2018

LATVENERGO GROUP CONSOLIDATED AND LATVENERGO AS ANNUAL REPORT

Financial statements are prepared in accordance with international financial reporting standards as adopted by the EU

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FINANCIAL CALENDAR

Interim Condensed Financial Statements:

For the 3 months of 2019 (unaudited) – 31.05.2019

For the 6 months of 2019 (unaudited) – 30.08.2019

For the 9 months of 2019 (unaudited) – 29.11.2019

LATVENERGO GROUP KEY FIGURES

Financial figures

EUR'000

	2018	2017	2016	2015	2014
Revenue	878,008	925,627	931,619	929,128	1,010,757
EBITDA[1)]	321,582	541,696	393,399	307,015	236,838
Operating profit[2)]	95,762	234,082	160,773	108,188	49,243
Profit before tax[3)]	88,513	224,114	148,945	92,535	31,510
Profit	75,955	322,021	130,593	85,039	29,790
Dividends[4)]	156,418	90,142	77,413	31,479	23,605
Total assets	3,798,819	4,415,725	3,901,231	3,517,372	3,486,576
Non–current assets	3,364,534	3,343,404	3,388,954	3,113,719	3,109,253
Total equity	2,320,065	2,846,891	2,418,713	2,096,702	2,020,801
Borrowings	814,343	826,757	791,566	797,483	827,222
Net debt[5)]	684,888	590,754	607,586	692,940	706,211
Net cash flows from operating activities	302,869	338,209	341,186	246,278	135,329
Investments	220,607	243,811	200,677	190,461	177,607

In order to ensure an objective and comparable presentation of the financial results, Latvenergo Group and Latvenergo AS uses various financial figures and ratios that are derived from the financial statements.

Based on the most commonly used financial figures and ratios in the industry, the Latvenergo Group Strategy for 2017-2022 (see also the Management Report – section Further development, and Sustainability Report), as well as the binding financial covenants set in the Group's loan agreements, Latvenergo Group has set and therefore uses the following financial figures and ratios:

- profitability measures – EBITDA[1]; EBITDA margin[6]; operating profit margin[7]; profit before tax margin[8]; profit margin[9]; return on assets (ROA)[14]; return on equity (ROE)[15]; return on capital employed (ROCE)[16];
- capital structure measures – net debt[5]; equity–to–asset ratio[10]; net debt / EBITDA[11]; net debt / equity[12]; current ratio[13];
- a dividend policy measure – dividend pay–out ratio[17].

The definitions and components of the financial figures and ratios are described below. The reported financial figures and ratios have not changed over previous period.

Financial ratios

	2018	2017	2016	2015	2014
EBITDA margin[6)]	36.6%	58.5%	42.2%	33.0%	23.4%
Operating profit margin[7)]	10.9%	25.3%	17.3%	11.6%	4.9%
Profit before tax margin[8)]	10.1%	24.2%	16.0%	10.0%	3.1%
Profit margin[9)]	8.7%	34.8%	14.0%	9.2%	2.9%
Equity–to–asset ratio[10)]	61%	64%	62%	60%	58%
Net debt / EBITDA[11)]	2.0	1.1	1.7	2.3	2.9
Net debt / equity[12)]	0.30	0.21	0.25	0.33	0.35
Current ratio[13)]	1.5	3.2	1.7	1.9	1.3
Return on assets (ROA)[14)]	1.8%	7.7%	3.5%	2.4%	0.8%
Return on equity (ROE)[15)]	2.9%	12.2%	5.8%	4.1%	1.5%
Return on capital employed (ROCE)[16)]	2.8%	6.8%	5.3%	3.8%	1.7%
Dividend pay–out ratio[17)]	104%	66%	82%	90%	92%

Operational figures

		2018	2017	2016	2015	2014
Total electricity supply, incl.:	GWh	9,984	10,371	10,140	9,868	9,427
Retail*	GWh	6,954	6,923	7,665	7,961	8,800
Wholesale**	GWh	3,030	3,448	2,474	1,907	627
Electricity generated	GWh	5,076	5,734	4,707	3,882	3,625
Thermal energy generated	GWh	2,274	2,612	2,675	2,408	2,560
Number of employees		3,508	3,908	4,131	4,177	4,563
Moody's credit rating		Baa2 (stable)	Baa2 (stable)	Baa2 (stable)	Baa2 (stable)	Baa3 (stable)

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

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

6) EBITDA margin = EBITDA / revenue
7) Operating profit margin = operating profit / revenue
8) Profit before tax margin = profit before tax / revenue
9) Profit margin = profit / revenue
10) Equity–to–asset ratio = total equity at the end of the year / total assets at the end of the year
11) Net debt / EBITDA = (net debt at the beginning of the year + net debt at the end of the year) * 0.5 / EBITDA (12-months rolling)
12) Net debt / equity = net debt at the end of the year / equity at the end of the year
13) Current ratio = current assets at the end of the year / current liabilities at the end of the year
14) Return on assets (ROA) = profit / average value of assets ((assets at the beginning of the year + assets at the end of the year) / 2)
15) Return on equity (ROE) = profit / average value of equity ((equity at the beginning of the year + equity at the end of the year) / 2)
16) Return on capital employed (ROCE) = operating profit / (average value of equity ((equity at the beginning of the year + equity at the end of the year) / 2) + average value of borrowings ((borrowings at the beginning of the year + borrowings at the end of the year) / 2))
17) Dividend pay–out ratio = dividends / profit of the Parent Company

LATVENERGO AS KEY FIGURES

Financial figures

EUR'000

	2018	2017	2016	2015	2014*
Revenue	435,199	498,580	513,563	521,146	564,550
EBITDA[1)]	160,927	387,100	241,606	180,982	105,052
Operating profit[2)]	33,803	177,416	141,071	90,475	18,158
Profit before tax[3)]	212,760	185,906	156,290	103,212	35,045
Profit	212,733	150,891	137,441	94,750	34,800
Dividends[4)]	156,418	90,142	77,413	31,479	23,605
Total assets	3,141,109	3,649,200	3,204,394	3,124,054	3,104,592
Non–current assets	2,661,307	2,546,014	2,626,560	2,638,048	2,634,150
Total equity	1,993,823	2,382,638	2,177,069	2,114,900	2,047,666
Borrowings	802,268	814,772	778,323	782,965	810,681
Net debt[5)]	674,714	581,917	597,126	681,146	721,715
Net cash flows from operating activities	394,395	449,352	201,427	174,797	94,604
Investments	41,350	89,278	79,913	78,694	52,465

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

Financial ratios

	2018	2017	2016	2015	2014
EBITDA margin[6)]	37.0%	77.6%	47.0%	34.7%	18.6%
Operating profit margin[7)]	7.8%	35.6%	27.5%	17.4%	3.2%
Profit before tax margin[8)]	48.9%	37.3%	30.4%	19.8%	6.2%
Profit margin[9)]	48.9%	30.3%	26.8%	18.2%	6.2%
Equity–to–asset ratio[10)]	63%	65%	68%	68%	66%
Net debt / equity[11)]	0.34	0.24	0.27	0.32	0.35
Current ratio[12)]	2.0	4.3	2.3	3.0	1.9
Return on assets (ROA)[13)]	6.3%	4.4%	4.3%	3.0%	1.1%
Return on equity (ROE)[14)]	9.7%	6.6%	6.4%	4.6%	1.7%
Return on capital employed (ROCE)[15)]	1.1%	5.8%	4.8%	3.1%	0.6%
Dividend pay–out ratio[16)]	104%	66%	82%	90%	92%

Operational figures

		2018	2017	2016	2015	2014
Retail electricity supply	GWh	4,406	4,619	5,290	5,422	5,748
Electricity generated	GWh	5,028	5,687	4,660	3,833	3,577
Thermal energy generation	GWh	2,007	2,354	2,422	2,179	2,312
Number of employees		1,355	1,431	1,472	1,464	1,439
Moody's credit rating		Baa2 (stable)	Baa2 (stable)	Baa2 (stable)	Baa2 (stable)	Baa3 (stable)

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

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

MANAGEMENT REPORT

Latvenergo Group (the Group) is one of the largest power supply providers in the Baltics operating in electricity and thermal energy generation and trade, natural gas trade, electricity distribution services and lease of transmission system assets.

Latvenergo Group – one of the largest power suppliers in the Baltics

The parent company of Latvenergo Group is Latvenergo AS which is a power supply utility operating in electricity and thermal energy generation and trade, as well as natural gas trade in Latvia.

OPERATING ENVIRONMENT

In 2018, electricity prices increased significantly in the Nordics and the Baltics compared to the previous year. The increase in electricity prices was affected by the warm, dry weather in Europe, which resulted in lower water levels at the Scandinavian hydropower reservoirs and lower output of hydroelectricity. The insufficient electricity output at hydropower plants (HPPs) and wind farms fostered the increase in electricity generation at fossil fuel power stations. The cost of electricity generated at fossil fuel power stations was affected negatively by higher raw material prices and CO_2 emission allowance prices. The electricity spot price in Latvia was 44% higher than year ago reaching almost 50 EUR/MWh.

Electricity prices increased by more than 40% in the Baltics

Due to the increase in oil, coal and CO_2 emission prices, there was an increase in the price of natural gas. In 2018, the average price of natural gas at the GASPOOL and TTF trading platforms was 30% higher than a year earlier.

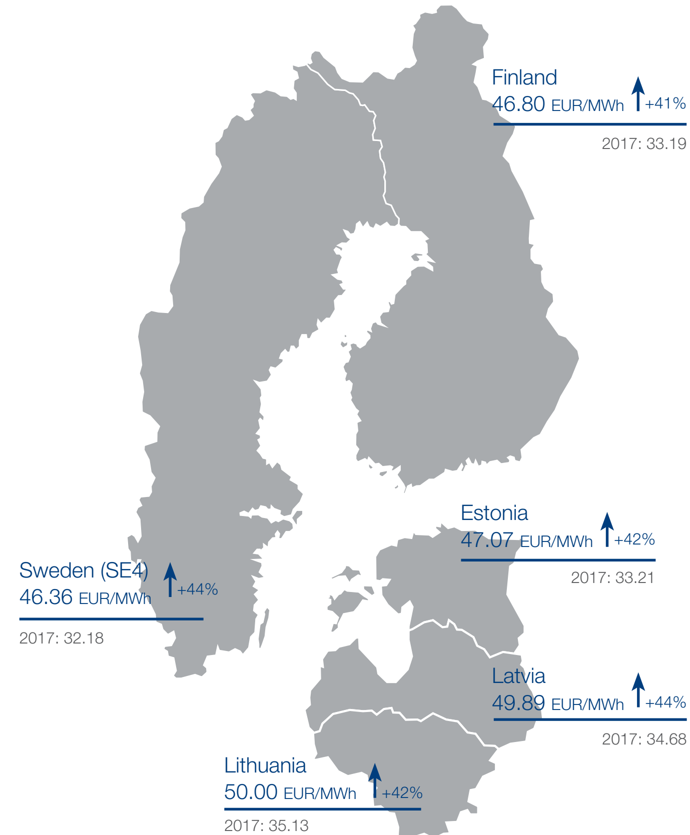
SIGNIFICANT EVENTS

CHANGES IN THE CAPACITY SUPPORT PAYMENT FOR LATVENERGO AS CHPPS

In October 2017, Latvenergo AS applied for a one-off compensation from the state, at the same time opting out of the receipt of 75% of the annual electrical capacity payments for cogeneration power plants CHPP–1 and CHPP–2. On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order which supports the reduction of the guaranteed support payments during the remaining support period for the installed capacity of Latvenergo AS CHPPs by paying out a one-off compensation in the amount of EUR 454.4 million, financed by the capital release of Latvenergo AS. The compensation was divided into two parts: EUR 140 million were to be recognised as other income in the profit or loss statement of Latvenergo AS in 2017, while EUR 314.4 million were to be recognised as income spread evenly over the following reporting periods until fulfilment of liabilities at the end of the support period on 23 September 2028.

On 26 September 2018, the Cabinet of Ministers decided to change conditions for a part of the grant in the amount of EUR 51.7 million stipulating it as unconditional, by reducing the remaining part of the compensation proportionally to this amount until the end of the support period. In 2018, EUR 81.0 million were recognised as other income of Latvenergo AS (in 2017: EUR 140 million).

Electricity wholesale price on *Nord Pool* power exchange



CHANGES IN CIT APPLICATION PROCEDURE

As of 1 January 2018 the application procedure for corporate income tax (CIT) in Latvia has changed. New CIT regulation eliminated all temporary differences between the financial accounting basis and tax basis of assets and liabilities as of 1 January 2018. As of 1 January 2018 distributed profits and conditionally distributed profits are taxed at a rate of 20% of the gross amount or 20/80 of the net amount. The Group recognises deferred tax liabilities in the balance sheet for the expected dividend payments of subsidiaries.

OPERATING RESULTS

GENERATION

In 2018, the total amount generated by Latvenergo Group's power plants comprised 5,076 GWh of electricity and 2,274 GWh of thermal energy (Latvenergo AS – 5,028 GWh and 2,007 GWh respectively).

