas purchase price, at the beginning of 2005 the Company submitted to the Public Utilities Commission (hereinafter PUC) a proposal for natural gas tariffs which provided for a gradual increase in natural gas transmission, storage, distribution and sales service as well as natural gas end-user tariffs as of the middle of 2005 through 2007. Natural gas service and end-user sales tariffs approved by PUC instruction No. 132 of June 8, 2005 "On JSC "Latvijas Gāze" natural gas tariffs" became effective as of July 1, 2005 and August 1, 2005 depending on the users' consumption group. Compared to the existing tariffs, the increase of tariffs constituted 9,7% - 17,0% depending on the consumption volume.

The total revenues from natural gas sales and other core business activities amounted to LVL 133,4 mio (EUR 189,8 mio) in 2005, expenses (excl. administration) – LVL 110,3 mio (EUR 156,9 mio), and gross profit from core business activities was LVL 23,1 mio (EUR 32,8 mio). The tariff increase provided additional revenues of LVL 6,1 mio (EUR 8,7 mio). Core business ensured to the Company net profit of approximately LVL 15 mio (EUR 21,3 mio). Net profitability (less the results of legal proceeding described below) in 2005 reached 11,5% and was behind the level reached in 2004 by 4%. In comparison with the year 2004, the net profit of the Company grew by 25,5% or LVL 4,8 mio (EUR 6,8 mio) and reached LVL 23,5 mio (EUR 33,5 mio). 36,2% of the total net profit was received in relation with Stockholm Court judgement.

Pursuant to an earlier arbitral award rendered by a Swedish arbitration tribunal and pursuant to a final judgement during the reporting period by the Svea Court of Appeal in Stockholm, Sweden, the Company received compensation for damages, interest payments and litigation costs from the State for a total amount of LVL 8,5 mio (EUR 12,1 mio). The abovementioned arbitral tribunal rendered an arbitral award favourable to the Company on June 19, 2003 in proceedings subject to UNCITRAL arbitration based on a claim against the Republic of Latvia for breach of the Share Sales and Purchase Agreement dated 2 April 1997. According to the arbitral award, the Republic of Latvia was under an obligation to compensate the Company for damages of LVL 6.9 mio (EUR 9.8 mio) plus interest payments and litigation costs. On September 19, 2003, the Republic of Latvia lodged an appeal to the Swedish Svea Court of Appeal to annul the arbitral award of June 19, 2003 and to reimburse it for all expenses related to the appeal. According to the ruling by the Swedish Svea Court of Appeal dated May 4, 2005 the arbitral award concerning the UNCITRAL arbitration case is in effect, the court ruling being final and non-appealable. In 2005 the Company booked to income the provisions made during previous periods of LVL 1,4 mio (EUR 2 mio) which were formed to finance the other parties' claimed litigation expenses in case of an unfavourable outcome in the court. As a result of the judgement by Svea Court of Appeal, net profit for the Company increased by LVL 8,6 mio (EUR 12,2 mio), LVL 8,3 mio (EUR 11,8 mio) of which are related to lost profits in previous periods starting from 2001.

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**Board report (continued)**

**1. Performance of the Company in the reporting year (continued)**

In 2005, a great attention was paid by the Company to further natural gas distribution system expansion and connection of new users to the existing system of gas supply. As of 1 January 2006 the total length of natural gas pipeline was 5 620,1 km including 1 280,7 km of transmission pipelines and 4 339,4 km of distribution pipelines. During the reporting year, gas pipelines by LVL 10,7 mio (EUR 15,2 mio) were put into operation – 250,2 km of distribution lines, including 20 km of house connections, and 46,5 km of gas transmission line Preiļi-Rēzekne.

The number of individual users consuming gas for heating grew by 4,2 thousand users during 2005 and reached 35 thousand by the end of the year. The total number of gas users approached 433,9 thousand.

In 2005, operational unit “Incukalna UGS” (hereinafter IUGS) achieved the highest ever operation indicators in the history of the facility. In the reporting period, 1,95 billion nm<sup>3</sup> of natural gas was injected into the storage and the total gas volume in the storage reached 4,46 billion nm<sup>3</sup> including active gas volume – 2,32 billion nm<sup>3</sup>.

Revaluation of fixed assets as at 31.12.2005 received for gratis and concretized of transmission pipelines' lengths and their replacement values during digital survey in the reporting year increased the values of assets. The value of the Company's assets increased by approx. LVL 1,7 mio (~ EUR 2,4 mio).

During the year 2005, the Company invested LVL 24,2 mio (EUR 34,4 mio) in the modernisation of the existing gas supply system and formation of new fixed assets. 40,7% of total investments were used for IUGS modernisation, 17,9% for development of gas transmission grid, but 41,4% for development of distribution system and for attraction of new consumers. The most significant projects concluded during 2005 were reconstruction of IUGS methanol facility, construction of gas transmission line Preiļi-Rēzekne, modernisation of four gas regulation stations and construction of Rēzekne GRS, inspection of gas transmission pipelines Pskov-Riga and Viresi-Tallinn with intellectual pig.

**2. Research and development activities**

To ensure uninterrupted gas supply to the consumers and safe exploitation of gas supply system in long-term, the Company has developed “Activity plan for safety increase of gas supply system of the Joint Stock Company “Latvijas Gāze” from the year 2006 to 2010”. The activity plan has been prepared based on assessments by Russian companies “Gazobezopasnostk” and “Ļentransgaz”, “VNIIGAS” institute, “Giprospeccgaz”, German companies “Pipeline Engineering GmbH”, “Untergrundspeicher und Geotechnologie – Systeme GmbH”, “E.ON Engineering GmbH”, “E.ON Ruhrgas International AG” and other collaboration partners about equipment's technical condition and modernization possibilities. Activity plan provides for investments in safety increase for total amount of LVL 73,8 mio (EUR 105 mio).

The activity plan contains mainly projects, the execution of which is necessary in order to increase the safety of system operation, gasification of new objects, and increase of gas supply stability in the whole region covering seasonal consumption fluctuations with gas supplies from IUGS to Estonia and Western part of Russia, as well as to Lithuania in further perspective.

The largest investments in IUGS are provided for installation of new compressor, modernisation of bore-wells and gas collection stations. In transmission pipeline system – for the completion of diagnostics and elimination of faults, replacement of line valves, modernisation of GRS Rīga-1 and GRS TEC-2.

**3. Management of financial risks**

The activities of the Company are exposed to several financial risks, including those of fluctuations of credit and foreign currency exchange rate. Management of the Company strives to minimize possible negative effects of financial risks on the Company's financial position.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**Board report (continued)**

**3. Management of financial risks (continued)**

Until the reporting year, the Company was exposed to the risk of foreign currency exchange rate fluctuations because the gas purchase price was set for in the USD, but sales tariffs in Lats. As of January 2005, the gas purchase price is set for in USD, but subsequently converted to EUR. Settlements for the supplied gas take place in EUR.

Since the exchange rate of the Lat is pegged to Euro as of 1 January 2005, fluctuations of LVL/EUR exchange rate are limited and no significant influence on financial results for next periods is anticipated. Changes of gas purchase prices in USD depending on heavy fuel oil quotation is covered by natural gas sales tariffs approved by PUC, which also cover EUR/USD exchange rate fluctuation up to a certain level. The risk of foreign currency exchange rate fluctuation, connected with the debts to the suppliers, is managed by keeping considerable cash funds in deposits of the respective currencies.

Cash funds and receivables are the main financial assets exposed to the credit risk. The Company's cash funds and their equivalents are kept with the largest financial institutions of Latvia. Receivables are shown at their initial value except of provisions for bad and doubtful debts. The Company is exposed to the concentration of the credit risk because considerable net turnover share refers to a limited number of customers. Four of the Company's consumers form up to 43% of the sales (in 2004 – 45%), the debt of one of these debtors on December 31, 2005 was 19,9% (in 2004 – 18%) of the total receivables. The individual total debt of the rest of the debtors in the end of the reporting year does not exceed 7% (in 2004 – 9%).

**4. Post balance sheet events**

Since the last day of the reporting year till the day of signing the report by the Board, there have been no significant or extraordinary circumstances that would have a material effect on the financial results and the financial position of the Company.

On the basis of the oil market trends and the rapid price increase of oil products, as of January 1, 2006 the amendments to the natural gas supply agreement became effective, removing the peg of natural gas price to the heavy fuel oil quotation ceiling to 200 USD/t, thus fixing the highest gas purchase price.

In December 2005, the Company submitted to the PUC the natural gas tariff project for 2006. According to PUC resolution of March 22, 2006 No.73 "On natural gas tariffs in 2006", tariffs that will become effective as of May 1, 2006 were approved. The new tariffs are pegged to heavy fuel oil quotation in the stock exchange and will cover the increase in gas purchase expenses. Service tariffs were not amended.

**5. Distribution of profit of 2005 proposed by the Board**

	<b>2005 LVL</b>	<b>2005 EUR</b>
Current year's profit according to statutory financial statements prepared under Latvian accounting regulations	23 640 926	33 638 006
Profit share not available for distribution (unrealized deferred income tax income in connection with the revaluation of fixed assets)	(1 182 713)	(1 682 849)
Profit available for distribution	22 458 213	31 955 157
Profit distribution proposed:		
Calculated dividends to shareholders (62,2%)	13 965 000	19 870 405
Dividend per share (LVL/1 share)	0,35	0,498
Transfer to reserves provided for in the Company's Charter	8 493 213	12 075 752

Several members of the Company's Council and Board own shares and hold managerial positions in several companies registered in the Register of Enterprises of the Republic of Latvia. Except as disclosed in the financial statements, the Company did not have material transactions with those companies during the reporting year.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**Board report (continued)**

**5. Distribution of profit of 2005 proposed by the Board (continued)**

Information on the shareholdings by the members of the Company's Council and Board in the Company is available from the Company's Board.