Latvenergo AS CHPPs played a significant role in ensuring electricity demand this year. Dry weather significantly decreased output of hydroelectricity in Latvia and entire *Nord Pool* region and this led to a rapid rise in electricity prices throughout region.

Electricity output at the Latvenergo AS CHPPs increased by 87%

In 2018, the amount of power generated at the Daugava HPPs decreased by 44% compared to a year earlier and reached 2,380 GWh. The amount of power generated at the Daugava HPPs was impacted by almost twice lower water inflow in the river Daugava compared to the previous year. According to data from the Latvian Environment, Geology and Meteorology Centre, the average water inflow in the Daugava River in 2018 was 485 m^3/s, which is 81% of the average long-term inflow. In 2018, the share of electricity generated from renewable energy sources at Latvenergo Group was 47% (in 2017 it was 75%).

The Latvenergo AS CHPPs operated in a market conjuncture by effectively planning operating modes and fuel consumption. The dry weather and higher electricity prices throughout the *Nord Pool* region contributed to an increase in electricity generation at Latvenergo AS CHPPs. In 2018, the amount increased by 87% compared to a year earlier, reaching 2,644 GWh. If the Latvenergo AS CHPPs were not available for generation in Latvia, we would have to use more expensive energy resources, for example a natural gas station in Lithuania or coal stations in Poland, to satisfy demand.

In 2018, the total amount of thermal energy generated by Latvenergo Group decreased by 13% compared to the previous year. The decrease was impacted by increasing competition in the thermal energy market. At the end of 2017 and at the beginning of 2018 four new competitors entered the territory of the Latvenergo AS CHPPs.

TRADE

Latvenergo Group is one of the largest energy trading companies in the Baltics. With the launch of natural gas trade to business customers in Lithuania in October 2018, the Group now operates in all segments of the market in Latvia, Lithuania and Estonia.

Latvenergo group operates in all energy trade segments in Latvia, Lithuania and Estonia

In the reporting year, the Group supplied 7.0 TWh of electricity to retail customers, which is approximately the same as the previous year. The overall amount of retail electricity trade outside Latvia accounted for 1/3 of the total, reaching 2.5 TWh. The electricity trade volume in Latvia was 4.4 TWh, while in Lithuania it was 1.6 TWh and in Estonia it was 0.9 TWh. The total number of electricity customers comprises approximately 800 thousand, including more than 35 thousand foreign customers.

The amount of natural gas supplied to business customers continued to increase in the reporting year. As of 31 December 2018, the total amount of customers exceeds 400, and natural gas sales to these customers amounted to 0.15 TWh. In the reporting year, the amount of natural gas used for both operating consumption and trade reached 6.9 TWh. Currently, Latvenergo Group is the second largest natural gas consumer in the Baltics. After the reporting year, in February 2019, Latvenergo expanded the range of services it provides to customers, thus implementing the goal set in the Latvenergo AS strategy, which is to develop new business directions. Under the Elektrum brand, it launched natural gas trade to households in Latvia.

In 2018 the retail activities of other products and services in the Baltic states continued. In the reporting year, we launched trade of *Elektrum Solārais* in Estonia. In 2018 we installed solar panels for about 70 customers in the Baltics. Also, the number of *Elektrum Insured* customers continued to increase, reaching more than 41,000 at the end of 2018.

FINANCIAL RESULTS

In 2018, Latvenergo Group's revenue decreased by 5% and comprised EUR 878.0 million. Meanwhile, EBITDA decreased by 41% and reached EUR 321.6 million. In 2018 Group's profit amounted to EUR 76.0 million.

The Group's results in the reporting year were mainly negatively impacted by:

- 44% lower electricity output at the Daugava HPPs;
- 75% lower revenue from the installed electrical capacity at the Latvenergo AS CHPPs;
- Changes in the application procedure for corporate income tax. In 2017 the Group's profit consisted of the annual operating result in the amount of EUR EUR 172.9 million and a deferred tax reversal in the amount of EUR 149.1 million as a result of the corporate income tax reform.

The Group's ROE in 2018 reaches 2.9%. The 2018 financial indicators of the capital structure ensured achievement of the set goals, exceeding average industry indicators as well. For information on achievement of the financial goals, see the Sustainability Report section "Group Strategy".

INVESTMENTS

In 2018, the total amount of investment decreased by 10% compared to the previous year; it comprised EUR 220.6 million.

Latvenergo AS investment amounted EUR 41.4 million in 2018 (2017: EUR 89.3 million).

To ensure high quality power network service, technical parameters and operational safety, a significant amount is invested in the modernisation of the power network. In the reporting year, the amount invested in power network assets represented 82% of total investment.

Investment in power network assets – 82% of the total amount

Investments in distribution assets during the reporting year reached EUR 95.1 million. The purpose of investments in the distribution segment is to promote the quality and security of the energy supply, reduce the frequency and duration of power supply disruptions caused by planned and unplanned maintenance, and ensure the appropriate voltage quality. Investments in modernisation of distribution assets have increased the quality of distribution services by lowering SAIFI and SAIDI indicators. In 2018, SAIDI has decreased by 13% and SAIFI has decreased by 11%.

During the reporting year, investment in transmission system assets was in the amount of EUR 87.1 million. The amount of investments increased by 38% compared to the previous year. The largest investment was made in the energy infrastructure project *Kurzeme Ring*. In 2018, EUR 65.2 million was invested in this project. The Kurzeme Ring project will increase the safety level of power supply in the Kurzeme region and Latvia as a whole, providing an opportunity for more efficient use of the Lithuania-Sweden marine cable NordBalt and allowing further integration of the Baltics into the Nordic electricity market.

Contributing to environmentally friendly projects, in 2018, EUR 21.1 million was invested in the Daugava HPPs' hydropower unit reconstruction. Gradual overhaul of eleven Daugava HPPs hydropower units is planned for completion until 2022. It will provide for further 40–year operation of the units. As of 31 December 2018, four reconstructed hydropower units have been put into operation within the programme. The estimated total reconstruction costs will exceed EUR 200 million. At the end of the reporting year, work completed within the scope of the contract reached EUR 149.5 million.

FUNDING

Diversified sources of funding

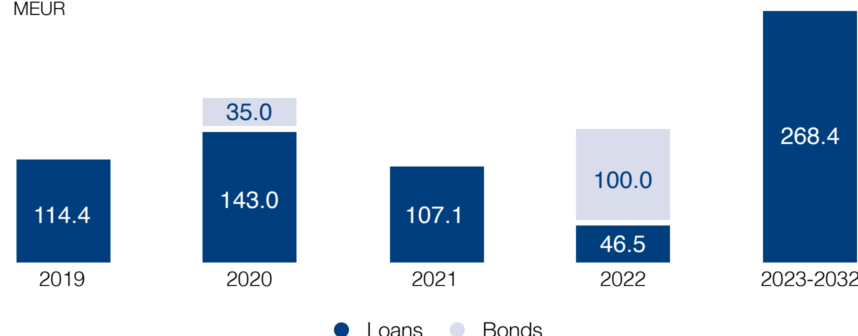
Latvenergo Group finances its investments from its own resources and external long-term borrowings, which are regularly sourced in financial and capital markets in a timely manner.

At the end of 2018, Latvenergo AS has committed loans from several banks for implementation of investment projects and in order to ensure loan refinancing risk management for a total amount of EUR 240 million with a repayment term of 7 and 10 years.

As of 31 December 2018, the Group's borrowings amount to EUR 814.3 million (31 December 2017: EUR 826.8 million), comprising loans from commercial banks, international investment banks, and bonds amounting to EUR 135 million, of which EUR 100 million are *green* bonds.

Latvenergo Group's debt repayment schedule

Total borrowings as of 31 December 2018 – 814.3 MEUR



As of 31 December 2018, the net borrowings of Latvenergo Group are EUR 684.9 million (31 December 2017: EUR 590.8 million), while the net debt / EBITDA ratio is 2.0 (31 December 2017: 1.1).

Moody's credit rating for Latvenergo AS has been stable for several years and is at the Baa2 level with a stable future outlook. The last credit rating affirmation was on 19 March 2019.

CORPORATE GOVERNANCE

In the reporting year, we successfully continued to improve our corporate governance. In 2018, the Corporate Governance Policy was updated and corporate governance principles were published on the Latvenergo website.

In 2018, the Supervisory Board of Latvenergo AS established the Strategic Communication Committee with the aim of ensuring the supervisory functions of the Supervisory Board within the scope of the strategic communication of Latvenergo AS. The Committee consists of the Members of the Supervisory Board.

Along with the financial results of Latvenergo Group, also the Corporate Governance Report of Latvenergo AS for 2018 is published. The company has complied with all applicable principles of corporate governance in all key material aspects.

NON-FINANCIAL REPORT

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

Non-financial report is in accordance with the GRI Standards

For detailed information on Corporate Social Responsibility (hereinafter – CSR) activities, description of the policies and procedures in relation to those matters, the outcome of the policies, risks and risk management, and non-financial key performance indicators, please see the Sustainability Report 2018 which is available on the Latvenergo website: http://www.latvenergo.lv. The report is prepared in accordance with the GRI Standards – Core option requirements.

The sustainability report addresses such topics as corporate social responsibility, economic performance, society, product responsibility, environmental protection, employees and the work environment etc.

CORPORATE SOCIAL RESPONSIBILITY

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

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

ECONOMIC PERFORMANCE

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

SOCIETY

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

PRODUCT RESPONSIBILITY

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

ENVIRONMENTAL PROTECTION

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

EMPLOYEES AND THE WORK ENVIRONMENT

Latvenergo Group's management acknowledges that its employees, with their diversity and variety of competences, provide a valuable opportunity to view operational aspects from different perspectives and thus achieve better results. The Group attracts and develops employees capable of driving its advancement. The Group ensures that its employees' competences contribute to the achievement of goals and future needs. Employee engagement and desire to implement innovative ideas in both improving the work environment and enhancing the Group's competitiveness is an important resource.

FURTHER DEVELOPMENT

Latvenergo Group's strategy for 2017–2022 foresees:

- strengthening of a sustainable and economically sound market position in core markets (in the Baltics) while considering geographic and / or product / service expansion;
- development of a generation portfolio that fosters synergy with trade and that promotes an increase in value for the Group;
- development of a customer-driven, functional, safe and efficient power network.

Comprehensive Efficiency Programme

Taking into consideration the defined development directions of the Group, Latvenergo AS approved the Strategic Development and Efficiency Programme in 2017. While the strategic development section includes major strategic projects, the efficiency section provides for the revision, centralisation and digitalisation of the Group's processes in order to maintain the Group's profitability in the long term considering the increase in costs due to inflation.

The estimated efficiency potential for the Group's EBITDA is up to EUR 30 million. This is the Group's largest optimisation plan in the last decade, and it will allow the Group to increase its value in the long run and to remain competitive in an open market and a changing energy industry.

The activities planned in the strategy have been successfully implemented in 2018. For more information, please see the Sustainability Report section "Group Strategy".

Along with the strategy approval, Latvenergo Group's financial targets have been set. The targets are divided into three groups – profitability, capital structure and dividend policy.

The financial targets are set to ensure:

- ambitious, yet achievable profitability, which is consistent with the average ratios of benchmark companies in the European energy sector and provides for an adequate return on the business risk;
- an optimal and industry–relevant capital structure that limits potential financial risks;
- an adequate dividend policy that is consistent with the planned investment policy and capital structure targets.

Target group	Ratio	Year 2022
Profitability	Return on equity	> 6%
Capital structure	Net debt to equity	< 50%
	Net debt to EBITDA	< 3 times
Dividend policy	Dividend pay–out ratio	> 80%

FINANCIAL RISK MANAGEMENT

The activities of Latvenergo Group and Latvenergo AS are exposed to a variety of financial risks: market risks, credit risk, and liquidity and cash flow risk. Latvenergo Group's Financial Risk Management Policy focuses on eliminating the potential adverse effects from such risks on financial performance. In the framework of financial risk management, Latvenergo Group and Latvenergo AS use various financial risk controls and hedging to reduce certain risk exposures.

a) Market risks

I) Price risk

Price risk might negatively affect the financial results of the Group and the Parent Company due to falling revenue from generation and a mismatch between floating market prices and fixed retail prices.

The main sources of Latvenergo Group's and Latvenergo AS exposure to price risk are the floating market prices of electricity on the *Nord Pool* power exchange in Baltic bidding areas and the fuel price for CHPPs. The financial results of the Group and the Parent Company may be negatively affected by the volatility of the electricity market price, which depends on the weather conditions in the Nordic countries, global prices of resources, and the influence of local factors (water availability and ambient air temperature) on electricity generation opportunities. Due to supply–demand factors and seasonal fluctuations, natural gas price volatility may have a negative effect on the difference between fixed retail electricity prices in contracts with customers and variable generation costs at CHPPs.

In order to hedge the price risk, the Group and the Parent Company enter into long–term fixed price customer contracts, use electricity financial derivatives and enter into fixed price contracts for natural gas supply. The impact of price risk on generation is hedged gradually – 80%–90% of projected electricity output is sold prior to the upcoming year. Further hedging of risk is limited by the seasonal generation pattern of the Daugava HPPs.