**6. Future perspective**

On the basis of investments made during the previous years and the reporting year in safety increase of the system operation, expansion of gas supply network, attraction of new clients, recovery of receivables, as well as the situation in the fuel market in Latvia, Board of the Company believes that the Company will continue successful development also in 2006 and will have a stable place in the fuel market.

Chairman of Board

A. Dāvis

Board meeting minutes Nr. \_\_\_\_ (2006)

Riga, May 3, 2006

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**JOINT STOCK COMPANY “LATVIJAS GĀZE”  
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**STATEMENT OF DIRECTORS’ RESPONSIBILITY**

The Board of Directors of JSC “Latvijas Gāze” (the Company) is responsible for the preparation of the financial statements of the Company.

The financial statements on pages 10 to 38 are prepared in accordance with the underlying accounting records and source documents and present fairly the financial position of the Company as of 31 December 2005 and the results of its operations and cash flows for the year ended 31 December 2005.

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

The Board of Directors of JSC “Latvijas Gāze” is responsible for the maintenance of proper accounting records, the safeguarding of the Company’s assets and the prevention and detection of fraud and other irregularities in the Company. The Board of Directors is also responsible for operating the Company in compliance with the legislation of the Republic of Latvia.

On behalf of the Board of Directors,

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Adrians Dāvis  
Chairman of the Board

May 19, 2006



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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**FOR THE YEAR ENDED 31 DECEMBER 2005**



PricewaterhouseCoopers SIA  
Kr. Valdemāra iela 19  
Rīga LV 1010  
Latvija  
Telephone +371 709 4400  
Facsimile +371 783 0055

Translation from Latvian original

**AUDITORS' REPORT**

**To the shareholders of JSC "Latvijas Gāze"**

We have audited the financial statements of JSC "Latvijas Gāze" for the year ended 31 December 2005 set out on pages 10 to 38. The audited financial statements include the balance sheet as of 31 December 2005, related income statement, statement of changes in equity and cash flow statement for the year then ended and note disclosure. These financial statements are the responsibility of JSC "Latvijas Gāze" management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing issued by International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We read the management report set out on pages 4 to 7 and did not identify material inconsistencies with the audited financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of JSC "Latvijas Gāze" as of 31 December 2005, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

In addition, in our opinion, the financial statements give a true and fair view of the financial position of JSC "Latvijas Gāze" as of 31 December 2005, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers SIA  
Audit company licence No. 5

Juris Lapshe  
Certified auditor  
Certificate No. 116

Member of the Board

May 19, 2006



Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**BALANCE SHEET AS AT 31 DECEMBER 2005**

	Note	31.12.2005. LVL'000	31.12.2004. LVL'000	31.12.2005. EUR'000	31.12.2004. EUR'000
<b>Assets</b>					
<u>Non-current assets</u>					
Property, plant and equipment	3	214 323	200 718	304 954	285 596
Intangible assets	4	1 414	1 275	2 012	1 814
Financial assets at fair value through profit or loss	5	4	9	6	13
Trade receivables	6	216	202	307	287
<u>Current assets</u>					
Inventories	7	43 602	27 394	62 040	38 978
Trade receivables	6	13 020	9 831	18 526	13 989
Overpaid current income tax	23	669	-	952	-
Other current assets	8	1 340	9 368	1 907	13 329
Cash and cash equivalents	9	23 868	12 202	33 961	17 362
<b>Total assets</b>		<b>298 456</b>	<b>260 999</b>	<b>424 665</b>	<b>371 368</b>
<b>Equity and liabilities</b>					
<u>Equity</u>					
Share capital	10	39 900	39 900	56 773	56 773
Share premium		14 320	14 320	20 376	20 376
Revaluation reserve		119 150	117 816	169 534	167 637
Other reserves		39 061	33 237	55 579	47 292
Retained earnings		16 745	10 898	23 825	15 506
<b>Total equity</b>		<b>229 176</b>	<b>216 171</b>	<b>326 087</b>	<b>307 584</b>
<u>Liabilities</u>					
<u>Non-current liabilities</u>					
Borrowings	11	18	46	26	65
Deferred income tax liabilities	23	19 897	20 034	28 311	28 505
Deferred income	12	6 675	4 500	9 498	6 403
<u>Current liabilities</u>					
Trade payables		32 337	11 181	46 012	15 910
Current income tax liabilities	23	-	891	-	1 268
Borrowings	11	35	31	50	44
Provisions for other liabilities and charges	13	-	1 386	-	1 972
Deferred income	12	244	163	347	232
Other current liabilities	14	10 074	6 596	14 334	9 385
<b>Total liabilities</b>		<b>69 280</b>	<b>44 828</b>	<b>98 578</b>	<b>63 784</b>
<b>Total equity and liabilities</b>		<b>298 456</b>	<b>260 999</b>	<b>424 665</b>	<b>371 368</b>

The notes on pages 15 to 38 are an integral part of these financial statements.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005**

	Note	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
Sales		133 386	121 119	189 791	172 337
Cost of sales	16	(110 318)	(93 963)	(156 968)	(133 697)
<b>Gross profit</b>		<b>23 068</b>	<b>27 156</b>	<b>32 823</b>	<b>38 640</b>
Administrative expenses	17	(7 375)	(6 977)	(10 494)	(9 927)
Other income	18	11 831	1 846	16 834	2 626
Other expenses	19	(1 287)	(1 169)	(1 831)	(1 663)
Finance income, net	21	635	797	903	1 133
<b>Profit before income tax</b>		<b>26 872</b>	<b>21 653</b>	<b>38 235</b>	<b>30 809</b>
Income tax expense	23	(3 325)	(2 892)	(4 731)	(4 115)
<b>Profit for the year</b>		<b>23 547</b>	<b>18 761</b>	<b>33 504</b>	<b>26 694</b>
<b>Earnings per share</b>		<b>LVL</b>	<b>LVL</b>	<b>EUR</b>	<b>EUR</b>
- Basic	24	<b>0.590</b>	<b>0.470</b>	<b>0.840</b>	<b>0.669</b>
- Diluted	24	<b>0.590</b>	<b>0.470</b>	<b>0.840</b>	<b>0.669</b>

The notes on pages 15 to 38 are an integral part of these financial statements.

The financial statements on pages 10 to 38 were approved by the Board of Directors and were signed on its behalf by:

\_\_\_\_\_  
Adrians Dāvis  
Chairman of the Board

\_\_\_\_\_  
Anda Ulpe  
Board Member

May 19, 2006

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2005**

	Share capital LVL'000	Share premium LVL'000	Revaluation reserve LVL'000	Other reserves LVL'000	Retained earnings LVL'000	Total LVL'000
<b>Balance as at 31 December 2003</b>	<b>39 900</b>	<b>14 320</b>	<b>8 020</b>	<b>30 190</b>	<b>5 046</b>	<b>97 476</b>
Transfers to reserves	-	-	-	3 047	(3 047)	-
Revaluation of property, plant and equipment	-	-	129 305	-	-	129 305
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(19 396)	-	-	(19 396)
Disposal of revalued property, plant and equipment	-	-	(133)	-	133	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	20	-	(20)	-
Net income / (expense) recognized directly in equity	-	-	109 796	3 047	(2 934)	109 909
Dividends for 2003	-	-	-	-	(9 975)	(9 975)
Profit for the year	-	-	-	-	18 761	18 761
<b>Balance as at 31 December 2004</b>	<b>39 900</b>	<b>14 320</b>	<b>117 816</b>	<b>33 237</b>	<b>10 898</b>	<b>216 171</b>
Transfers to reserves	-	-	-	5 824	(5 824)	-
Revaluation of property, plant and equipment	-	-	1 680	-	-	1 680
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(252)	-	-	(252)
Disposal of revalued property, plant and equipment	-	-	(111)	-	111	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	17	-	(17)	-
Net income / (expense) recognized directly in equity	-	-	1 334	5 824	(5 730)	1 428
Dividends for 2004	-	-	-	-	(11 970)	(11 970)
Profit for the year	-	-	-	-	23 547	23 547
<b>Balance as at 31 December 2005</b>	<b>39 900</b>	<b>14 320</b>	<b>119 150</b>	<b>39 061</b>	<b>16 745</b>	<b>229 176</b>

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	Share capital EUR'000	Share premium EUR'000	Revaluation reserve EUR'000	Other reserves EUR'000	Retained earnings EUR'000	Total EUR'000
<b>Balance as at 31 December 2003</b>	<b>56 773</b>	<b>20 376</b>	<b>11 411</b>	<b>42 956</b>	<b>7 180</b>	<b>138 696</b>
Transfers to reserves	-	-	-	4 336	(4 336)	-
Revaluation of property, plant and equipment	-	-	183 984	-	-	183 984
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(27 598)	-	-	(27 598)
Disposal of revalued property, plant and equipment	-	-	(189)	-	189	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	29	-	(29)	-
Net income / (expense) recognized directly in equity	-	-	156 226	4 336	(4 176)	156 386
Dividends for 2003	-	-	-	-	(14 193)	(14 193)
Profit for the year	-	-	-	-	26 695	26 695
<b>Balance as at 31 December 2004</b>	<b>56 773</b>	<b>20 376</b>	<b>167 637</b>	<b>47 292</b>	<b>15 506</b>	<b>307 584</b>
Transfers to reserves	-	-	-	8 287	(8 287)	-
Revaluation of property, plant and equipment	-	-	2 390	-	-	2 390
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(359)	-	-	(359)
Disposal of revalued property, plant and equipment	-	-	(158)	-	158	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	24	-	(24)	-
Net income / (expense) recognized directly in equity	-	-	1 897	8 287	(8 153)	2 031
Dividends for 2004	-	-	-	-	(17 032)	(17 032)
Profit for the year	-	-	-	-	33 504	33 504
<b>Balance as at 31 December 2005</b>	<b>56 773</b>	<b>20 376</b>	<b>169 534</b>	<b>55 579</b>	<b>23 825</b>	<b>326 087</b>

Dividends are distributed and transfers to reserves are made based upon profits and retained earnings as per statutory financial statements prepared under Latvian accounting regulations. Changes in other reserves can be made only with shareholders' approval. Revaluation reserve and share premium cannot be distributed as dividends to shareholders.

The notes on pages 15 to 38 are an integral part of these financial statements.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005**

	Note	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
<b>Cash flows from operating activities</b>					
Cash generated from operations	26	51 932	10 445	73 893	14 862
Interest received		1 191	1 163	1 694	1 655
Income tax paid	23	(5 257)	(1 508)	(7 480)	(2 146)
<b>Net cash generated from operating activities</b>		<b>47 866</b>	<b>10 100</b>	<b>68 107</b>	<b>14 371</b>
<b>Cash flows from investing activities</b>					
Purchases of property, plant and equipment		(23 658)	(23 191)	(33 662)	(32 997)
Proceeds from sale of property, plant and equipment		17	15	24	21
Purchases of intangible assets		(569)	(472)	(810)	(672)
Proceeds from sales of securities		6	-	9	-
<b>Net cash used in investing activities</b>		<b>(24 204)</b>	<b>(23 648)</b>	<b>(34 439)</b>	<b>(33 648)</b>
<b>Cash flows from financing activities</b>					
Repayment of long term borrowings		(24)	(35)	(34)	(50)
Interest paid		(2)	(2)	(3)	(3)
Dividends paid		(11 970)	(9 975)	(17 032)	(14 193)
<b>Net cash used in financing activities</b>		<b>(11 996)</b>	<b>(10 012)</b>	<b>(17 069)</b>	<b>(14 246)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>		<b>11 666</b>	<b>(23 560)</b>	<b>16 599</b>	<b>(33 523)</b>
Cash and cash equivalents at the beginning of the year		12 202	35 762	17 362	50 885
<b>Cash and cash equivalents at the at end of the year</b>	9	<b>23 868</b>	<b>12 202</b>	<b>33 961</b>	<b>17 362</b>

The notes on pages 15 to 38 are an integral part of these financial statements.

Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS**

**1 INCORPORATION AND ACTIVITIES**

JSC Latvijas Gāze was re-organised on January 31, 1994 as a joint stock company wholly owned by the Government of the Republic of Latvia. The Company was formerly a state enterprise which had its assets transferred to and obligations assumed by the joint stock company in accordance with the law. Since 15 February 1999 the shares of the Company are quoted on Riga Stock Exchange. The registered office of the Company is 6 A. Briāna Street, Riga, Latvia.

The Company is involved in import and sales of natural gas in territory of Latvia as well as supply of gas transmission and storage services to foreign companies. The Company is the sole supplier of natural gas in Latvia. The service territory of the Company has a population of approximately 2,3 million.

The tariffs of gas sold to corporate and retail customers are set by the Regulator of the Public Utilities Commission (PUC) of the Republic of Latvia. Changes to tariffs are considered by PUC based on applications of the Company and in accordance with the methodology approved by PUC.

During 2005 the average number of persons employed by the Company was 1 306 (2004: 1 267).

These financial statements have been approved by the Board of Directors on May 3, 2006.

**2 ACCOUNTING POLICIES**

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

**(a) Basis of preparation**

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted for use in the European Union (EU) and International Financial Reporting Standards (IFRS). All International Financial Reporting Standards issued by IASB and effective at the time of preparing these financial statements have been adopted for use in the EU through the endorsement procedure established by the European Commission, with the exception of the International Accounting Standard IAS 39 "Financial Instruments: Recognition and Measurement". Following the Accounting Regulatory Committee decision of October 2004, the Commission adopted the Regulation 2086/2004 requiring the use of IAS 39, minus certain provisions on the full fair value option and portfolio hedging of core deposits, by all listed companies from 1 January 2005.

Since the Company has not elected to follow the fair value option in IAS 39 and is not affected by the provisions regarding portfolio hedging that are not required by the EU-endorsed version of IAS 39, the accompanying financial statements comply with both International Financial Reporting Standards as adopted for use in the European Union and International Financial Reporting Standards.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of property, plant and equipment as disclosed in the Accounting policies Note (d) below.

In 2005, the Company adopted all new and revised IFRS which became effective for the Company from 1 January 2005 as follows:

IAS 1 (revised 2003)	Presentation of Financial Statements
IAS 2 (revised 2003)	Inventories
IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003)	Events after the Balance Sheet Date
IAS 16 (revised 2003)	Property, Plant and Equipment
IAS 17 (revised 2003)	Leases
IAS 21 (revised 2003)	The Effects of Changes in Foreign Exchange Rates
IAS 24 (revised 2003)	Related Party Disclosures
IAS 27 (revised 2003)	Consolidated and Separate Financial Statements
IAS 31 (revised 2003)	Interests in Joint Ventures

Translation from Latvian Original

**JOINT STOCK COMPANY “LATVIJAS GĀZE”  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(a) Basis of preparation (continued)**

IAS 32 (revised 2003)	Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003)	Earnings per Share
IAS 36 (revised 2004)	Impairment of Assets
IAS 38 (revised 2004)	Intangible assets
IAS 39 (revised 2003)	Financial Instruments: Recognition and Measurement
IAS 40 (revised 2003)	Investment property
IFRS 2 (issued 2004)	Share based payments
IFRS 3 (issued 2004)	Business Combinations
IFRS 5 (issued 2004)	Non-current Assets held for Sale and Discontinued Operations

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 24, 27, 31, 32, 33, 39 and 40 (all revised 2003), IAS 36, 38 (all revised 2004) and IFRS 2, 3, 5 (all issued 2004) resulted in no material changes to the Company's accounting policies or disclosures and presentation in the financial statements.

New accounting standards, amendments and IFRIC interpretations have been published that are mandatory for accounting periods beginning on or after 1 January 2006 or later periods. These accounting standards, amendments and IFRIC interpretations have not yet been endorsed by EU. As the Company has not adopted these accounting standards, amendments and IFRIC interpretations, there is no difference between International Financial Reporting Standards as adopted for use in the European Union and International Financial Reporting Standards. New accounting standards, amendments and IFRIC interpretations are as follows:

*IAS 19 (Amendment), Employee benefits (effective from 1 January 2006)*

This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. The amendments to the standard will not affect the Company's financial statements.

*IAS 21 (Amendment), The effect of Changes in Foreign Exchange Rates (effective from 1 January 2006)*

This amendment is not relevant to the Company's operations.

*IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006)*

This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognised at their fair value and subsequently measured at the higher of: (a) the unamortised balance of the related fees received and deferred, and (b) the expenditure required to settle the commitment at the balance sheet date. This amendment is not relevant to the Company.

*IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)*

IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company assessed the impact of IFRS 7 and the amendments to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1. The Company will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.



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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(a) Basis of preparation (continued)**

*IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)*

The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the financial statements, provided that: (a) the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction; and (b) the foreign currency risk will affect income statement. This amendment is not relevant to the Company as the Company does not have intragroup transactions that would qualify as hedged item in the financial statements for 2005 or 2004.

*IAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006)*

This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Company believes that this amendment should not have a significant impact on the classification of financial instruments. The amendment will not affect the Company's financial statements.

*IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards (effective from 1 January 2006)*

These amendments are not relevant to the Company, as the Company is not a first-time adopter of IFRS.

*IFRS 6, Exploration and Evaluation of Mineral Resources (effective from 1 January 2006)*

The standard will not affect the Company's financial statements.

*IFRIC 4, Determining whether an Arrangement Contains a Lease (effective from 1 January 2006)*

IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether; (a) fulfillment of the arrangement is dependant on the use of a specific asset or assets, and (b) the arrangement conveys a right to use the asset.

The interpretation will not affect the Company's financial statements.

*IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)*

The Company does not have interests in decommissioning, restoration and environmental rehabilitation funds. This interpretation will not affect the Company's financial statements.

*IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005)*

This interpretation is not relevant to the Company's operations.

*IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007)*

This interpretation is not relevant to the Company's operations.

*IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007)*

The interpretation clarifies that the accounting standard IFRS 2 Share-based Payment applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. This interpretation is not relevant to the Company's operations.

*IFRIC 9, Reassessment of Embedded Derivatives (effective for periods beginning on or after 1 June 2006)*

This interpretation is not relevant to the Company's operations.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(a) Basis of preparation (continued)**

The Company holds its free cash resources on the deposits with the banks. In previous year's financial statements all high liquidity deposits were disclosed as cash and cash equivalents. In these financial statements deposits with original term over 90 days are reclassified to Other current assets. As the result of the change of presentation of deposits the total effect on the comparative information is decrease of cash and cash equivalents and increase of other current assets by LVL 8 000 thousand (EUR 11 383 thousand). Also following reclassifications are made for 2004: interest income on deposits with original term over 90 days was reclassified from finance income to other income of LVL 508 thousand (EUR 723 thousand), net foreign exchange gain on the result of conversion of currency for gas payments of LVL 447 thousand (EUR 635 thousand) was reclassified from finance income to other income. All these reclassifications had no impact on equity and net profit.