II) Interest rate risk

Latvenergo Group's and Latvenergo AS interest rate risk mainly arises from non–current borrowings at variable interest rates. They expose the Group and the Parent Company to the risk that finance costs might increase significantly when the reference rate surges. Most of the borrowings from financial institutions have a variable interest rate, comprising 6 or 12–month EURIBOR and a margin. The Group's Financial Risk Management Policy stipulates maintaining at least 35% of its borrowings as fixed interest rate borrowings (taking into account the effect of interest rate swaps and issued bonds) with a duration of 2–4 years. Taking into account the effect of interest rate swaps and bonds with a fixed interest rate, 53% of the Group's and 54% of the Parent Company's borrowings had a fixed interest rate with an average period of 2.1 years both for the Group and the parent Company as of 31 December 2018.

III) Currency risk

Foreign currency exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency other than the functional currency which is euro.

As of 31 December 2018, all borrowings of Latvenergo Group and Latvenergo AS are denominated in euros, and during the reporting year, there was no substantial exposure to foreign currency risk in relation to the Group's investments. All revenues of Latvenergo Group and Latvenergo AS are generated in euros.

To manage the Group's and the Parent Company's foreign currency exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy envisages use of forward contracts.

b) Credit risk

Credit risk is managed at the Latvenergo Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, and receivables. Credit risk exposure of receivables is limited due to the large number of Group customers as there is no significant concentration of credit risk with any single counterparty or group of counterparties with similar characteristics.

Credit risk related to cash and short-term deposits with banks is managed by balancing the placement of financial assets in order to simultaneously choose the best offers and reduce the probability of incurrence of loss. No credit limits were exceeded during the reporting year, and the management does not expect any losses due to the occurrence of credit risk.

c) Liquidity risk and cash flow risk

Latvenergo Group's liquidity and cash flow risk management policy is to maintain a sufficient amount of cash and cash equivalents and the availability of long and short-term funding through an adequate amount of committed credit facilities in order to meet existing and expected commitments and compensate for fluctuations in cash flows due to the occurrence of a variety of financial risks. On 31 December 2018, Latvenergo Group's liquid assets (cash and short-term deposits up to 3 months) reached EUR 129.5 million (31/12/2017: EUR 236.0 million), while the Latvenergo AS liquid assets reached EUR 127.6 million (31/12/2017: EUR 232.9 million).

The Group and the Parent Company continuously monitor cash flow and liquidity forecasts, which comprise the undrawn borrowing facilities and cash and cash equivalents.

EVENTS AFTER THE REPORTING PERIOD

All significant events that would materially affect the financial position of the Latvenergo Group and Latvenergo AS after the reporting period are disclosed in Note 30 of the Group's and the Parent Company's Financial Statements.

STATEMENT OF MANAGEMENT RESPONSIBILITY

Based on the information available to the Management Board of Latvenergo AS, the Latvenergo Group Consolidated and Latvenergo AS Annual Report 2018, including the Management Report, have been prepared in accordance with the International Financial Reporting Standards as adopted by the EU and in all material aspects present a true and fair view of the assets, liabilities, financial position, profit and loss and its cash flows of Latvenergo Group and Latvenergo AS. Information provided in the Management Report is accurate.

The Management Board of Latvenergo AS:

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Kaspars Cikmačs
Member of the Management Board

16 April 2019

PROFIT DISTRIBUTION

Fulfilling the requirements of the Article No. 45 of the law "On the State budget 2019" that determines the amount of dividends payable in the year 2019, the Management Board of Latvenergo AS proposes to pay out in dividends EUR 132.9 million. The distribution of net profit and amount of dividends payable is subject to a resolution of the Latvenergo AS Shareholders Meeting. Net profit of the year 2018 is EUR 212.7 million.

FINANCIAL STATEMENTS

STATEMENT OF PROFIT OR LOSS

EUR'000

	Notes	Group 2018	Group 2017	Parent Company 2018	Parent Company 2017
Revenue	6	878,008	925,627	435,199	498,580
Other income	7	93,260	149,950	91,181	147,502
Raw materials and consumables used	8	(497,293)	(349,690)	(284,592)	(156,103)
Personnel expenses	9	(103,762)	(113,289)	(42,396)	(44,892)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	13 a, 14 a	(225,820)	(307,614)	(127,124)	(209,684)
Impairment losses on financial assets, net		478	–	236	–
Other operating expenses	10	(49,109)	(70,902)	(38,701)	(57,987)
Operating profit		**95,762**	**234,082**	**33,803**	**177,416**
Finance income	11 a	1,157	1,243	11,446	11,433
Finance costs	11 b	(8,406)	(11,211)	(10,135)	(12,054)
Dividends from subsidiaries	15	–	–	177,646	9,111
Profit before tax		**88,513**	**224,114**	**212,760**	**185,906**
Current income tax	12	(261)	(51,199)	(27)	(45,097)
Deferred tax changes	12	(12,297)	149,106*	–	10,082*
Profit for the year		**75,955**	**322,021**	**212,733**	**150,891**
Profit attributable to:					
– Equity holder of the Parent Company		73,423	319,670	212,733	150,891
– Non-controlling interests		2,532	2,351	–	–
Basic earnings per share (in euros)	20 c	0.081	0.250	0.234	0.117
Diluted earnings per share (in euros)	20 c	0.081	0.250	0.234	0.117

* In 2017 deferred tax liabilities reversed in the Statement of Profit or Loss in accordance with the changes of tax regulations and laws of the Republic of Latvia starting from 1 January 2018

The notes on pages 15 to 68 are an integral part of these Financial Statements

STATEMENT OF COMPREHENSIVE INCOME

EUR'000

	Notes	Group 2018	Group 2017	Parent Company 2018	Parent Company 2017
Profit for the year		**75,955**	**322,021**	**212,733**	**150,891**
Comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):					
Gains from change in hedge reserve	20 a, 23	9,531	5,422	9,531	5,422
Net comprehensive income to be reclassified to profit or loss in subsequent periods		**9,531**	**5,422**	**9,531**	**5,422**
Comprehensive income / (loss) not to be reclassified to profit or loss in subsequent periods (net of tax):					
Gains on revaluation of property, plant and equipment	20 a	–	18,842	–	18,842
Gains / (losses) as a result of re–measurement on defined post–employment benefit plan	20 a, 26 a	436	3,460	(108)	1,053
Reversal of deferred income tax	12	–	169,978	–	119,503
Net comprehensive income / (loss) not to be reclassified to profit or loss in subsequent periods		**436**	**192,280**	**(108)**	**139,398**
Comprehensive income for the year, net of tax		**9,967**	**197,702**	**9,423**	**144,820**
TOTAL comprehensive income for the year		**85,922**	**519,723**	**222,156**	**295,711**
Attributable to:					
– Equity holder of the Parent Company		83,390	517,372	222,156	295,711
– Non-controlling interests		2,532	2,351	–	–

The notes on pages 15 to 68 are an integral part of these Financial Statements

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Member of the Management Board

Uldis Bariss
Member of the Management Board

Kaspars Cikmačs
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

16 April 2019

STATEMENT OF FINANCIAL POSITION

EUR'000

	Notes	Group 31/12/2018	Group 31/12/2017	Parent Company 31/12/2018	Parent Company 31/12/2017
ASSETS					
Non–current assets					
Intangible assets	13 a	19,079	13,413	22,813	17,461
Property, plant and equipment	14 a	3,297,093	3,308,985	1,133,886	1,231,454
Investment property	14 b	467	753	61,796	64,807
Non–current financial investments	15	40	40	830,542	817,048
Non–current loans to subsidiaries	28 e	–	–	595,004	397,976
Other non-current receivables	17 b	30,920	3,229	331	284
Investments in other financial assets	21	16,935	–	16,935	–
Investments in held-to-maturity financial assets	21	–	16,984	–	16,984
TOTAL non–current assets		**3,364,534**	**3,343,404**	**2,661,307**	**2,546,014**
Current assets					
Inventories	16	71,975	76,328	58,410	61,824
Receivables from contracts with customers	17 a	117,955	105,369	81,025	82,799
Other current receivables	17 b, c	84,830	646,761	14,445	18,079
Deferred expenses		2,598	3,241	1,552	2,205
Current loans to subsidiaries	28 e	–	–	170,811	700,805
Prepayment for income tax		11,619	–	10,152	–
Derivative financial instruments	23	15,853	4,619	15,853	4,619
Cash and cash equivalents	18	129,455	236,003	127,554	232,855
TOTAL current assets		**434,285**	**1,072,321**	**479,802**	**1,103,186**
TOTAL ASSETS		**3,798,819**	**4,415,725**	**3,141,109**	**3,649,200**

Statement of Financial Position (continued)

EUR'000

	Notes	Group 31/12/2018	Group 31/12/2017	Parent Company 31/12/2018	Parent Company 31/12/2017
EQUITY AND LIABILITIES					
EQUITY					
Share capital	19	834,791	1,288,715	834,791	1,288,715
Reserves	20 a	1,125,466	1,125,728	794,555	791,681
Retained earnings		351,350	424,406	364,477	302,242
Equity attributable to equity holder of the Parent Company		**2,311,607**	**2,838,849**	**1,993,823**	**2,382,638**
Non–controlling interests		8,458	8,042	–	–
TOTAL equity		**2,320,065**	**2,846,891**	**1,993,823**	**2,382,638**
LIABILITIES					
Non–current liabilities					
Borrowings	22	700,028	718,674	690,568	710,125
Deferred income tax liabilities	12	12,297	–	–	–
Provisions	26	20,178	21,910	8,625	8,835
Derivative financial instruments	23	3,923	4,914	3,923	4,914
Deferred income from contracts with customers	27 I a	143,494	142,132	–	–
Other deferred income	27 I b, c	303,519	350,926	210,105	286,085
TOTAL non–current liabilities		**1,183,439**	**1,238,556**	**913,221**	**1,009,959**
Current liabilities					
Trade and other payables	25	135,008	147,072	92,062	94,689
Deferred income from contracts with customers	27 II a	13,271	12,500	–	–
Other deferred income	27 II b, c	26,438	31,728	24,022	29,358
Income tax payable		2	27,725	–	24,739
Borrowings	22	114,315	108,083	111,700	104,647
Derivative financial instruments	23	6,281	3,170	6,281	3,170
TOTAL current liabilities		**295,315**	**330,278**	**234,065**	**256,603**
TOTAL EQUITY AND LIABILITIES		**3,798,819**	**4,415,725**	**3,141,109**	**3,649,200**

The notes on pages 15 to 68 are an integral part of these Financial Statements

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Kaspars Cikmačs
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

16 April 2019

STATEMENT OF CHANGES IN EQUITY

EUR'000

		Group						Parent Company			
		Attributable to equity holder of the Parent Company						Attributable to equity holder of the Parent Company			
	Notes	Share capital	Reserves	Retained earnings	TOTAL	Non–con-trol–ling interests	TOTAL	Share capital	Reserves	Retained earnings	TOTAL
As of 31 December 2016		**1,288,715**	**933,459**	**189,455**	**2,411,629**	**7,084**	**2,418,713**	**1,288,715**	**648,934**	**239,420**	**2,177,069**
Implementation effect of IFRS 15 'Revenue from Contracts with Customers'		–	–	(10)	**(10)**	–	**(10)**	–	–	–	–
As of 1 January 2017		**1,288,715**	**933,459**	**185,845**	**2,411,619**	**7,084**	**2,418,703**	**1,288,715**	**648,934**	**238,334**	**2,177,069**
Dividends for 2016	20 b	–	–	(90,142)	**(90,142)**	(1,393)	**(91,535)**	–	–	(90,142)	**(90,142)**
Disposal of non-current assets revaluation reserve net of deferred income tax	20 a	–	(4,377)	4,377	**–**	–	**–**	–	(1,762)	1,762	**–**
TOTAL contributions and profit distributions recognised directly in equity		**–**	**(4,377)**	**(85,765)**	**(90,142)**	**(1,393)**	**(91,535)**	**–**	**(1,762)**	**(88,380)**	**(90,142)**
Profit for the year		–	–	319,670	**319,670**	2,351	**322,021**	–	–	150,891	**150,891**
Other comprehensive income	12, 20 a	–	196,646	1,056	**197,702**	–	**197,702**	–	144,509	311	**144,820**
TOTAL comprehensive income for the year		**–**	**196,646**	**320,726**	**517,372**	**2,351**	**519,723**	**–**	**144,509**	**151,202**	**295,711**
As of 31 December 2017		**1,288,715**	**1,125,728**	**424,406**	**2,838,849**	**8,042**	**2,846,891**	**1,288,715**	**791,681**	**302,242**	**2,382,638**
Implementation effect of IFRS 9 'Financial instruments'	2.28	–	–	(290)	**(290)**	–	**(290)**	–	–	(629)	**(629)**
As of 1 January 2018		**1,288,715**	**1,125,728**	**424,116**	**2,838,559**	**8,042**	**2,846,601**	**1,288,715**	**791,681**	**301,613**	**2,382,009**
Decrease in share capital	19	(454,413)	–	–	**(454,413)**	–	**(454,413)**	(454,413)	–	–	**(454,413)**
Increase in share capital	14 a, 19	489	–	–	**489**	–	**489**	489	–	–	**489**
Dividends for 2017	20 b	–	–	(156,418)	**(156,418)**	(2,116)	**(158,534)**	–	–	(156,418)	**(156,418)**
Disposal of non-current assets revaluation reserve	20 a	–	(10,229)	10,229	**–**	–	**–**	–	(6,549)	6,549	**–**
TOTAL contributions and profit distributions recognised directly in equity		**(453,924)**	**(10,229)**	**(146,189)**	**(610,342)**	**(2,116)**	**(612,458)**	**(453,924)**	**(6,549)**	**(149,869)**	**(610,342)**
Profit for the year		–	–	73,423	**73,423**	2,532	**75,955**	–	–	212,733	**212,733**
Other comprehensive income	12, 20 a	–	9,967	–	**9,967**	–	**9,967**	–	9,423	–	**9,423**
TOTAL comprehensive income for the year		**–**	**9,967**	**73,423**	**83,390**	**2,532**	**85,922**	**–**	**9,423**	**212,733**	**222,156**
As of 31 December 2018		**834,791**	**1,125,466**	**351,350**	**2,311,607**	**8,458**	**2,320,065**	**834,791**	**794,555**	**364,477**	**1,993,823**

The notes on pages 15 to 68 are an integral part of these Financial Statements

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Kaspars Cikmačs
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

16 April 2019

STATEMENT OF CASH FLOWS

EUR'000

	Notes	Group 2018	Group 2017	Parent Company 2018	Parent Company 2017*
Cash flows from operating activities					
Profit before tax		88,513	224,114	212,760	185,906
Adjustments:					
– Amortisation, depreciation and impairment of intangible assets and property, plant and equipment	13 a, 14 a	225,820	307,614	127,124	209,684
– Loss from disposal of non-current assets		17,638	5,476	12,320	1,601
– Interest costs	11 b	8,267	9,825	10,020	10,667
– Interest income	11 a	(1,114)	(1,221)	(11,403)	(11,410)
– Fair value loss on derivative financial instruments	8, 11	417	3,435	417	3,435
– Dividends from subsidiaries	15	–	–	(177,646)	(9,111)
– (Decrease) / increase in provisions	26	(1,295)	6,726	(318)	1,966
– Unrealised income on currency translation differences	11 b	2	(22)	2	(22)
Operating profit before working capital adjustments		**338,248**	**555,947**	**173,276**	**392,716**
Decrease / (increase) in inventories		4,353	(34,870)	3,414	(36,013)
Decrease / (increase) in receivables from contracts with customers and other receivables		98,125	(7,770)	140,461	(112,853)
(Decrease) / increase in trade and other liabilities		(90,344)	(123,783)	(79,741)	6,749
Impact of non-cash offsetting of operating receivables and liabilities from subsidiaries, net		–	–	201,571	246,554
Cash generated from operating activities		**350,382**	**389,524**	**438,981**	**497,153**
Interest paid		(9,066)	(11,484)	(10,781)	(12,283)
Interest received		1,113	1,390	1,113	1,390
Paid corporate income tax		(39,560)	(41,221)	(34,918)	(36,908)
Net cash flows from operating activities		**302,869**	**338,209**	**394,395**	**449,352**

Statement of Cash Flows (continued)

EUR'000

	Notes	Group 2018	Group 2017	Parent Company 2018	Parent Company 2017*
Cash flows from investing activities					
Loans issued to subsidiaries, net	28 e	–	–	(323,539)	(268,218)
Purchase of intangible assets and PPE		(238,501)	(233,744)	(60,644)	(88,793)
Proceeds from investments in subsidiaries	15	–	–	53,378	9,111
Proceeds from redemption of other financial investments		49	3,569	49	3,569
Net cash flows used in investing activities		**(238,452)**	**(230,175)**	**(330,756)**	**(344,331)**
Cash flows from financing activities					
Repayment of issued debt securities (bonds)	22	–	(70,000)	–	(70,000)
Proceeds on borrowings from financial institutions	22	93,500	186,500	90,000	185,000
Repayment of borrowings	22	(105,931)	(80,976)	(102,522)	(78,221)
Dividends paid to non-controlling interests	20 b	(2,116)	(1,393)	–	–
Dividends paid to equity holder of the Parent Company	20 b	(156,418)	(90,142)	(156,418)	(90,142)
Net cash flows used in financing activities		**(170,965)**	**(56,011)**	**(168,940)**	**(53,363)**
Net (decrease)/ increase in cash and cash equivalents		**(106,548)**	**52,023**	**(105,301)**	**51,658**
Cash and cash equivalents at the beginning of the year	18	236,003	183,980	232,855	181,197
Cash and cash equivalents at the end of the year	18	**129,455**	**236,003**	**127,554**	**232,855**

* See note 2.1.

The notes on pages 15 to 68 are an integral part of these Financial Statements

Āris Žīgurs
Chairman of the Management Board

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Liāna Ķeldere
Accounting director of Latvenergo AS

16 April 2019

NOTES TO THE FINANCIAL STATEMENTS

1.CORPORATE INFORMATION

All shares of public limited company Latvenergo, parent company of Latvenergo Group (hereinafter – Latvenergo AS or the Parent Company) are owned by the Republic of Latvia and are held by the Ministry of Economics of the Republic of Latvia. The registered address of the Parent Company is 12 Pulkveža Brieža Street, Riga, Latvia, LV–1230. According to the Energy Law of the Republic of Latvia, Latvenergo AS is designated as a national economy object of State importance and, therefore, is not subject to privatisation.

Latvenergo AS is power supply utility engaged in electricity and thermal energy generation, as well as sales of electricity and natural gas. Latvenergo AS is one of the largest corporate entities in the Baltics.

Latvenergo AS heads the Latvenergo Group (hereinafter – the Group) that includes the following subsidiaries:

- Sadales tīkls AS (since 18 September 2006) with 100% interest held;
- Elektrum Eesti OÜ (since 27 June 2007) and its subsidiary Elektrum Latvija SIA (since 18 September 2012) with 100% interest held;
- Elektrum Lietuva UAB (since 7 January 2008) with 100% interest held;
- Latvijas elektriskie tīkli AS (since 10 February 2011) with 100% interest held;
- Liepājas enerģija SIA (since 6 July 2005) with 51% interest held;
- Enerģijas publiskais tirgotājs AS (since 25 February 2014) with 100% interest held.

Latvenergo AS and its subsidiaries Sadales tīkls AS, Latvijas elektriskie tīkli AS and Enerģijas publiskais tirgotājs AS are also shareholders with 48.15% interest held in company Pirmais Slēgtais Pensiju Fonds AS that manages a defined–contribution corporate pension plan in Latvia.

Latvenergo AS shareholding in subsidiaries, associates and other non–current financial investments is disclosed in Note 15.

The Management Board of Latvenergo AS since 16 November 2015 until 1 March 2018 was comprised of the following members: Āris Žīgurs (Chairman of the Board), Uldis Bariss, Māris Kuņickis, Guntars Baļčūns and Guntis Stafeckis. From 1 March 2018 Guntis Stafeckis and from 5 October 2018 Māris Kuņickis does not continue work on the Management Board. Since 25 September 2018 Kaspars Cikmačs has been acting as a member of the Management Board of Latvenergo AS and until the end of the reporting period the Management Board of Latvenergo AS was comprised of the following members: Āris Žīgurs (Chairman of the Board), Uldis Bariss, Guntars Baļčūns and Kaspars Cikmačs.

On 16 December 2016 the Supervisory Board of Latvenergo AS was established and it was comprised of the following members: Andris Ozoliņš (Chairman), Andris Liepiņš (Deputy Chairman), Baiba Anda Rubesa, Mārtiņš Bičevskis and Martin Sedlacky.

The Supervisory body – Audit Committee since 3 March 2017 was comprised of the following members: Torben Pedersen (Chairman of the Committee), Svens Dinsdorfs, Andris Ozoliņš, Andris Liepiņš and Marita Salgrāve.

The Financial Statements for year 2018 include the financial information in respect of the Latvenergo Group and Latvenergo AS for the year ending 31 December 2018 and comparative information for year 2017. Where it has been necessary, comparatives for year 2017 are reclassified using the same principles applied for preparation of the Financial Statements for 2018 (Note 2.1.).

The Management Board of Latvenergo AS has approved the Latvenergo Group and Latvenergo AS Financial statements 2018 on 16 April 2019. The Financial Statements are subject to Shareholder's approval on the Shareholder's Meeting.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1. BASIS OF PREPARATION

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

The Financial Statements are prepared under the historical cost convention, except for some financial assets and liabilities (including derivative financial instruments and non-current financial investments) measured at fair value and certain property, plant and equipment carried at revalued amounts as disclosed in the accounting policies presented below.

As of 31 December 2017 the Group and the Parent Company has reclassified individual positions in the Statement of Financial Position for post–employment benefit plan revaluation reserve and retained earnings. The Parent Company also has reclassified individual positions in the statement of cash flows for the year 2017 for the mutual offsetting with related parties.

Reclassification of individual positions in the Group's and the Parent Company's Statement of Financial Position as of 31 December 2017:

EUR'000

	Group			Parent Company		
	31/12/2017 before reclassification	Reclassification	31/12/2017 after reclassification	31/12/2017 before reclassification	Reclassification	31/12/2017 after reclassification
Equity and liabilities						
Equity						
Reserves	1,126,521	(793)	1,125,728	791,906	(225)	791,681
Retained earnings	423,613	793	424,406	302,017	225	302,242
TOTAL equity	**2,846,891**	**–**	**2,846,891**	**2,382,638**	**–**	**2,382,638**

Reclassification of individual positions in the Parent Company's Statement of Cash Flows for the year ended 31 December 2017:

EUR'000

	2017 before reclassification	Reclassification	2017 after reclassification
Operating profit before working capital adjustments	**392,716**	**–**	**392,716**
(Increase) / decrease in receivables from contracts with customers and other receivables	(123,095)	10,242	(112,853)
Increase / (decrease) in trade and other liabilities	6,790	(41)	6,749
Impact of non-cash offsetting of operating receivables and liabilities from subsidiaries, net	–	246,554	246,554
Cash generated from operating activities	**240,398**	**256,755**	**497,153**
Interest paid	(12,324)	41	(12,283)
Interest received	11,632	(10,242)	1,390
Net cash flows from operating activities	**202,798**	**246,554**	**449,352**
Cash flows from investing activities			
Loans issued to subsidiaries	(81,889)	(186,329)	(268,218)
Repayment of loans issued to subsidiaries	60,225	(60,225)	–
Net cash flows used in investing activities	**(97,777)**	**(246,554)**	**(344,331)**
Cash and cash equivalents at the end of the year	**232,855**	**–**	**232,855**

All amounts shown in these Financial Statements are presented in thousands of euros (EUR'000 or EUR thousand).

The preparation of the Financial Statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the Management's best knowledge of current events and actions, actual results ultimately may differ from those. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the Financial Statements are disclosed in Note 2.2 and Note 4.

ADOPTION OF NEW AND/OR REVISED IFRS AND INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE (IFRIC) INTERPRETATIONS

The following new and/or revised International Financial Reporting Standards or interpretations published or revised during the reporting year, which became effective for the reporting period started from 1 January 2018, have been adopted by the Group and the Parent Company:

IFRS 9: Financial Instruments:

The standard is effective for annual periods beginning on or after 1 January 2018.

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

a) Classification and measurement

From a classification and measurement perspective, the new standard requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories have been replaced by fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI) and amortised cost. IFRS 9 also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or fair value through OCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities is largely the same as the requirements of IAS 39.

b) Impairment

IFRS 9 also fundamentally change the credit loss recognition methodology. The standard replaces IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Group and the Parent Company to record expected credit losses on all of its debt securities, loans, receivables from contracts with customers and cash and its equivalents, either on a 12-month or lifetime basis. The Group and the Parent Company have applied two expected credit loss models: counterparty model and portfolio model. Counterparty model is used on individual contract basis for deposits, investments in State Treasury bonds, loans, unsettled revenue on mandatory procurement PSO fee, cash and cash equivalents and trade receivables with large customers. The expected credit losses according to this model are based on

assessment of the individual counterparty's risk of default based on *Moody's* annual corporate default and recovery rates for the relevant industry of business partner. Portfolio model is used for trade receivables with consumers and small business customers and defined for basic business activities. For trade receivables grouped by portfolio model the Group and the Parent Company apply the simplified approach and record lifetime expected losses on receivables based on historical analysis of credit losses taking into account also expected future development. The Group and the Parent Company use provision matrix based on historical observed default rates, adjusted for forward-looking estimates. IFRS 9 impairment requirements are applied retrospectively, with transition impact recognised in retained earnings (see Note 4 b).

c) Hedge accounting

Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The Group and the Parent Company have applied IFRS 9 Financial Instruments, except for hedge accounting, for the first time in the 2018 financial statements with initial application date as of 1 January 2018 and have chosen a modified retrospective application of IFRS 9. The Group and the Parent Company have decided to continue to apply hedge accounting requirements of IAS 39.