**(b) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

**(c) Foreign currency translation**

*Functional and presentation currency*

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Latvian Lats (LVL), which is the Company's functional and presentation currency. According to the requirements of Riga Stock Exchange as of 2005 all amounts are also presented in Euro (EUR). For presentation purposes a conversion is performed by using the official fixed EUR / LVL rate (1 EUR = 0,702804 LVL) set by the Bank of Latvia from 1 January 2005. The management of the Company believes that this exchange rate is the most suitable for conversion and the effect of the application to the comparative information of actual exchange rates (as at 31 December 2004 of 1 EUR = 0,7030 LVL for the balance sheet and average rates of 2004 of 1 EUR = 0,6682 LVL for the income statement) is not material for presentation in the financial statements.

*Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

**(d) Property, plant and equipment**

Buildings, gas transmission system and equipment are stated at fair value, based on periodic valuation less subsequent depreciation or impairment charge. All other property, plant and equipment are stated at historical cost, less accumulated depreciation and impairment charge. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Assets purchased, but not yet ready for intended use or under installation process are included in Assets under construction.

Subsequent costs are included in the asset's carrying amount or recognized as separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(d) Property, plant and equipment (continued)**

Any accumulated depreciation at the date of revaluation is restated proportionately with the charge in gross carrying amount of the asset. Increases in the carrying amount arising on revaluation of building, gas transmission system and equipment are credited to revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged against revaluation reserve directly in equity; any further decreases are charged to the income statement. The revaluation surplus is transferred to retained earnings on the retirement or disposal of the asset.

Land, buffer gas, advances for property, plant and equipment and assets under construction are not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives starting from the date when the asset is available for use, using the following rates:

	<b>years</b>
Buildings:	60 - 100
Gas transmission system:	40 - 50
Machinery and equipment:	5 - 20
Furniture and fittings:	5 - 10
Computers and equipment:	3,33

The Company's policy is to capitalize tangible assets with cost exceeding LVL 50 and useful life exceeding 1 year.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. 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 f).

Gains or losses on disposals are determined by comparing carrying amount with proceeds and are charged to the income statement during the period in which they are incurred. When revalued assets are sold, the amounts included in revaluation reserve are transferred to retained earnings.

**(e) Intangible assets**

Intangible assets primarily consist of licences and patents. Intangible assets have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated from the date when the asset is available for use. Amortisation is calculated using the straight-line method to allocate the cost of intangible assets over their useful lives. Generally intangible assets are amortised over a period of 5 years.

**(f) Impairment of non-financial assets**

All Company's non-financial assets have a finite useful life (except land). Assets that are subject to amortization 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 an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets are reviewed for possible reversal of the impairment at each reporting date.

**(g) Financial assets**

The Company classifies its financial assets in the following categories: loans and receivables and financial assets at fair value through profit and loss. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for assets with maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as 'trade receivables' in the balance sheet (Note 6 and (i)).

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(g) Financial assets (continued)**

*Financial assets at fair value through profit and loss*

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

Gains or losses arising, from changes in the fair value of the 'financial assets at fair value through profit or loss' category, including interest and dividend income, are presented in the income statement.

All purchases and sales of financial assets are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset.

The Company assesses at least at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

**(h) Inventories**

The cost of natural gas is determined using the first-in first-out (FIFO) method. The natural gas that is permanently at storages (i.e. technological buffer gas) is a part of property, plant and equipment and measured accordingly. Materials, spare parts, gas meters and other inventories cost is determined using the weighted average method. The cost of natural gas comprises cost of gas purchased. Direct labour, other direct costs and related production overheads are recognised on an accruals basis and charged to the income statement in the period when incurred.

Inventories are recorded at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. When the net realisable value of inventories is lower than its purchase price, provisions are created to reduce the value of inventories to their realisable value.

**(i) Trade receivables**

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of trade receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivables are impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

**(j) Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand, deposits held at call with banks with original term less than 90 days and other short-term highly liquid investments, which can be easily converted to cash and are not subject of significant change in value.

**(k) Share capital and dividend authorised**

Ordinary shares are classified as equity. Incremental external costs directly attributable to the issues of new shares, other than in connection with business combination, are shown in equity as a deduction, net of tax, from the proceeds.

Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

**(l) Borrowings**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(m) Deferred income tax**

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, if the deferred income tax 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, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the temporary differences will reverse.

The principal temporary differences arise from different property, plant and equipment depreciation rates, as well as provisions for slow-moving inventory, accrued expenses for unused annual leave and bonuses and provisions for bad and doubtful debts where the management is of the opinion that they will meet the criteria stated in Article 9 of the law "On Corporate Income Tax". Deferred income tax asset is recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Increase in deferred income tax liability that results from revaluation of property, plant and equipment is charged to equity as deduction from respective increase in the Revaluation reserve.

Decrease in deferred income tax liability that results from depreciation of revalued property, plant and equipment is charged to the income statement.

**(n) Accrued unused annual leave expenses**

Amount of accrual for unused annual leave is determined by multiplying the average daily wage of employees for the last six months of the reporting year by the amount of accrued but unused annual leave at the end of the reporting year.

**(o) Employee benefits**

*Bonus plans*

The Company recognizes a liability and expense for bonuses, based on formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Company recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

*Social security and pension contribution*

The Company pays social security contributions to the state Social Security Fund (the Fund) on behalf of its employees based on the defined contribution plan in accordance with the local legal requirements. The Company also makes contributions to an external defined contribution pension plan (the Plan). A defined contribution plan is a plan under which the Company pays fixed contributions into the Fund or the Plan and will have no legal or constructive obligations to pay further contributions if the Fund or the Plan do not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior period. The social security and pension contributions are recognised as an expense on an accrual basis and are included within staff costs.

**(p) Provisions**

Provisions are recognised when the Company has a present legal or constructive 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 a reliable estimate of the amount of the obligation can be made. Provisions are measured at the present value of the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

**(q) Revenue recognition**

*Sales of natural gas*

Sales are recognised upon delivery of gas, net of value added tax and discounts. Sales of natural gas are recorded on the basis of meter readings reported by customers. Where relevant, this includes an estimate of the sales value of gas supplied between the date of the last meter reading and the year-end. Natural gas sales to corporate customers are recognized based on invoice issued according to meter reading of customers.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(q) Revenue recognition (continued)**

The Company as well as the Regulator of the Public Utilities Commission have the right during the tariff period (which is 3 years long) to apply for the revision of the tariffs if any of the price factors (like foreign exchange rate, natural gas purchase price etc.) has changed more than by 5% compared to the approved.

*Income of transmission and storage on natural gas*

Income of performance of services is recognised upon performance of services, net of value added tax and discounts. Income on natural gas transmission and storage is recognized based on actual amount of transmitted and stored gas, which are determined by meter readings.

*Interest income and penalties income*

Interest income and penalties income is recognised as it accrues unless its collectability is in doubt.

*Income from contribution to financing of construction works*

The income from residents and enterprises contribution to financing of construction works of gas pipelines is accounted for as deferred income and recognized in the income statement over the expected period of the customer relationship of 30 to 40 years.

**(r) Earnings per share**

Earnings per share is determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting year.

**(s) Related parties**

Related parties are defined as shareholders, that have a significant influence, members of the Council and Board, their close relatives and companies in which they have a significant influence or control.

**(t) Critical estimates and judgements**

The preparation of the financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies.

IFRS requires that in preparing the financial statements, management of the Company make estimates and assumptions that affect the reported amounts of assets and liabilities and required disclosure at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The areas involving a higher degree of judgement are revaluation of property, plant and equipment, determination of frequency of revaluations, the management assumptions and estimates in determination of useful lives of property, plant and equipment, recoverable amount of accounts receivable and inventories as described in respective notes.

*Valuation of Property, Plant and Equipment*

The management determines fair value and the remaining useful life of property, plant and equipment based on valuations performed by independent certified valuers in accordance with real estate valuation standards and based on the average construction costs relevant for the reporting year. The management considers that the revaluation of property, plant and equipment is to be performed at least each five years.

*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, only the significant debtors are assessed individually. Receivables that are not individually assessed for impairment are classified into groups of receivables with 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.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 ACCOUNTING POLICIES (continued)**

**(t) Critical estimates and judgements (continued)**

*Inventory Valuation*

Upon valuation of inventories, the management will rely on its best knowledge taking into consideration historical experience, general background information and potential assumptions and conditions of future events. In determining the impairment of inventories, the sales potential as well as the net realisable value of inventory.



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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**3 PROPERTY PLANT AND EQUIPMENT**

	Land, buildings and gas transmission system LVL'000	Equipment and machinery LVL'000	Other assets LVL'000	Advances LVL'000	Assets under construction LVL'000	Total LVL'000
<b><u>Cost or revaluation</u></b>						
<b>At December 31, 2003</b>	<b>62 683</b>	<b>23 715</b>	<b>3 155</b>	<b>102</b>	<b>7 813</b>	<b>97 468</b>
Additions	-	-	-	2 656	20 532	23 188
Reclassified	6 439	4 009	990	(2 353)	(9 085)	-
Revaluation	241 326	12 899	-	-	-	254 225
Disposals	(212)	(260)	(241)	-	(75)	(788)
<b>At December 31, 2004</b>	<b>310 236</b>	<b>40 363</b>	<b>3 904</b>	<b>405</b>	<b>19 185</b>	<b>374 093</b>
<b><u>Depreciation</u></b>						
<b>At December 31, 2003</b>	<b>20 895</b>	<b>15 700</b>	<b>2 386</b>	-	-	<b>38 981</b>
Charged for 2004	6 670	2 968	384	-	-	10 022
Reclassified	(121)	221	(100)	-	-	-
Revaluation	123 457	1 463	-	-	-	124 920
Disposals	(141)	(170)	(237)	-	-	(548)
<b>At December 31, 2004</b>	<b>150 760</b>	<b>20 182</b>	<b>2 433</b>	-	-	<b>173 375</b>
<b>Net book value at December 31, 2004</b>	<b>159 476</b>	<b>20 181</b>	<b>1 471</b>	<b>405</b>	<b>19 185</b>	<b>200 718</b>
<b>Net book value at December 31, 2003</b>	<b>41 788</b>	<b>8 015</b>	<b>769</b>	<b>102</b>	<b>7 813</b>	<b>58 487</b>
	Land, buildings and gas transmission system LVL'000	Equipment and machinery LVL'000	Other assets LVL'000	Advances LVL'000	Assets under construc- tion LVL'000	Total LVL'000
<b><u>Cost or revaluation</u></b>						
<b>At December 31, 2004</b>	<b>310 236</b>	<b>40 363</b>	<b>3 904</b>	<b>405</b>	<b>19 185</b>	<b>374 093</b>
Additions	-	-	257	2 578	20 636	23 471
Reclassified	13 665	4 479	483	(2 743)	(15 884)	-
Revaluation	2 394	195	-	-	-	2 589
Disposals	(245)	(332)	(207)	-	(21)	(805)
<b>At December 31, 2005</b>	<b>326 050</b>	<b>44 705</b>	<b>4 437</b>	<b>240</b>	<b>23 916</b>	<b>399 348</b>
<b><u>Depreciation</u></b>						
<b>At December 31, 2004</b>	<b>150 760</b>	<b>20 182</b>	<b>2 433</b>	-	-	<b>173 375</b>
Charged for 2005	7 405	3 466	524	-	-	11 395
Reclassified	-	(1)	1	-	-	-
Revaluation	895	14	-	-	-	909
Disposals	(141)	(306)	(207)	-	-	(654)
<b>At December 31, 2005</b>	<b>158 919</b>	<b>23 355</b>	<b>2 751</b>	-	-	<b>185 025</b>
<b>Net book value at December 31, 2005</b>	<b>167 131</b>	<b>21 350</b>	<b>1 686</b>	<b>240</b>	<b>23 916</b>	<b>214 323</b>
<b>Net book value at December 31, 2004</b>	<b>159 476</b>	<b>20 181</b>	<b>1 471</b>	<b>405</b>	<b>19 185</b>	<b>200 718</b>

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**JOINT STOCK COMPANY "LATVIJAS GAZE"**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**3 PROPERTY PLANT AND EQUIPMENT (continued)**

	Land, buildings and gas transmission system EUR'000	Equipment and machinery EUR'000	Other assets EUR'000	Advances EUR'000	Assets under construction EUR'000	Total EUR'000
<b><u>Cost or revaluation</u></b>						
<b>At December 31, 2003</b>	<b>89 190</b>	<b>33 743</b>	<b>4 489</b>	<b>145</b>	<b>11 118</b>	<b>138 685</b>
Additions	-	-	-	3 779	29 214	32 993
Reclassified	9 162	5 704	1 409	(3 348)	(12 927)	-
Revaluation	343 376	18 354	-	-	-	361 730
Disposals	(302)	(370)	(343)	-	(107)	(1 122)
<b>At December 31, 2004</b>	<b>441 426</b>	<b>57 431</b>	<b>5 555</b>	<b>576</b>	<b>27 298</b>	<b>532 286</b>
<b><u>Depreciation</u></b>						
<b>At December 31, 2003</b>	<b>29 731</b>	<b>22 339</b>	<b>3 395</b>	-	-	<b>55 465</b>
Charged for 2004	9 491	4 223	546	-	-	14 260
Reclassified	(172)	314	(142)	-	-	-
Revaluation	175 663	2 082	-	-	-	177 745
Disposals	(201)	(242)	(337)	-	-	(780)
<b>At December 31, 2004</b>	<b>214 512</b>	<b>28 716</b>	<b>3 462</b>	-	-	<b>246 690</b>
<b>Net book value at December 31, 2004</b>	<b>226 914</b>	<b>28 715</b>	<b>2 093</b>	<b>576</b>	<b>27 298</b>	<b>285 596</b>
<b>Net book value at December 31, 2003</b>	<b>59 459</b>	<b>11 404</b>	<b>1 094</b>	<b>145</b>	<b>11 118</b>	<b>83 220</b>
	Land, buildings and gas transmission system EUR'000	Equipment and machinery EUR'000	Other assets EUR'000	Advances EUR'000	Assets under construction EUR'000	Total EUR'000
<b><u>Cost or revaluation</u></b>						
<b>At December 31, 2004</b>	<b>441 426</b>	<b>57 431</b>	<b>5 555</b>	<b>576</b>	<b>27 298</b>	<b>532 286</b>
Additions	-	-	366	3 668	29 362	33 396
Reclassified	19 444	6 373	687	(3 903)	(22 601)	-
Revaluation	3 406	277	-	-	-	3 683
Disposals	(349)	(472)	(295)	-	(30)	(1 146)
<b>At December 31, 2005</b>	<b>463 927</b>	<b>63 609</b>	<b>6 313</b>	<b>341</b>	<b>34 029</b>	<b>568 219</b>
<b><u>Depreciation</u></b>						
<b>At December 31, 2004</b>	<b>214 512</b>	<b>28 716</b>	<b>3 462</b>	-	-	<b>246 690</b>
Charged for 2005	10 535	4 930	746	-	-	16 211
Reclassified	-	(1)	1	-	-	-
Revaluation	1 276	20	-	-	-	1 296
Disposals	(201)	(436)	(295)	-	-	(932)
<b>At December 31, 2005</b>	<b>226 122</b>	<b>33 229</b>	<b>3 914</b>	-	-	<b>263 265</b>
<b>Net book value at December 31, 2005</b>	<b>237 805</b>	<b>30 380</b>	<b>2 399</b>	<b>341</b>	<b>34 029</b>	<b>304 954</b>
<b>Net book value at December 31, 2004</b>	<b>226 914</b>	<b>28 715</b>	<b>2 093</b>	<b>576</b>	<b>27 298</b>	<b>285 596</b>

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**3 PROPERTY PLANT AND EQUIPMENT (continued)**

During 2003 and 2004 buildings, gas transmission system and equipment were revalued using amortised replacement cost method. The amortised replacement cost was determined by a certified assessor LLC BDO "Invest Riga". Where the amortised cost of the asset replacement amount was lower than their carrying amount the decrease in value was charged to 2003 and 2004 income statements. Increase in value resulting from the revaluation is recognised as increase in the Revaluation reserve, according to the decisions of the Board on February 13, 2004 and February 15, 2005. According to the Board's decision as of March 7, 2006 as at December 31, 2005 the management revalued the assets which were received for gratis during 2005 using the same basis as in revaluation performed during 2003 and 2004.

Property, plant and equipment include fully depreciated assets with a total book value of LVL 4 790 thousand or EUR 6 815 thousand (2004: LVL 2 629 thousand or EUR 3 740 thousand).

As at December 31, 2005 the carrying amount in case the property, plant and equipment would be carried under the cost model is LVL 98 660 thousand or EUR 140 381 thousand (December 31, 2004: LVL 78 741 thousand or EUR 112 038).

**4 INTANGIBLE ASSETS**

	LVL'000	EUR'000
<b><u>Cost</u></b>		
As at December 31, 2003	1 899	2 702
Additions	472	672
As at December 31, 2004	2 371	3 374
<b><u>Amortisation</u></b>		
As at December 31, 2003	746	1 061
Charge for the year	350	498
As at December 31, 2004	1 096	1 559
<b>Net Book Value as at December 31, 2004</b>	<b>1 275</b>	<b>1 815</b>
<b>Net Book Value as at December 31, 2003</b>	<b>1 153</b>	<b>1 641</b>
	LVL'000	EUR'000
<b><u>Cost</u></b>		
As at December 31, 2004	2 371	3 373
Additions	569	810
Disposals	(13)	(18)
As at December 31, 2005	2 927	4 165
<b><u>Amortisation</u></b>		
As at December 31, 2004	1 096	1 559
Charge for the year	425	605
On disposals	(8)	(11)
As at December 31, 2005	1 513	2 153
<b>Net Book Value as at December 31, 2005</b>	<b>1 414</b>	<b>2 012</b>
<b>Net Book Value as at December 31, 2004</b>	<b>1 275</b>	<b>1 814</b>

Intangible assets mainly consist of computer programs. The major intangible assets are finance software Oracle at carrying amount of LVL 458 thousand (EUR 652 thousand) and remaining useful life of 2 years and geographical informative system GIS at carrying amount of LVL 344 thousand (EUR 490 thousand) and remaining useful life of 4 years as at December 31, 2005.

Intangible assets include fully amortised intangible assets with a total cost value of LVL 670 thousand or EUR 953 thousand (2004: LVL 367 thousand or EUR 522 thousand).

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**5 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS**

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
At the beginning of the year	9	9	13	13
Sold	(6)	-	(8)	-
Revalued	1	-	1	-
<b>At the end of the year</b>	<b>4</b>	<b>9</b>	<b>6</b>	<b>13</b>

Financial assets at fair value through profit and loss comprise unlisted equity securities.