Adoption of new standard is disclosed in Note 2.28.

The Group and the Parent Company has applied IFRS 15 Revenue from contracts with customers with initial application date as of 1 January 2017 and has chosen a modified retrospective application with cumulative effect.

Other new or revised standards or interpretations that have become effective in current accounting period do not have significant effect on the Group and the Parent Company.

STANDARDS ISSUED AND NOT YET EFFECTIVE, BUT ARE RELEVANT FOR THE GROUP'S AND THE PARENT COMPANY'S OPERATIONS AND NOT EARLY ADOPTED BY THE GROUP AND THE PARENT COMPANY

IFRS 16: Leases

The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognise most leases on their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Group and the Parent Company will adopt IFRS 16 for the financial year beginning as of 1 January 2019. The Group and the Parent Company have assessed that the impact of adoption of this Standard will be material on the Group's and the Parent Company's financial statements, and consider that as the lessee the Group and the Parent Company will have to recognise right-of-use assets in their financial statements. Upon implementation of IFRS 16, among other considerations, the Group and the Parent Company will make an assessment on the identified right-of-use assets, non–cancellable lease terms (including the extension and termination options) and lease payments (including fixed and variable payments, termination option penalties etc.).

The statement of profit or loss will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest expenses and depreciation, so key metrics like EBITDA (earnings before interest, income tax, depreciation and amortisation, and impairment of intangible assets and property, plant and equipment) will change. Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

The Group and the Parent Company will apply simplified approach and will not restate any comparative information and cumulative effect of applying the standard will be recognised as an adjustment to the opening balance of retained earnings at the date of initial application. Right-of-use assets will be measured at the amount of the lease liability on adoption. The Group and the Parent Company will use an optional exemption for short-term and low-value leases.

Based on assessment for the remaining lease commitments, the Group expects to recognise right-of-use assets and lease liabilities of approximately EUR 9,392 thousand on 1 january 2019 (Parent Company: approximately EUR 4,978 thousand of right-of-use assets and lease liabilities).

The Group expects other operating expenses will decrease by EUR 1,440 thousand, depreciation will increase by EUR 1,364 thousand and interest expense for 2019 will increase by EUR 124 thousand. The Parent Company expects other operating expenses will decrease by EUR 513 thousand, depreciation will increase by EUR 473 thousand and interest expense for 2019 will increase by EUR 67 thousand.

The Group and the Parent Company as lessor do not expect any significant effect on the financial statements, however, some additional disclosures will be required from 2019.

Other new or revised standards or interpretations that will become effective in next accounting period (s) do not have significant effect on the Group and the Parent Company.

2.2. CONSOLIDATION (GROUP)

a) Subsidiaries

Subsidiaries', which are those entities where the Group has control over the financial and operating policies of the entity, financial reports are consolidated. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee).

Subsidiaries' financial reports are consolidated from the date on which control is transferred to the Parent Company and are no longer consolidated from the date when control ceases. General information about entities included in consolidation and its primary business activities are disclosed in Note 15.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured, as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Costs directly attributable to the acquisition are expensed to the Statement of Profit or Loss as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in business combination are measured initially at their fair values at the acquisition date.

Intercompany transactions, balances and unrealised gains on transactions between the Group's entities are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

b) Transactions with non–controlling interests and owners

The Group treats transactions with non–controlling interests as transactions with equity owners of the Group's Parent Company. Changes in a Parent's ownership interest in a subsidiary that do not result in the Parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). For purchases from non–controlling interests, the difference between any

consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in the Group's equity.

c) Associates

Associates are all entities over which the Parent Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Currently the Group has no investments in associates (Note 15).

2.3. DISCLOSURES OF REPORTABLE SEGMENTS

For segment reporting purposes the division into operating segments is based on the Latvenergo Group's and the Parent Company's internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the operating segment decision maker.

The Group divides its operations into three main operating segments – generation and trade, distribution and lease of transmission system assets. The Parent Company divides its operations into one main operating segment – generation and trade.

In addition, corporate functions, that cover administration and other support services, are presented in the Group and the Parent Company as separate segment (Note 5).

2.4. FOREIGN CURRENCY TRANSLATION

a) Functional and presentation currency

Items included in the Financial Statements are measured using the currency of the primary economic environment in which the Group's entity operates ("the functional currency"). The Financial Statements have been prepared in euros (EUR), which is the Parent Company's functional currency, and presented in thousands of EUR. All figures, unless stated otherwise are rounded to the nearest thousand.

b) Transactions and balances

All transactions denominated in foreign currencies are translated into functional currency at the exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into functional currency using the exchange rate at the last day of the reporting year. The resulting gain or loss is charged to the Statement of Profit or Loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions.

NON-FINANCIAL ASSETS AND LIABILITIES

2.5. INTANGIBLE ASSETS

Intangible assets are measured on initial recognition at historical cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

Assets under development are recognised in Statement of Financial Position within intangible assets and measured at cost until the intangible assets are completed and received.

a) Usage rights, licenses and software

Usage rights, licenses and software are shown at historical cost less accumulated amortisation and accumulated impairment losses. Amortisation is calculated using the straight–line method to allocate the cost of usage rights, licenses and software over their estimated useful lives. Computer software development costs recognised as assets are amortised over their estimated useful lives, not exceeding a period of use defined in agreement or five years.

Connection usage rights are the payments for the rights to use the transmission or distribution system's power grid. Connection usage rights are recognised in the basis of upfront payments to transmission or distribution system operator for connection installation services. Connection usage rights are measured at cost net of amortisation and accumulated impairment that is calculated on straight–line basis to allocate the cost of connection usage rights to the residual value over the estimated period of relationship with a supplier (connection installer).

b) Greenhouse gas emission allowances

Emission rights for greenhouse gases (or allowances) are recognised at purchase cost when the Group or the Parent Company is able to exercise the control. Allowances received from the Government free of charge are recognised at zero cost. In those cases, when the quantity of emitted greenhouse gases exceeds the quantity of allowances allocated by the state free of charge, the Group and the Parent Company purchases additional allowances. Allowances are accounted for within 'Intangible assets' (see Note 13 b).

2.6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment (PPE) are measured on initial recognition at cost. Following initial recognition PPE are stated at historical cost or revalued amount (see 2.8) less accumulated depreciation and accumulated impairment loss, if any.

The acquisition cost comprises the purchase price, transportation costs, installation, and other direct expenses related to the acquisition or implementation. The cost of the self–constructed item of PPE includes the cost of materials, services and workforce. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group or the Parent Company and the cost of an item can be measured reliably. All other repair and maintenance expenses are charged directly to the Statement of Profit or Loss when the expenditure is incurred. Borrowing costs are capitalised to fixed assets proportionally to the part of the cost of fixed assets under construction over the period of construction.

If an item of PPE consists of components with different useful lives and acquisition costs of such components are significant concerning the PPE value, these components are accounted as separate items.

Land is not depreciated. Depreciation on the other assets is calculated using the straight–line method to allocate their cost over their estimated useful lives, as follows:

Type of property, plant and equipment (PPE)	Estimated useful life, years
Buildings and facilities	
Assets of Hydropower plants:	**15 – 100**
▪ hydropower plants' buildings and facilities,	25 – 100
▪ hydropower plants' technology equipment and machinery	10 – 40
Transmission system electrical lines and electrical equipment:	
▪ electricity transmission lines	20 – 50
▪ electrical equipment of transformer substations	12 – 40
Distribution system electrical lines and electrical equipment:	
▪ electricity distribution lines	30 – 50
▪ electrical equipment of transformer substations	30 – 35
Technology equipment and machinery	**3 – 40**
Other property, plant and equipment	**2 – 25**

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see 2.9).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. Those are included in the Statement of Profit or Loss. If revalued property, plant and equipment have been sold, appropriate amounts are reclassified from revaluation reserve to retained earnings.

All fixed assets under construction are stated at historical cost and comprise of costs of construction of assets. The initial cost includes construction and installation costs and other direct costs related to construction of fixed assets. General and specific borrowing costs directly attributable to the acquisition or construction of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. Borrowing costs consist of interest and other costs that the Group or the Parent Company incur in connection with the borrowing of funds. Assets under construction are not depreciated as long as the relevant assets are completed and ready for intended use, impairment test is performed when there is indication for impairment, either individually or at the cash-generating unit level. The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the recoverable amount that is higher of the asset's the fair value less costs to sell and value in use.

2.7. INVESTMENT PROPERTY

Investment properties are land or a building or part of a building held by the Group or the Parent Company as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business. Investment property generates cash flows independently of the other assets held. The investment properties are initially recognised at cost and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses. The applied depreciation rates are based on estimated useful life set for respective fixed asset categories – from 15 to 80 years.

2.8. REVALUATION OF PROPERTY, PLANT AND EQUIPMENT

Revaluations have been made with sufficient regularity to ensure that the carrying amount of property, plant and equipment items subject to valuation does not differ materially from that which would be determined using fair value at the end of reporting period.

The following hydropower plants, transmission system and distribution system assets (property, plant and equipment) are revalued regularly but not less frequently than every five years:

a) Assets of Hydropower plants:

- hydropower plants' buildings and facilities,
- hydropower plants' technology equipment and machinery;

b) Transmission system electrical lines and electrical equipment:

- electricity transmission lines,
- electrical equipment of transformer substations;

c) Distribution system electrical lines and electrical equipment:

- electricity distribution lines,
- electrical equipment of transformer substations.

Increase in the carrying amount arising on revaluation is recognised to the Statement of Comprehensive income as "Non–current assets revaluation reserve" in shareholders' equity. Decrease in the carrying amount arising on revaluation primarily offset previous increases recognised in 'Comprehensive income' and if decrease exceeds revaluation reserve, it is recognised in the Statement of Profit or Loss.

At the date of revaluation, initial carrying amounts and accumulated depreciation are increased or decreased proportionately with the change in the carrying amount of the asset so that the carrying amount of the asset after the revaluation equals its revalued amount.

Non–current assets revaluation reserve is decreased and transferred to retained earnings at the moment, when revalued asset has been written off or disposed.

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

2.9. IMPAIRMENT OF NON-FINANCIAL ASSETS

Assets that are subject to depreciation or amortisation, land and investments in subsidiaries are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre–tax discount rate that reflects the current market expectations regarding the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash–generating unit to which the asset belongs. Impairment losses are recognised in the Comprehensive Income within PPE revaluation reserve for the assets accounted at revalued amount and in the Statement of Profit or Loss within amortisation, depreciation and impairment charge expenses for the assets that are accounted at cost, less depreciation and impairment, and for the assets accounted at revalued amount in case if impairment charge exceeds revaluation surplus previously recognised on individual asset.

The key assumptions used in determining recoverable amount of the asset are based on the Group entities' or the Parent Company's management best estimation of the range of economic conditions that will exist over the remaining useful life of the asset, on the basis of the most recent financial budgets and forecasts approved by the management for a maximum period of 10 years. Assets are reviewed for possible reversal of the impairment whenever events or changes in circumstances indicate that impairment must be reviewed. The reversal of impairment for the assets that are accounted at cost, less depreciation and impairment, is recognised in the Statement of Profit or Loss. Reversal of impairment loss for revalued assets is recognised in the Statement of Profit or Loss to the extent that an impairment loss on the same revalued asset was previously recognised in the Statement of Profit or Loss; the remaining reversals of impairment losses of revalued assets are recognised in Comprehensive Income.

2.10. LEASES

a) The Group or the Parent Company is the lessee

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the Statement of Profit or Loss on a straight–line basis over the period of the lease (Note 14 e).

b) The Group or the Parent Company is the lessor

Properties leased out under operating leases are recorded within investment property at historic cost or revaluated amounts less depreciation and accumulated impairment loss. Rental income from operating lease less any incentives given to lessee are recognised in the Statement of Profit or Loss on a straight-line basis over the period of the lease (Note 14 e).

2.11. NON–CURRENT ASSETS HELD FOR SALE

The Group and the Parent Company classifies non–current assets as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, and sale is considered highly probable. Non–current assets held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

2.12. INVENTORIES

Inventories are stated 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. Cost is determined using the weighted average method, except of natural gas inventory where cost is determined using FIFO method.

Purchase cost of inventories consists of the purchase price, import charges and other fees and charges, freight–in and related costs as well as other costs directly incurred in bringing the materials and goods to their present location and condition. The value of inventories is assigned by charging trade discounts, reductions and similar allowances.

Existence of inventories as of the end of reporting period is verified during stock–taking.

At the end of each reporting year the inventories are reviewed for any indications of obsolescence. When obsolete or damaged inventories are identified allowances are recognised to their recoverable amount. Additionally, during the reporting year at least each month inspection of idle inventories is performed with the purpose to identify obsolete and damaged inventories. Allowances for an impairment loss are recognised for those inventories.

The following basic principles are used in determining impairment losses for idle inventories:

- Maintenance inventories for machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 12 months are impaired in amount of 90%, while inventories haven't turned over during last 6 months are impaired in amount of 45%
- All other inventories that haven't turned over during last 12 months are fully impaired, while inventories that haven't turned over during last 6 months are impaired in amount of 50%,
- Allowances are not calculated for the fuel necessary to ensure uninterrupted operations of hydropower and combined heat and power plants, for natural gas and scraps.