**6 TRADE RECEIVABLES**

	<b>31.12.2005.</b>	<b>31.12.2004.</b>	<b>31.12.2005.</b>	<b>31.12.2004.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
<i>Non-current trade receivables</i>				
Gross value	216	752	307	1 070
Provisions for impairment of receivables	-	(550)	-	(783)
	<b>216</b>	<b>202</b>	<b>307</b>	<b>287</b>
<i>Current trade receivables</i>				
Gross value	15 106	11 376	21 494	16 187
Provisions for impairment of receivables	(2 086)	(1 545)	(2 968)	(2 198)
	<b>13 020</b>	<b>9 831</b>	<b>18 526</b>	<b>13 989</b>
<b>Total trade receivables</b>	<b>13 236</b>	<b>10 033</b>	<b>18 833</b>	<b>14 276</b>

Provisions for impairment of bad and doubtful debts:

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Provisions at the beginning of the year	<b>3 111</b>	<b>2 974</b>	<b>4 427</b>	<b>4 232</b>
Charged to income statement	613	252	872	359
Released to income statement	(257)	(63)	(366)	(90)
<b>Net charge to income statement</b>	<b>356</b>	<b>189</b>	<b>506</b>	<b>269</b>
Written off	(432)	(52)	(615)	(74)
<b>Provisions at the year end</b>	<b>3 035</b>	<b>3 111</b>	<b>4 318</b>	<b>4 427</b>

Of the provisions as at 31 December 2005 LVL 2 086 thousand (EUR 2 968 thousand) relate to current trade receivables and LVL 949 thousand (EUR 1 350 thousand) relate to current other debtors, but for year 2004 LVL 550 thousand (EUR 783 thousand) are attributable to non-current trade receivables, LVL 1 545 thousand (EUR 2 198 thousand) to current trade receivables and LVL 1 016 thousand (EUR 1 446 thousand) to current other debtors.

Provisions were created based on evaluation of the financial position and operations of separate groups of customers. The eventual losses may differ from the current calculations, as the specific amounts required are regularly reviewed and changes are reflected in the income statement.

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**7 INVENTORIES**

	<b>31.12.2005.</b>	<b>31.12.2004.</b>	<b>31.12.2005.</b>	<b>31.12.2004.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Materials and spare parts (at net realisable value)	1 612	1 288	2 294	1 833
Gas and fuel (at cost)	41 898	26 032	59 615	37 040
Other (at cost)	92	74	131	105
	<b>43 602</b>	<b>27 394</b>	<b>62 040</b>	<b>38 978</b>

Provisions for impairment of obsolete and slow moving inventories:

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Provisions at the beginning of the year	365	377	519	536
Charged to income statement	96	78	136	111
Released to income statement	(25)	(41)	(35)	(58)
Written off	(6)	(49)	(8)	(70)
<b>Provisions at the year end</b>	<b>430</b>	<b>365</b>	<b>612</b>	<b>519</b>

Provisions of 100% have been created for slow moving materials and spare parts. During 2005 the Company sold inventories of LVL 7 thousand or EUR 10 thousand (2004: LVL 17 thousand or EUR 24 thousand) and used in operations inventories of LVL 16 thousand or EUR 23 thousand (2004: LVL 22 thousand or EUR 31 thousand) that had been written off in previous years.

**8 OTHER CURRENT ASSETS**

	<b>31.12.2005.</b>	<b>31.12.2004.</b>	<b>31.12.2005.</b>	<b>31.12.2004.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Term deposits*	-	8 000	-	11 383
Prepayments and deferred expense	520	399	740	568
Value added tax overpaid	216	619	307	881
Natural resource tax overpaid	173	-	246	-
Interest accrued on bank deposits	12	79	17	113
Claims according to court decisions	86	133	123	189
Receivable for services supplied	34	95	48	135
Other debtors	1 248	1 059	1 776	1 506
	<b>2 289</b>	<b>10 384</b>	<b>3 257</b>	<b>14 775</b>
Provisions for impairment of bad and doubtful debts**	(949)	(1 016)	(1 350)	(1 446)
	<b>1 340</b>	<b>9 368</b>	<b>1 907</b>	<b>13 329</b>

\* In 2004 financial statements the deposits with original term from 90 days to 1 year were presented as Cash and Cash equivalents (see Note 9).

\*\* Provisions for impairment of bad and doubtful debts relate principally to Other debtors.

**9 CASH AND CASH EQUIVALENTS**

	<b>2</b>	<b>2</b>	<b>3</b>	<b>3</b>
Cash on hand	2	2	3	3
Current accounts with banks	8 666	2 794	12 330	3 976
Term deposits*	15 200	9 406	21 628	13 383
	<b>23 868</b>	<b>12 202</b>	<b>33 961</b>	<b>17 362</b>

\* In 2004 financial statements deposits with original term from 90 days to 1 year were presented as Cash and Cash equivalents (see Note 8).

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
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**NOTES TO THE FINANCIAL STATEMENTS** (continued)

**9 CASH AND CASH EQUIVALENTS** (continued)

Term deposits fixed interest rate is from 2,10% to 4,75% per annum (2004: from 1,10% to 4,75% per annum).

**10 SHARE CAPITAL**

(a) Authorised, subscribed and paid-up share capital as at December 31, 2005 consists of 39 900 000 ordinary shares of LVL 1 each. All shares have equal voting rights and rights to dividend.

	<b>31.12.2005.</b>		<b>31.12.2004.</b>	
	<b>% from total share capital</b>	<b>Number of shares</b>	<b>% from total share capital</b>	<b>Number of shares</b>
Registered (closed issues) shares	36,52	14 571 480	36,52	14 571 480
Bearer (public issues) shares	63,48	25 328 520	63,47	25 326 020
Bearer (the Board's) shares	-	-	0,01	2 500
	<b>100,00</b>	<b>39 900 000</b>	<b>100,00</b>	<b>39 900 000</b>

(b) Shareholders

	<b>31.12.2005.</b>		<b>31.12.2004.</b>	
	<b>% from total share capital</b>	<b>Number of shares</b>	<b>% from total share capital</b>	<b>Number of shares</b>
E.ON Ruhrgas International AG (including registered shares of closed issues 7 285 740)	47,23	18 846 385	47,23	18 846 385
Itera Latvija LLC	16,00	6 384 001	25,00	9 975 701
JSC Gazprom (including registered shares of closed issues 7 285 740)	34,00	13 566 701	25,00	9 975 001
Shares owned by the State	0,00	117	0,00	117
Bearer (public issues) shares	2,77	1 102 796	2,76	1 100 296
Bearer shares of the Board	-	-	0,01	2 500
	<b>100,00</b>	<b>39 900 000</b>	<b>100,00</b>	<b>39 900 000</b>

State owned shares are held by the Latvian Privatisation Agency.

Extraordinary shareholders meeting held on 15 December 2004 approved the new edition of the Company's Charter. Closed issue shares were converted into registered shares, while public issue shares were transformed into bearer's shares. Board member reserve shares were converted into bearer's shares. All shares have the same voting rights and rights to receive dividend.

On January 28, 2005 JSC Gazprom purchased 3 591 700 Company shares from Itera Latvija LLC.

<b>11 BORROWINGS</b>	<b>31.12.2005. LVL'000</b>	<b>31.12.2004. LVL'000</b>	<b>31.12.2005. EUR'000</b>	<b>31.12.2004. EUR'000</b>
Ministry of Finance, 2007	<b>53</b>	<b>77</b>	<b>76</b>	<b>109</b>

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**11 BORROWINGS (continued)**

On November 7, 1995 an agreement was concluded between the Company and the Ministry of Finance of the Republic of Latvia. The agreement provided for assignment of a Danish Government interest free loan of DKK 3 493 thousand that should be used to finance the project stipulated in an agreement of May 4, 1995 between Lyngso Energi & Miljo and JSC "Latvijas Gāze" branch "Rīgas gāze". In 1999 the total amount of the agreement was specified and fixed as USD 508 thousand. The repayment of the loan should be made in 17 semi-annual equal payments commencing June 1999.

Maturity of the borrowings:

	31.12.2005. LVL'000	31.12.2004. LVL'000	31.12.2005. EUR'000	31.12.2004. EUR'000
Current portion of borrowings	35	31	50	44
Non-current portion of borrowings	18	46	26	65
	<b>53</b>	<b>77</b>	<b>76</b>	<b>109</b>

Maturity of non-current borrowings:

between 1 and 2 years	18	31	26	44
between 2 and 5 years	-	15	-	21
	<b>18</b>	<b>46</b>	<b>26</b>	<b>65</b>

**12 DEFERRED INCOME**

Income from residents and enterprises contribution to financing of construction works of gas pipelines:

Non-current portion	6 675	4 500	9 498	6 403
Current portion	244	163	347	232
	<b>6 919</b>	<b>4 663</b>	<b>9 845</b>	<b>6 635</b>

Movement of deferred income:

	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
At the beginning of the year	4 663	2 843	6 635	4 045
Received from residents and enterprises during the reporting year	2 505	1 974	3 564	2 809
Recognized as income in the reporting year (see Note 18)	(249)	(154)	(354)	(219)
<b>Deferred to the following periods</b>	<b>6 919</b>	<b>4 663</b>	<b>9 845</b>	<b>6 635</b>

See also Accounting policies Note (r).

**13 PROVISIONS FOR OTHER LIABILITIES AND CHARGES**

Provisions at the beginning of the year	1 386	670	1 972	953
Increase / (decrease) of provisions	(1 386)	716	(1 972)	1 019
Provisions at the end of the year	-	<b>1 386</b>	-	<b>1 972</b>

Provisions had been made to cover potential legal expenses and are written off in 2005 as the Court decision was beneficial to the Company.



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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**14 OTHER CURRENT LIABILITIES**

	<b>31.12.2005.</b>	<b>31.12.2004.</b>	<b>31.12.2005.</b>	<b>31.12.2004.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Prepayments received	3 016	1 791	4 291	2 548
Social insurance contributions	338	446	481	634
Personal income tax	289	331	411	471
Value added tax	2 230	775	3 173	1 103
Real estate tax	20	925	29	1 316
Salaries	314	224	447	319
Accrued expenses for unused annual leave	442	523	629	744
Accrued expenses for bonuses	1 965	1 565	2 796	2 227
Other current liabilities	1 460	16	2 077	23
	<b>10 074</b>	<b>6 596</b>	<b>14 334</b>	<b>9 385</b>

**15 SEGMENT INFORMATION**

As the Company is operating in the single business segment – natural gas, no separate information on segments is presented.

There are no geographical segments of the Company as all principal operations are carried out in Latvia.

**16 COST OF SALES**

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Purchase of natural gas	83 367	70 264	118 621	99 977
Salaries	7 166	6 563	10 196	9 338
Social insurance contributions	1 675	1 528	2 383	2 174
Life, health and pension insurance	515	503	733	716
Materials and spare parts	3 061	2 505	4 355	3 564
Depreciation and amortisation	11 237	9 885	15 989	14 065
Other	3 297	2 715	4 691	3 863
	<b>110 318</b>	<b>93 963</b>	<b>156 968</b>	<b>133 697</b>

**17 ADMINISTRATIVE EXPENSES**

Salaries	2 737	2 082	3 894	2 962
Social insurance contributions	332	334	472	475
Life, health and pension insurance	115	116	164	165
Maintenance and utilities	593	590	844	840
Real estate tax	1 286	1 163	1 830	1 655
Depreciation and amortisation	564	457	803	650
Bank charges	173	164	246	233
Provisions for impairment of bad and doubtful debts, net	356	189	506	269
Other expenses	1 219	1 882	1 735	2 678
	<b>7 375</b>	<b>6 977</b>	<b>10 494</b>	<b>9 927</b>

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**18 OTHER INCOME**

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Penalties from customers	380	442	541	629
Income from contribution to financing of construction works (see Note 12)	249	154	354	219
Profit on sale of fixed assets	15	-	21	-
Indemnity of loss*	6 906	-	9 827	-
Other income	3 516	295	5 003	420
Net foreign exchange gains**	278	447	395	635
Interest income**	487	508	693	723
	<b>11 831</b>	<b>1 846</b>	<b>16 834</b>	<b>2 626</b>

\* Indemnity of loss is received as a result of court case won in Stockholm. LVL 6 906 thousand (EUR 9 827 thousand) represent the principal of the received amount. Total sum received (including the interest and compensated legal expenses) is LVL 8,5 million (EUR 12,1 million).

\*\* In 2004 financial statements Net foreign exchange on the result of conversion of payments for gas and interest income on deposits with original term over 90 days was included in Financial income, net (see Notes 21 and 22).

**19 OTHER EXPENSES**

Materials	11	9	16	13
Salaries	109	114	155	162
Social insurance contributions	8	10	11	14
Depreciation and amortisation	18	23	26	33
Sponsorship	814	730	1 158	1 038
Loss on disposal of property, plant and equipment	-	17	-	24
Provisions for slow moving and obsolete inventories impairment	71	37	102	53
Other expense	256	229	363	326
	<b>1 287</b>	<b>1 169</b>	<b>1 831</b>	<b>1 663</b>

**20 EXPENSES BY NATURE**

Purchase of natural gas	83 367	70 264	118 621	99 977
Depreciation and amortisation	11 820	10 372	16 816	14 758
Employee benefit expense (see Note 28)	12 657	11 250	18 010	16 008
Material and spare parts	3 072	2 514	4 371	3 577
Net provisions for impaired receivables	356	189	506	269
Other expenses	7 709	7 520	10 971	10 699
	<b>118 981</b>	<b>102 109</b>	<b>169 295</b>	<b>145 288</b>

**21 FINANCE INCOME, NET**

**Finance income**

- Interest income*	637	668	906	950
- Net foreign exchange gains*	-	131	-	186
	<b>637</b>	<b>799</b>	<b>906</b>	<b>1 136</b>

**Finance expenses**

- Service charge for borrowings	(2)	(2)	(3)	(3)
	<b>(2)</b>	<b>(2)</b>	<b>(3)</b>	<b>(3)</b>

**Finance income, net**

	<b>635</b>	<b>797</b>	<b>903</b>	<b>1 133</b>
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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**21 FINANCE INCOME, NET (continued)**

\* In 2004 financial statements Interest income included interest on deposits with original term over 90 days, but Net foreign exchange gains included the result of conversion of payments for gas. In 2005 this income / gain is included Other income (see Notes 18 and 22).

**22 NET FOREIGN EXCHANGE GAINS AND INTEREST INCOME**

The exchange differences credited to the income statement are included as follows:

	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
Other income (see Note 18)	278	447	395	635
Finance income, net (see Note 21)	-	131	-	186
	<b>278</b>	<b>578</b>	<b>395</b>	<b>821</b>

Interest income credited to the income statement is included as follows:

Other income (see Note 18)	487	508	693	723
Finance income, net (see Note 21)	637	668	906	950
	<b>1 124</b>	<b>1 176</b>	<b>1 599</b>	<b>1 673</b>

**23 INCOME TAX EXPENSE**

Current tax	3 697	3 391	5 260	4 825
Unrealised deferred income tax gain related to revalued property, plant and equipment	(1 183)	(1 079)	(1 682)	(1 535)
Deferred income tax	811	580	1 153	825
	<b>3 325</b>	<b>2 892</b>	<b>4 731</b>	<b>4 115</b>

Corporate income tax differs from the theoretically calculated tax amount that would arise applying the 15% rate stipulated by the law to profit before taxation:

<b>Profit before income tax</b>	<b>26 872</b>	<b>21 653</b>	<b>38 235</b>	<b>30 809</b>
<b>Theoretically calculated tax at tax rate of 15%</b>	<b>4 031</b>	<b>3 248</b>	<b>5 735</b>	<b>4 621</b>
<i>Tax effect of:</i>				
Tax non-deductible expenses, net	1 170	1 380	1 664	1 964
Tax relief on donations	(693)	(657)	(986)	(935)
Unrealised deferred income tax gain related to revalued property, plant and equipment	(1 183)	(1 079)	(1 682)	(1 535)
<b>Tax charge</b>	<b>3 325</b>	<b>2 892</b>	<b>4 731</b>	<b>4 115</b>

Deferred income tax is calculated by using the enacted tax rate – 15%.

Reconciliation between actual corporate income tax charge and the amount of corporate income tax payable:

Liabilities as at 1 January	891	(992)	1 268	(1 411)
Charge for the year	3 697	3 391	5 260	4 825
Paid during the year	(5 257)	(1 508)	(7 480)	(2 146)
<b>(Overpaid) / liabilities as at 31 December</b>	<b>(669)</b>	<b>891</b>	<b>(952)</b>	<b>1 268</b>

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**23 INCOME TAX EXPENSE (continued)**

**Calculation of deferred income tax**

	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
<b>Deferred income tax liabilities at the beginning of the reporting year</b>	<b>20 034</b>	<b>1 157</b>	<b>28 505</b>	<b>1 646</b>
Increase of deferred income tax liabilities (charged to income statement)	811	580	1 153	825
Increase in deferred income tax liabilities that results from revaluation of property, plant and equipment (charged to equity)	252	19 396	359	27 598
Decrease in deferred income tax liabilities that results from depreciation of revalued property, plant and equipment (charged to income statement)	(1 183)	(1 079)	(1 682)	(1 535)
Deferred income tax that results from disposal of revalued property, plant and equipment (charged to equity)	(17)	(20)	(24)	(29)
<b>Deferred income tax liabilities at the end of the reporting year</b>	<b>19 897</b>	<b>20 034</b>	<b>28 311</b>	<b>28 505</b>

**Deferred income tax assets and liabilities are attributable to the following items:**

	31.12.2005. LVL'000	31.12.2004. LVL'000	31.12.2005. EUR'000	31.12.2004. EUR'000
Temporary difference on depreciation of property, plant and equipment (to be recovered within 12 months)	960	1 381	1 365	1 965
Temporary difference on depreciation of property, plant and equipment (to be recovered after more than 12 months)	19 861	19 655	28 260	27 965
Temporary difference on provisions for impairment of bad and doubtful debts (to be recovered within 12 months)*	(492)	(634)	(700)	(902)
Temporary difference on accrued expenses for unused annual leave and bonuses (to be recovered within 12 months)	(367)	(313)	(522)	(445)
Temporary difference on provisions for impairment of inventories (to be recovered within 12 months)	(65)	(55)	(92)	(78)
<b>Deferred income tax liability, net</b>	<b>19 897</b>	<b>20 034</b>	<b>28 311</b>	<b>28 505</b>

\* These are provisions for impairment of debts that are expected to become allowable for corporate income tax purposes in the foreseeable future as relevant debtor companies are in liquidation.

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**24 EARNINGS PER SHARE**

The Company has no dilutive potential ordinary shares and therefore diluted earnings per share are the same as the basic earnings per share.

Basic earnings per share are calculated by dividing the net profit attributable to the shareholders by the weighted average number of ordinary shares in issue during the year.