2.13. PENSIONS, POST–EMPLOYMENT AND EMPLOYEE TERMINATION BENEFITS

a) Pension obligations

The Group and the Parent Company make monthly contributions to a closed defined contribution pension plan on behalf of their employees. The plan is managed by the non–profit public limited company *Pirmais Slēgtais Pensiju Fonds*, with the participation of the Group companies amounting for 48.15% (Parent Company – 46.30%) of its share capital. A defined contribution plan is a pension plan under which the Group and the Parent Company pay contributions into the plan. The Group and the Parent Company have no legal or constructive obligations to pay further contributions if the plan does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods. The contributions amount to 5% of each pension plan member's salary. The Group and the Parent Company recognise the contributions to the defined contribution plan as an expense when an employee has rendered services in exchange for those contributions.

b) Provisions for post–employment obligations arising from collective agreement

In addition to the aforementioned plan, the Group and the Parent Company provide certain post–employment benefits to employees whose employment conditions meet certain criteria. Obligations for benefits are calculated taking into account the current level of salary and number of employees eligible to receive the payment, historical termination rates as well as number of actuarial assumptions.

The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

The liability recognised in the Statement of Financial Position in respect of post–employment benefit plan is the present value of the defined benefit obligation at the end of the reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using weighted average discount rate of EIOPA risk-free interest rate, interest rates of Latvian government bonds (maturity of 3 and 5 years) and EURBMK BBB electricity industry rate. The discount rate used is determined by reference to market yields on government bonds due to lack of deep market on high quality corporate bonds. The Group and the Parent Company use projected unit credit method to establish the present value of fixed benefit obligation and related present and previous employment expenses. According to this method it has been stated that each period of service gives rise to an additional unit of benefit entitlement and the sum of those units comprises total Group's and the Parent Company's obligations of post–employment benefits. The Group and the Parent Company use objective and mutually compatible actuarial assumptions on variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts).

Actuarial gains or losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Statement of Comprehensive Income in the period in which they arise. Past service costs are recognised immediately in the Statement of Profit or Loss.

c) Provisions for termination benefits

Termination benefits are measured in accordance with IAS 19 and are payable when employment is terminated by the Group Companies before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The Group and the Parent Company recognise termination benefits at the earlier of the following dates: (a) when the Group entity can no longer withdraw the offer of those benefits; and (b) when the Group entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of terminations benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to present value. Management judgements related to the measurement of provisions for termination benefits is disclosed in Note 4.

2.14. PROVISIONS

Provisions are recognised when the Group or the Parent Company has a present obligation as a result of past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and when a reliable estimate can be made of the amount of the obligation. Provisions are not recognised for future operating losses.

Provisions are presented in the Statement of Financial Position at the best estimate of the expenditure required to settle the present obligation at the end of reporting period. Provisions are used only for expenditures for which the provisions were originally recognised and are reversed if an outflow of resources is no longer probable.

Provisions are measured at the present value of the expenditures expected to be required for settling the obligation by using pre–tax rate that reflects current market assessments of the time value of the money and the risks specific to the obligation as a discount rate. The increase in provisions due to passage of time is recognised as interest expense.

Environmental protection provisions are recognised to cover environmental damages that have occurred before the end of the reporting period when this is required by law or when the Group's or the Parent Company's past environmental policies have demonstrated that the Group or the Parent Company has a constructive present obligation to liquidate this environmental damage. Experts' opinions and prior experience in performing environmental work are used to set up the provisions (see Note 26 c).

2.15. GRANTS

a) Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. Government grants are recognised as income over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis.

For grants received as part of a package of financial or fiscal aid to which a number of conditions are attached, those elements which have different costs and conditions are identified. Treatment of the different elements determine the periods over which the grant will be earned.

I) Grants related to expense items

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to a company with no future related costs are recognised in profit or loss of the period in which it becomes receivable. Related income is recognised in the Statement of Profit or Loss as 'Other income' (Note 7).

When a grant relates to an expense item, and it has a number of conditions attached, it is initially recognised at fair value as deferred income. Grants are credited to income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed (Note 27). Management judgements related to the measurement of government grants is disclosed in Note 4.

II) Grants related to assets

Property, plant and equipment received at nil consideration are accounted for as grants. Those grants are recognised at fair value as deferred income and are credited to the Statement of Profit or Loss on a straight–line basis over the expected lives of the related assets.

FINANCIAL ASSETS AND LIABILITIES

2.16. CLASSIFICATION, INITIAL RECOGNITION, SUBSEQUENT MEASUREMENT AND DE–RECOGNITION

a) Accounting policies applied from 1 January 2018

I) Classification

From 1 January 2018, the Group and the Parent Company classify its financial assets and liabilities under IFRS 9 in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss), and
- those to be measured at amortised cost.

The classification depends on the entity's business model for managing the financial assets and liabilities and the contractual terms of the cash flows.

For assets and liabilities measured at fair value, gains and losses is either recorded in profit or loss or in other comprehensive income. For investments in equity instruments that are not held for trading, this depends on whether the Group and the Parent Company have made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income (FVOCI).

The Group and the Parent Company reclassify debt investments when and only when its business model for managing those assets changes.

II) Initial recognition and measurement

All financial instruments are initially measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs. Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date when the Group and the Parent Company commits to purchase or sell the asset.

III) Subsequent measurement

Debt instruments

Subsequent measurement of debt instruments depends on the Group's and the Parent Company's business model for managing the asset and the cash flow characteristics of the asset. The Group and the Parent Company classify all of their debt instruments:

- in Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Any gain or loss arising on de-recognition is recognised directly in profit or loss. Impairment losses are presented as separate line item in the statement of profit or loss.

Equity instruments

The Group and the Parent Company subsequently measure all equity investments at fair value. Where the Group's or the Parent Company's management has elected to present fair value gains and losses on equity investments in OCI, there is no subsequent reclassification of fair value gains and losses to profit or loss following the de-recognition of the investment. Dividends from such investments continue to be recognised in profit or loss when the Group's and the Parent Company's right to receive payments is established.

Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI or FVPL are not reported separately from other changes in fair value.

Financial Liabilities

Financial liabilities are classified as measured at amortised cost or FVPL. A financial liability is classified as at FVPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVPL are measured at fair value and net gains or losses, including any interest expense, are recognised in profit or loss. Other financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in profit or loss.

IV) De–recognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired,
- the Group and the Parent Company have transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement; and either (a) the Group and the Parent Company have transferred substantially all the risks and rewards of the asset, or (b) the Group and the Parent Company have neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

The Group and the Parent Company derecognise a financial liability when its contractual obligations are discharged or cancelled, or expire. The Group and the Parent Company also derecognise a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognised at fair value. On de-recognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognised in profit or loss.

V) Impairment

From 1 January 2018, the Group and the Parent Company assess on a forward-looking basis the expected credit losses associated with their debt instruments carried at amortised cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

The Group and the Parent Company have applied two expected credit loss models: counterparty model and portfolio model.

Counterparty model is used on individual contract basis for deposits, investments in State Treasury bonds, loans to subsidiaries and cash and cash equivalents. The expected credit losses according to this model for those are based on assessment of the individual counterparty's risk of default based on *Moody's* 12 months corporate default and recovery rates if no significant increase in credit risk is identified. The circumstances indicating a significant increase in credit risk is significant increase in *Moody's* default and recovery rates (by 1 percentage point) and counterpart's inability to meet payment terms (overdue 30 days or more, insolvency or bankruptcy, or initiated similar legal proceedings and other indications on inability to pay). If significant increase in credit risk identified, calculated lifetime expected credit loss.

For estimation of expected credit loss for unsettled revenue on mandatory procurement PSO fee, individually significant other receivables and other receivables of energy industry companies and related parties the Group and the Parent Company apply the simplified approach and record lifetime expected losses based on corporate default and recovery rates.

Portfolio model is used for trade receivables by grouping together receivables with similar risk characteristics and the days past due and defined for basic business activities. For trade receivables grouped by portfolio model the Group and the Parent Company apply the simplified approach and record lifetime expected losses on receivables based on historical observed default rates, adjusted for forward-looking estimates.

Derivative financial instruments

Derivative financial instruments are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. The Group and the Parent Company have decided to continue to apply hedge accounting requirements of IAS 39. Accounting principles for derivative financial instruments are disclosed in Note 2.19.

b) Accounting policies applied until 31 December 2017

I) Classification

The Group and the Parent Company classified financial assets within the scope of IAS 39 as financial assets at fair value through profit or loss, loans and receivables, held–to–maturity investments and available–for–sale financial assets or as derivatives designated as hedging instruments in an effective hedge, as appropriate. Meanwhile financial liabilities were classified as trade and other payables, loans and borrowings, financial liabilities at fair value through profit or loss or derivatives designated as hedging instruments in an effective hedge, as appropriate (see 2.19.). The classification of financial assets and liabilities was determined at initial recognition.

II) Initial recognition and measurement

All financial assets were recognised initially at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss. The Group and the Parent Company classified it financial assets as loans and receivables, held–to–maturity investments, available–for–sale financial assets and as derivatives financial instruments (see 2.19.).

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) were recognised on the trade date, i.e., the date that the Group and the Parent Company committed to purchase or sell the asset.

All financial liabilities were recognised initially at fair value and, in the case of trade and other payables and loans and borrowings, net of directly attributable transaction costs.

III) Subsequent measurement

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets were classified as held for trading if they were acquired for the purpose of selling or repurchasing in the near term. Derivatives were also categorised as held for trading unless they were designated as hedges. Assets in this category were classified as current assets if expected to be settled within 12 months; otherwise, they were classified as non–current. Financial assets at fair value through profit or loss were carried in the statement of financial position at fair value with net changes in fair value presented as expense (negative net changes in fair value) or income (positive net changes in fair value) in the Statement of Profit or Loss. Financial assets designated upon initial recognition at fair value through profit or loss were designated at their initial recognition date and only if the criteria under IAS 39 were satisfied. The Group and the Parent Company has not designated any financial assets at fair value through profit or loss.

Derivatives embedded in host contracts were accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks were not closely related to those of the host contracts and the host contracts were not held for trading or designated at fair value though profit or loss. These embedded derivatives were measured at fair value with changes in fair value recognised in profit or loss.

Loans and receivables

Loans and receivables were non–derivative financial assets with fixed or determinable payments that were not quoted in an active market. After initial measurement, such financial assets were subsequently measured at amortised cost using the effective interest rate (hereinafter – EIR) method, less impairment. The losses arising from impairment were recognised in the Statement of Profit or Loss in other operating expenses for receivables.

Held–to–maturity investments

Listed, non–derivative financial assets with fixed or determinable payments and fixed maturities were classified as held to maturity when exists positive intention and ability to hold them to maturity. After initial measurement, held to maturity investments were measured at amortised cost using the EIR, less impairment. If the Group and the Parent Company were to sell other than an insignificant amount of held–to–maturity financial assets, the whole category would be tainted and reclassified as available for sale. Held–to–maturity financial assets with maturities more than 12 months from the end of the reporting period were included in non–current assets, however those with maturities less than 12 months from the end of the reporting period were classified as current assets.

The Group and the Parent Company followed the IAS 39 guidance on classifying non–derivative financial assets with fixed or determinable payments and fixed maturity as held–to–maturity. This classification required significant judgement. In making this judgement, the Group and the Parent Company evaluated its intention and ability to hold such investments to maturity.

Available–for–sale financial assets

Available–for–sale financial assets include equity instruments and debt securities. After initial measurement available–for–sale financial assets were subsequently measured at fair value with gains or losses recognised in other comprehensive income and credited in the available–for–sale financial assets reserve until the investment is derecognised. The Group and the Parent Company does not have such assets.

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. This category includes derivative financial instruments entered into by the Group and the Parent Company that were not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives were also classified as held for trading unless they were designated as effective hedging instruments. Gains or losses on liabilities held for trading were recognised in the Statement of Profit or Loss.

Loans and borrowings

Loans and borrowings were recognised initially at fair value. After initial recognition, interest bearing loans and borrowings were subsequently measured at amortised cost using the EIR method. Gains and losses were recognised in profit or loss when the liabilities were derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that were an integral part of the EIR. The EIR amortisation is included as finance costs in the Statement of Profit or Loss, except for the capitalised part. Borrowings were classified as current liabilities unless the Group and the Parent Company has an unconditional right to defer settlement of the liability at least for 12 months after the end of reporting period.

Trade and other payables

The Group's and the Parent Company's trade payables were recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

IV) De–recognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired,
- the Group and the Parent Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement; and either (a) the Group and the Parent Company has transferred substantially all the risks and rewards of the asset, or (b) the Group and the Parent Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability were substantially modified, such an exchange or modification is treated as the de–recognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the Statement of Profit or Loss.

2.17. RECEIVABLES FROM CONTRACTS WITH CUSTOMERS AND OTHER RECEIVABLES

Receivables from contracts with customers and other receivables are classified in groups:

- Energy and related services sales, including distribution system services,
- Heating sales,
- Other sales (IT & telecommunication services, connection service fees and other services),
- Receivables from subsidiaries,
- Other financial receivables.