	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
Net profit attributable to shareholders (a)	23 546 833	18 760 677	33 504 124	26 694 038
<b>Ordinary shares as at 1 January</b>	<b>number</b> 39 900 000	<b>number</b> 39 900 000	<b>number</b> 39 900 000	<b>number</b> 39 900 000
<b>Ordinary shares as at 31 December</b>	39 900 000	39 900 000	39 900 000	39 900 000
<b>Weighted average number of ordinary shares outstanding during the year (b)</b>	39 900 000	39 900 000	39 900 000	39 900 000
<b>Basic earnings per share during the year (a/b) in LVL or EUR</b>	<b>0.590</b>	<b>0.470</b>	<b>0.840</b>	<b>0.669</b>

**25 DIVIDENDS PER SHARE**

Dividends payable are not accounted for until they are declared at the Annual General Meeting. At the meeting, a dividend in respect of 2005 of LVL 0,35 (EUR 0,5) per share (2004 actual dividend LVL 0,30 (EUR 0,43) per share) amounting to LVL 13 965 thousand (EUR 19 870 thousand) (2004 actual LVL 11 970 thousand (EUR 17 032 thousand) is to be proposed. These financial statements do not reflect these dividends payable, which will be accounted for in the shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2005.

**26 CASH GENERATED FROM OPERATIONS**

Reconciliation of profit before tax to cash generated from operations:

	2005 LVL'000	2004 LVL'000	2005 EUR'000	2004 EUR'000
Profit before income tax	26 872	21 653	38 235	30 809
<i>Adjustments for:</i>				
Depreciation (Note 3)	11 395	10 022	16 211	14 260
Amortisation (Note 4)	425	350	605	498
Provision for impairment of slow moving inventories (Note 7)	71	37	101	53
Revaluation of financial assets at fair value though profit and loss (Note 5)	(1)	-	(1)	-
Accrued expenses for bonuses	(400)	(351)	(569)	(499)
Accrued expenses for unused annual leave	(81)	(202)	(115)	(287)
Provision (release) / charge (Note 13)	(1 386)	716	(1 972)	1 019
Interest income (Note 22)	(1 124)	(1 176)	(1 599)	(1 673)
Interest expense (Note 21)	2	2	3	3
(Profit) / loss on sale of property plant and equipment (Note 18, 19)	(15)	17	(21)	24
<i>Changes in working capital</i>				
- trade and other receivables	4 758	(8 835)	6 770	(12 572)
- inventories	(16 145)	(20 979)	(22 972)	(29 850)
- trade and other payables	27 561	9 191	39 217	13 077
	<b>51 932</b>	<b>10 445</b>	<b>73 893</b>	<b>14 862</b>

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**27 RELATED PARTY TRANSACTIONS**

No entity exercise a control over the Company. Entities disclosed below own or owned more than 20% of the shares that deemed to provide a significant influence over the Company.

**(a) Sale of services**

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
JSC “Gazprom”	<b>4 267</b>	<b>3 288</b>	<b>6 071</b>	<b>4 678</b>

**(b) Purchase of natural gas**

JSC “Gazprom” and “Itera Latvija” LLC*	<b>75 766</b>	<b>92 314</b>	<b>107 805</b>	<b>131 351</b>
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\*“Itera Latvija” LLC was a related party until 28 January 2005. See Note 10.

**(c) Purchase of services**

E.ON Ruhrgas International AG	19	8	27	11
E.ON Ruhrgas AG	17	-	24	-
	<b>36</b>	<b>8</b>	<b>51</b>	<b>11</b>

**(d) Accounts payable for natural gas and services as at 31 December**

	<b>31.12.2005.</b>	<b>31.12.2004.</b>	<b>31.12.2005.</b>	<b>31.12.2004.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
JSC “Gazprom”	7 575	4 410	10 778	6 274
“Itera Latvija” LLC	-	4 631	-	6 589
E.ON Ruhrgas International AG	19	-	26	-
	<b>7 594</b>	<b>9 041</b>	<b>10 804</b>	<b>12 863</b>

Payables are payable in cash and are not secured by a pledge or otherwise. “Itera Latvija” LLC was a related party until 28 January 2005. See Note 10.

**(e) Remuneration to Board of Directors and Council**

A listing of the members of the Board of Directors and Council is shown on page 3.

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Salaries*	1 393	794	1 982	1 130
Social insurance contributions*	102	72	145	102
Health and life insurance	11	5	16	7
Contributions to pension funds	29	33	41	47
	<b>1 535</b>	<b>904</b>	<b>2 184</b>	<b>1 286</b>

\* Salaries and social insurance contributions include accrued bonuses for the reporting year.

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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**28 EMPLOYEE BENEFIT COSTS**

	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Wages and salaries	10 012	8 759	14 246	12 463
Social insurance contributions	2 015	1 872	2 867	2 664
Life, health and pension insurance	630	619	897	881
	<b>12 657</b>	<b>11 250</b>	<b>18 010</b>	<b>16 008</b>

**29 FINANCIAL RISK MANAGEMENT**

The Company's activities expose it to a variety of financial risks: market risk (including currency exchange risk, fair value risk) and credit risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

**(a) Credit risk**

Cash funds and receivables are the main financial assets exposed to the credit risk. The Company's cash funds and their equivalents are kept with the largest financial institutions of Latvia. Receivables are shown at their recoverable amount. The Company is exposed to the concentration of the credit risk because considerable part of the net turnover refers to a limited number of customers. Four of the Company's customers form up to 43% of the sales (in 2004 – 45%), the debt of one of these debtors on December 31, 2005 was 19,9% (in 2004 – 18%) of the total trade receivables. None of the rest of the debtors at the end of the reporting year did exceed 7% (in 2004 – 9%).

**(b) Currency exchange risk**

The Company is exposed to currency exchange risk as its gas purchases are denominated in USD while payable in EUR (2004: in USD), whereas most of the sales are in lats. Trade payables currency exchange risk is hedged by holding a significant part of cash in respective currency deposits.

	<b>2005</b>		<b>2004</b>	
	<b>USD' 000</b>	<b>EUR' 000</b>	<b>USD' 000</b>	<b>EUR'000</b>
Financial assets	227	1 818	142	2 842
Financial liabilities	(172)	(43 865)	(17 700)	(41)
Balance sheet position in original currency	55	(42 047)	(17 558)	2 801
Balance sheet position in LVL	33	(29 551)	(9 060)	1 969

**(c) Fair value**

The carrying value of financial assets and liabilities which are not accounted for at fair value as at December 31, 2005 and December 31, 2004 approximates their fair value. Fair values are obtained from quoted market prices or discounted cash flow models, as appropriate.

**30 CAPITAL COMMITMENTS**

The Company has planned to spend the following amounts for capital expenditures for property, plant and equipment and intangible assets in the subsequent year:

	<b>31.12.2005.</b>	<b>31.12.2004.</b>	<b>31.12.2005.</b>	<b>31.12.2004.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Contracted for but not delivered	12 065	11 364	17 167	16 169
Authorised but not yet contracted for	20 455	13 516	29 105	19 232
	<b>32 520</b>	<b>24 880</b>	<b>46 272</b>	<b>35 401</b>



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**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**31 CONTINGENT LIABILITIES**

During 2005 the proceedings at Riga city Vidzeme Suburb Court was commenced and continues regarding "E.ON Ruhrgas International AG" claim against Joint Stock Company "Latvijas Gāze" to declare invalid the resolution of Meeting of Shareholders of the Company by which the amendments to the Charter, whereas the quorum of Meeting of Shareholders necessary for decision making is increased from 75% to 85% were passed. As a third party LLC "ITERA Latvija" was invited. Since the court rejected E.ON Ruhrgas International AG claim the court judgement has been appealed to Riga Regional court.

On November 23, 2005 Administrative Regional Court reviewed claim submitted by E.ON Ruhrgas International AG demanding cancellation of the December 20, 2004 decision passed by the Register of Enterprises of the Republic of Latvia regarding re-registration of the Joint Stock Company "Latvijas Gāze" into Commercial Register. The court stopped legal proceedings until civil suit submitted by E.ON Ruhrgas International AG is considered in substance at general jurisdiction court.

In July 2005 two applications were submitted to Administrative Regional Court regarding Public Utilities Commission resolutions, by which new natural gas supply tariffs for the years 2005, 2006 and 2007 were approved (further PUC resolutions). On July 19, 2005, Administrative Regional Court considered application on suspension of the PUC resolutions activity until the settlement of issue in substance and rejected this request wherewith new tariffs for the year 2005 were applied to natural gas consumers as of August 1, 2005, and for the year 2006 – as of January 1, 2006. The Administrative Regional Court, having reviewed 2 neighboring complaints about this Court decision, for 2 times left it as legally valid decisions. The case has not yet been appointed for review in substance.

On August 2, 2005, the Administrative Regional Court, having reviewed application on applying of provisional regulation, postponed review of the application until December 5, 2005 based on the assumption that before proceedings of the case in substance the tariffs effective in the year 1997 had to be applied. The Administrative Regional Court, having reviewed the public organization's "Tenants' Movement for their Rights" neighboring claims on procedural violations committed in the Court meeting, rejected them and, having reviewed the request on application of provisional regulation on December 5, 2005, the Administrative Regional Court rejected it. The public organization's "Tenants' Movement for their Rights" has submitted a neighboring claim also about this court decision. On January 26, 2006 the Administrative Regional Court has rejected the claim. The case has not yet been appointed for review in substance.

The management of the Company believes that it is less than probable that any of the above litigations will result in a material outflow of the Company's resources.

**32 TAX CONTINGENT LIABILITIES**

The tax authorities have carried out full-scope tax audit at the Company for the years 2002 and 2004. The effect of this audit was not significant to these financial statements.

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 Company's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

**33 SUBSEQUENT EVENTS**

There are no subsequent events since the last date of the reporting year, which would have a significant effect on the financial position of the Company as at December 31, 2005.

\* \* \*