Receivables from contracts with customers are recognised initially when they originated. Receivables without a significant financing component are initially measured at the transaction price.

After initial recognition receivables from contracts with customers are measured at amortised cost if they meet both of the following conditions:

- they are held within a business model whose objective is to hold assets to collect contractual cash flows;
- and their contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Group and the Company consider the evidence of impairment for the receivables from contracts with customers and other receivables at both an individual and a collective level. All individually significant receivables and receivables of energy industry companies and related parties are individually assessed for impairment. Those found not to be impaired are then collectively assessed for any impairment that has been incurred but not yet individually identified. Receivables that are not individually significant are collectively assessed for impairment using the portfolio model. Collective assessment is carried out by grouping together receivables with similar risk characteristics and the days past due. The Group and the Company have applied two expected credit loss models: portfolio model and counterparty model.

Under the portfolio model receivables from contracts with customers and other receivables are grouped as disclosed in Note 17 a.

The expected loss rates are based on the payment profiles of sales over a period of 2 years before 1 January 2018 and the corresponding historical credit losses experienced within this period. The Group and the Parent Company apply the IFRS 9 simplified approach to measuring expected credit losses of these receivables which uses a lifetime expected loss allowance (see Note 4 b).

For individually significant other receivables and other receivables of energy industry companies and related parties' receivables the counterparty model is used based on individual contract basis. The expected credit losses according to this model are based on assessment of the individual counterparty's risk of default based on *Moody's* corporate default and recovery rates for the relevant industry's entity.

2.18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash balances on bank accounts, demand deposits at bank and other short–term deposits with original maturities of three months or less. Cash and cash equivalents also are consisting of restricted cash, if it is readily convertible to cash.

2.19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The Group and the Parent Company use derivatives such as interest rate swaps, electricity forward and future contracts and natural gas swap contracts to hedge risks associated with the interest rate and purchase price fluctuations, respectively. The Group and the Parent Company have decided to continue to apply hedge accounting requirements of IAS 39 for derivatives.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re–measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate (see 2.20.).

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, on the nature / content of the item being hedged. Other derivatives are accounted for at fair value through profit or loss.

The Group and the Parent Company designate certain derivatives as hedges of a particular risk associated with highly probable forecasted transactions or variable rate borrowings (cash flow hedge). The Group and the Parent Company document at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group and the Parent Company also document their assessment, both at hedge inception and on an on–going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The fair value of the derivative instruments is presented as current or non–current based on settlement date. Derivative instruments that have maturity of more than twelve months and have been expected to be hold for more than twelve months after the end of the reporting year are classified as non–current assets or liabilities. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

a) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and accumulated in equity within ‘Hedging reserve’. The gain or loss relating to the ineffective portion, if such arise, would be recognised immediately in the Statement of Profit or Loss.

Amounts accumulated in equity are recognised in the Statement of Profit or Loss in the periods when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the Statement of Profit or Loss.

2.20. FAIR VALUE MEASUREMENT

The Group and the Parent Company measure financial instruments, such as, derivatives, at fair value at each balance sheet date. Non–financial assets such as investment properties are measured at amortised cost, but some items of property, plant and equipment at revalued amounts. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 24.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair values are estimated based on market prices and discounted cash flow models as appropriate.

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of reporting period. The quoted market prices used for financial assets held by the Group and the Parent Company are the actual closing prices.

The fair value of financial instruments that are not traded in active market is determined by using valuation techniques. The Group and the Parent Company use a variety of methods and make assumptions that are based on market conditions existing at each end of reporting period. Estimated discounted cash flows are used to determine fair value for the remaining financial instruments.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows using euro annual bond 6 month Euribor forward starting interest rate swap curve.

The fair value of electricity forward and future contracts and natural gas swap contracts is calculated as discounted difference between actual market and settlement prices multiplied by the volume of the agreement.

If counterparty is a bank, then fair values of financial instruments are obtained from corresponding bank’s revaluation reports and in financial statements fair values of financial instruments as specified by banks are disclosed. In case of electricity forward and future contracts and natural gas swap contracts are concluded with counterparties others than a bank; fair values as calculated by the Group and the Parent Company are disclosed in Financial Statements.

2.21. REVENUE RECOGNITION

REVENUE FROM CONTRACTS WITH CUSTOMERS (IFRS 15)

Revenue from contracts with customers in scope for IFRS 15 encompasses sold goods or services provided as output of the entity’s ordinary activities. The Group and Parent Company use the following criteria to identify contracts with customers:

- the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- each party’s rights regarding the goods or services to be transferred can be identified;
- the payment terms for the goods or services to be transferred can be identified;
- the contract has commercial substance (i.e. the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract);

- it is probable that the company will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In evaluating whether collectability of an amount of consideration is probable, the Group and the Parent Company use portfolio approach practical expedient for all energy and related supply services, distribution system services and heat sales customers. Group and the Parent Company reasonably expects that the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Collectability is assessed individually for other customers.

The Group and the Parent Company consider only the customer's ability and intention to pay that amount of consideration when it is due.

Performance obligations are promises in the contracts (either explicitly stated or implied) with Group's and the Parent Company's customers to transfer to the customers either distinct goods or services, or series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Promised goods or services represent separate performance obligations if the goods or services are distinct. A promised good or service is considered distinct if the customer can benefit from the good or service on its own or with other readily available resources (i.e. distinct individually) and the good or service is separately identifiable from other promises in the contract (distinct within the context of the contract). Both of these criteria must be met to conclude that the good or service is distinct.

Major distinct performance obligations identified in the contracts with customers by the Group and the Parent Company include sale of energy and related supply services, provision of distribution system services and sale of heat. Group has assessed that connecting a customer to the distribution grid as a separate performance obligation is not distinct as connection fees to distribution system are not distinct within the context of the contract due to being highly interrelated to sales of distribution services (Note 4 c III).

The Group and the Parent Company have further assessed that in providing Mandatory procurement PSO fees it is acting as an agent due to lack of control over PSO fee (Note 4 c I). The Parent Company has also concluded that it is acting as an agent in the provision of distribution system services and transmission system services because the Parent Company has no control over these services (Note 4 c II).

Where contracts with customers include variable consideration, the Group and the Parent Company estimate at contract inception the variable consideration expected over the life of the respective contracts and updates that estimate each reporting period. A constrained variable consideration is identified in relation to sales of distribution system services.

The Group and the Parent Company recognise revenue when (or as) it satisfies a performance obligation to transfer a promised good or service to a customer. Revenue is recognized when customer obtains control of the respective good or service.

The Group and the Parent Company use output method to measure progress towards complete satisfaction of a performance obligations. Revenue from sale of energy and related supply services, provision of distribution system services and sale of heat are recognised over time as a continuous delivery of these goods and services is made over the term of the respective contracts.

Revenue from satisfied performance obligations under such contracts is recognised over time, if one of the following criteria is met:

- customer simultaneously receives and consumes the benefits;
- customer controls the asset as it is created or enhanced;
- the Group's and Parent Company's performance does not create an asset with an alternative use and has a right to payment for performance completed.

Revenue from satisfaction of performance obligations is recognised based on identified transaction price. Transaction price reflects the amount to which the Group and the Parent Company have rights under the present contract. It is allocated to the distinct performance obligations based on standalone selling prices of the goods or services promised in the contract. The Group and the Parent Company allocate transaction price to the distinct performance obligations in proportion to their observable stand-alone selling prices and recognises revenue as those performance obligations are satisfied.

Payment terms for goods or services transferred to customers according to contract terms are within 20 to 45 days from the provision of services or sale of goods. Invoices are mostly issued monthly.

Revenue from contracts with customers is recognised as follows:

I) Revenue recognised over time

Trade of energy and related supply services

Revenue from electricity and natural gas sales are recognised on the basis of issued invoices to customers for supplied electricity on the basis of reported meter readings. Revenue from other energy and related supply services are recognised on the basis of goods delivered or provided services and prices included in contracts with customers. Revenues from trade of electricity in *Nord Pool* power exchange are based on the calculated market prices in accordance with contract terms, therefore 'right to invoice' practical expedient is used to recognise revenue from such contracts as the amount corresponds directly with the value of the performance completed to date.

Sales of distribution system services (the Group)

Revenues from electricity distribution services are based on regulated tariffs that are subject to approval by the Public Utilities Commission and regulations by Cabinet of Ministers of the Republic of Latvia 'Regulations on electricity trade and usage'. The Group recognises revenue from sales of distribution system services at the end of each month on the basis of the automatically made meter readings or customers' reported meter readings, on the period in which the services are rendered. Revenue is recognised in the amount for which the Group has right to invoice.

Heat sales

Revenue from sales of thermal energy is recognised at the end of each month on the basis of the meter readings and corresponds to the invoiced amount.

Connection fees to distribution system (the Group)

Connection fees to distribution system are non-refundable upfront fees paid by customers to secure connection to the distribution network, such fees are not distinct performance obligations as are highly interrelated with distribution system services. Connection fees partly reimburses for the cost of infrastructure to be built needed to connect the respective customer to the network. Connection fees to distribution system fee is calculated in accordance with Latvian regulatory authority (Public Utilities Commission) stated methodology.

Revenue from connection fees to distribution system are initially recognised as contract liabilities and recognised over the estimated customer relationship period of 20 years (Note 4 c III).

Sales of IT & telecommunication services

Other revenue (Note 6), mainly includes revenues derived from information technology services (internet connection services, data communication services), open electronic communication network and telecommunication services to customers. Revenues are recognised on the basis of invoices which are prepared for clients upon usage of services listed in telecommunications billing system. Revenue is recognised in the amount for which the Group and the Parent Company have right to invoice.

II) Revenue recognised applying agent accounting principle

Mandatory procurement PSO fees

Mandatory procurement PSO fees

Revenue from mandatory procurement public service obligation (PSO) fees in the Group is recognised on net (agent) basis. PSO fee is managed within the context of mandatory procurement process by subsidiary Enerģijas publiskais tirgotājs AS (hereinafter – EPT) and is the difference (residual) between the revenue from the sale of electricity in *Nord Pool* power exchange by market price, received mandatory procurement PSO fee, received government grant for compensating the increase of mandatory procurement costs and the related costs – costs of purchased electricity under the mandatory procurement from electricity producers, as well as guaranteed fees for installed electrical capacity in cogeneration plants. EPT is acting as agent in administration of the mandatory procurement process and receives revenue from mandatory procurement administration services (agent fee), which is recognised over time in the Group's Statement of Profit or Loss as "Other revenue" (Notes 6 and 4 c, I).

PSO fees are included in invoices issued by trader (Parent Company – Latvenergo AS) and by distribution system operator (Sadales tīkls AS) and are paid by customers together with unite invoice for electricity and distribution or transmission system services. System operators have the obligation to collect revenues of PSO fees from customers or traders and further to transfer these revenues to EPT. PSO fees are based on regulated tariffs that are subject to approval by the Public Utilities Commission. Due to lack of influence and control over PSO fees, the Group and the Parent Company consider themselves an agent in these transactions. Therefore, PSO fees obtained from electricity end-users and transferred to EPT are recognised in the Statement of Profit or Loss in net amount by applying the agent accounting principles (Note 6, Note 4 c, I).

Distribution system and transmission system services (Parent Company)

The Parent Company on behalf of distribution system operator (DSO) and transmission system operator (TSO) issues unite invoice including the fees for the distribution system or transmission system services, and transfers these fees to DSO or TSO accordingly.

Distribution system services and transmission system services are based on regulated tariffs that are subject to approval by the Public Utilities Commission. The Parent Company considers itself an agent in these transactions, therefore, the fees for distribution system and transmission system services obtained from customers and transferred to DSO and TSO are recognised in the Statement of Profit or Loss in net amount by applying the agent accounting principles (Note 4 c, II).

REVENUE FROM OTHER SOURCES

Lease of transmission system assets (IAS 17) (Group)

Revenues from lease of transmission system assets are recognised on the basis of lease payment amount which are calculated for transmission system operator accordingly to determined fee per lease agreement and recognised on a straight–line basis over term of the lease. Concluded agreements on the lease of transmission system assets meet IAS 17 ‘Leases’ criteria that is used for revenue recognition from lease. Revenue is disclosed per Note 6 and 14 e.

Connection fees to transmission system (IAS 17) (Group)

Revenue from connection fees to transmission system are within the scope of IAS 17. Connection fees to transmission system are received as upfront payments from lessee under operating lease agreement. Upfront payments are recognised as deferred income (Note 27).

Connection fees to transmission system are carried in the Statement of Financial Position as deferred income and amortised to Statement of Profit or Loss on a straight–line over basis estimated lease period (see Note 4 f).

Electricity connection fees to transmission system are recognised by the Group based on the necessity for a connection to the transmission network based on the request of lessee, which acts on behalf of users. For each connection fee a separate arrangement within the base lease agreement is concluded. Connection fee to transmission system partly reimburses the cost of infrastructure to be built and is needed for connection of transmission system user to the network. Connection service fee to transmission system is calculated in accordance with Latvian regulatory authority (Public Utilities Commission) stated methodology.

2.22. DIVIDEND DISTRIBUTION

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

2.23. INCOME TAX

Corporate income tax includes current and deferred taxes.

a) Corporate income tax

Latvia

Legal entities are not required to pay income tax on earned profits starting from 1 January 2018 in accordance with amendments made to the Corporate Income Tax Law of the Republic of Latvia issued on 28 July 2017. Corporate income tax is paid on distributed profits and deemed profit distributions. Consequently, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits. Both distributed profits and deemed profit distributions are subject to the tax rate of 20% of their gross amount, or 20/80 of net expense. Corporate income tax on dividends is recognised in the statement of profit or loss as expense in the reporting period when respective dividends are declared, while, as regards other deemed profit distribution items, at the time when expense is incurred in the reporting year.

Lithuania

Current corporate income tax is applied at the rate of 15% on taxable income generated by a company during the taxation period.

Income tax expense for the period comprises current income tax and deferred income tax. Current income tax charges are calculated on current profit before tax using the tax rate 15% in accordance with applicable tax regulations as adjusted for certain non–deductible expenses/non–taxable income and are based on the taxable income reported for the taxation period.

Estonia

Under the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Corporate income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non–business related disbursements and adjustments of the transfer price. The tax rate on the net dividends paid out of retained earnings is 20/80. In certain circumstances, it is possible to distribute dividends without any additional income tax expense. The corporate income tax arising from the payment of dividends is accounted for as a liability and expense in the period in which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

b) Deferred income tax

Latvia

Following the amendments to the tax legislation of the Republic of Latvia effective from 1 January 2018 deferred tax liability is recognised in the consolidated financial statements on undistributed profits of the subsidiaries which has been generated as of 1 January 2018 and which will be subject to taxation upon distribution in foreseeable future. No other deferred tax assets and liabilities are recognised. Accordingly, deferred tax liabilities which have been calculated and recognised before the year 2017, in 2017 were reversed through the current statement of profit or loss or other comprehensive income (depending on whether the original entry was recorded in the statement of profit or loss or other comprehensive income) in the financial statements for the year ended 31 December 2017, as it is laid down in the IAS 12, changes in the tax legislation must be presented in financial statements in the period when they are adopted (Note 12).

Lithuania

Deferred income tax is provided in full, using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted by the end of reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit of the respective Group entity will be available against which the temporary differences can be utilised.

Estonia

Due to the nature of the taxation system, the entities registered in Estonia do not have any differences between the tax bases of assets and liabilities and their carrying amounts and hence, no deferred income tax assets and liabilities arise.

2.24. SUBSIDISED ENERGY TAX

In order to limit the increase of the mandatory procurement public service obligation (PSO) fee for electricity consumers in Latvia, a Subsidised Energy Tax (SET) had been introduced for a four–year period as of 1 January 2014, which was applied to state support for generators of subsidised electricity. The SET applied both to income from electricity supplied under the mandatory procurement process as well as to mandatory procurement capacity payments for installed capacity at cogeneration plants, achieved from 1 January 2014 till 31 December 2017. SET applied for the subsidised electricity produced was recognised in the Statement of Profit or Loss as ‘Other operating expenses’ (Note 10) at gross amount.

2.25. RELATED PARTIES

The parties are considered related when one party has a possibility to control the other one or has significant influence over the other party in making financial and operating decisions. Related parties of the Group and the Parent Company are Shareholder of the Company who controls the Company in accepting operating business decisions, members of Latvenergo Group entities' management boards, members of the Supervisory board of the Company, members of Supervisory body of the Company – the Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence.

As the shares of Latvenergo AS belong 100% to the Republic of Latvia, the related parties also include entities under the control or significant influence of the state (Note 28).

2.26. SHARE CAPITAL

The Group's share capital consists of the Parent Company's ordinary shares. All shares have been fully paid.

2.27. EVENTS AFTER THE REPORTING PERIOD

Events after the reporting period that provide significant additional information about the Group's and the Parent Company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Events after the reporting period that are not adjusting events are disclosed in the notes when material.

2.28. CHANGES IN ACCOUNTING POLICIES

The Group and the Parent Company have applied IFRS 9 *Financial instruments*, except for hedge accounting, for the first time in the 2018 financial statements with initial application date: 1 January 2018. IFRS 9 was adopted without restating comparative information, the reclassifications and the adjustments arising from new impairment rules are therefore recognised in the opening balance of statement of financial position on 1 January 2018 and the impact of the IFRS 9 adoption has been only recognised for the new impairment requirements based on the expected credit loss model. Reclassification of financial instruments into the IFRS 9 categories had no impact on their respective measurement basis and therefore no adjustment to retained earnings related to classification and measurement as of 1 January 2018 was recognised.

All relevant figures in the financial statements for the year ended 31 December 2018 have been presented in accordance with IFRS 9.

The following tables show the adjustments recognised for each individual line item. Line items that were not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided.

Impact on Statement of Financial Position upon adoption of IFRS 9:

EUR'000

Statement of Financial Position (extract)	Measurement category		Group				Parent Company			
	Original (IAS 39)	New (IFRS 9)	31/12/2017	Effect on IFRS 9 adoption	Positions reclassified	01/01/2018	31/12/2017	Effect on IFRS 9 adoption	Positions reclassified	01/01/2018
ASSETS										
Non–current assets										
Non–current financial investments	Available for sale	FVOCI	40	–	–	40	39	–	–	39
Non–current loans to related parties	Loans and receivables	Amortised cost	–	–	–	–	397,976	(271)	–	397,705
Other non–current receivables	Loans and receivables	Amortised cost	3,229	(4)	–	3,225	284	–	–	284
Investments in held–to–maturity financial assets	Held–to–maturity	–	16,984	–	(16,984)	–	16,984	–	(16,984)	–
Investments in other financial assets	–	Amortised cost	–	–	16,984	16,984	–	–	16,984	16,984
TOTAL non–current assets			**3,343,404**	**(4)**	**–**	**3,343,400**	**2,546,014**	**(271)**	**–**	**2,545,743**
Current assets										
Receivables from contracts with customers	Loans and receivables	Amortised cost	105,369	(122)	–	105,247	82,799	(115)	–	82,684
Other current receivables	Loans and receivables	Amortised cost	646,761	(164)	–	646,597	18,079	1	–	18,080
Current loans to related parties	Loans and receivables	Amortised cost	–	–	–	–	700,805	(244)	–	700,561
Derivative financial instruments*	Hedging derivatives at FVOCI	Hedging derivatives at FVOCI	4,074	–	–	4,074	4,074	–	–	4,074
	Derivatives at FVPL	Derivatives at FVPL	545	–	–	545	545	–	–	545
Cash and cash equivalents	Loans and receivables	Amortised cost	236,003	–	–	236,003	232,855	–	–	232,855
TOTAL current assets			**1,072,321**	**(286)**	**–**	**1,072,035**	**1,103,186**	**(358)**	**–**	**1,102,828**
TOTAL ASSETS			**4,415,725**	**(290)**	**–**	**4,415,435**	**3,649,200**	**(629)**	**–**	**3,648,571**
EQUITY										
Retained earnings			423,613	(290)	–	423,323	302,017	(629)	–	301,388
TOTAL equity			**2,846,891**	**(290)**	**–**	**2,846,601**	**2,382,638**	**(629)**	**–**	**2,382,009**
LIABILITIES										
Non–current liabilities										
Borrowings	Amortised cost	Amortised cost	718,674	–	–	718,674	710,125	–	–	710,125
Derivative financial instruments*	Hedging derivatives at FVOCI	Hedging derivatives at FVOCI	4,914	–	–	4,914	4,914	–	–	4,914
TOTAL non–current liabilities			**1,238,556**	**–**	**–**	**1,238,556**	**1,009,959**	**–**	**–**	**1,009,959**
Current liabilities										
Borrowings	Amortised cost	Amortised cost	108,083	–	–	108,083	104,647	–	–	104,647
Trade and other payables	Amortised cost	Amortised cost	96,489	–	–	96,489	69,753	–	–	69,753
Derivative financial instruments*	Hedging derivatives at FVOCI	Hedging derivatives at FVOCI	3,147	–	–	3,147	3,147	–	–	3,147
	Derivatives at FVPL	Derivatives at FVPL	23	–	–	23	23	–	–	23
Other current liabilities	Amortised cost	Amortised cost	12,787	–	–	12,787	6,197	–	–	6,197
TOTAL current liabilities			**330,278**	**–**	**–**	**330,278**	**256,603**	**–**	**–**	**256,603**
TOTAL EQUITY AND LIABILITIES			**4,415,725**	**(290)**	**–**	**4,415,435**	**3,649,200**	**(629)**	**–**	**3,648,571**

* The Group and the Parent Company have decided to continue to apply hedge accounting requirements of IAS 39

While other non–current financial debt investments in State Treasury bonds are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial as these debt investments are considered by the management to have low credit risk because the issuer has a strong capacity to meet its contractual cash flow obligations in the near term and an investment grade credit rating with at least one major rating agency.

While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial, considering also fact that almost all of cash and cash equivalents are held in financial institutions with the credit rating grade of the institution or its parent bank at investment grade credit rating (mostly 'A level' credit rating).

3. FINANCIAL RISK MANAGEMENT

3.1. FINANCIAL RISK FACTORS

The Group's and the Parent Company's activities expose them to a variety of financial risks: market risk (including currency risk, fair value and cash flow interest rate risk), credit risk, price risk and liquidity risk. The Group's and the Parent Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's and the Parent Company's financial performance. The Group and the Parent Company use derivative financial instruments to hedge certain risk exposures.

Risk management (except for price risk) is carried out by the Parent Company's Treasury department (the Group Treasury) according to the Financial Risk Management Policy approved by the Parent Company's Management Board. The Group Treasury identifies, evaluates and hedges financial risks in close co–operation with the Group's operating units / subsidiaries. The Parent Company's Management Board by approving the Financial Risk Management Policy provides written principles for overall risk management, as well as written policies covering specific areas, such as interest rate risk, foreign exchange risk, liquidity risk, and credit risk, use of financial instruments and investment of excess liquidity. Price risk management is carried out by the Parent Company's Electricity Trading department according to Electricity Wholesale Regulation approved by the Parent Company's Management Board.

Financial assets and financial liabilities that are exposed to financial risks disclosed in the table below by measurement categories:

EUR'000

		Group			Parent Company		
	Notes	Financial assets at amortised cost	Hedging derivatives at FVOCI	Derivatives at FVPL	Financial assets at amortised cost	Hedging derivatives at FVOCI	Derivatives at FVPL
Financial assets as of 31 December 2018							
Receivables from contracts with customers	17 a	117,955	–	–	81,025	–	–
Other current receivables	17 b	84,613	–	–	14,233	–	–
Loans to related parties	28 e	–	–	–	765,815	–	–
Other non-current receivables	17 b	30,920	–	–	331	–	–
Derivative financial instruments	23 l	–	15,748	105	–	15,748	105
Other financial investments	21	16,935	–	–	16,935	–	–
Cash and cash equivalents	18	129,455	–	–	127,554	–	–
		379,878	**15,748**	**105**	**1,005,893**	**15,748**	**105**
Financial assets as of 31 December 2017							
Receivables from contracts with customers	17 a	105,369	–	–	82,799	–	–
Other current receivables	17 b	641,832	–	–	17,938	–	–
Loans to related parties	28 e	–	–	–	1,098,781	–	–
Other non-current receivables	17 b	3,229	–	–	284	–	–
Derivative financial instruments	23 l	–	4,074	545	–	4,074	545
Held–to–maturity financial assets	21	16,984	–	–	16,984	–	–
Cash and cash equivalents	18	236,003	–	–	232,855	–	–
		1,003,417	**4,074**	**545**	**1,449,641**	**4,074**	**545**
Financial liabilities as of 31 December 2018							
Borrowings	22	814,343	–	–	802,268	–	–
Derivative financial instruments	23 l	–	10,204	–	–	10,204	–
Trade and other financial current payables	25	103,707	–	–	78,726	–	–
		918,050	**10,204**	**–**	**880,994**	**10,204**	**–**
Financial liabilities as of 31 December 2017							
Borrowings	22	826,757	–	–	814,772	–	–
Derivative financial instruments	23 l	–	8,061	23	–	8,061	23
Trade and other financial current payables	25	115,742	–	–	79,341	–	–
		942,499	**8,061**	**23**	**894,113**	**8,061**	**23**

a) Market risk

I) Foreign currencies exchange risk

As of 31 December 2018 and 31 December 2017 the Group and the Parent Company had borrowings denominated only in euros (Note 22). Their revenues and most of the financial assets and liabilities were denominated in euros. Accordingly, neither the Group or the Parent Company were subject to a significant foreign currencies exchange risk.

Foreign currencies exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency that is not the Group's and the Parent Company's functional currency.

The Group Treasury's Financial Risk Management Policy is to hedge all anticipated cash flows (capital expenditure and purchase of inventory) in each major foreign currency that might create significant currency risk. During 2018 and 2017 the Group and the Parent Company had no capital expenditure project which expected transactions would create significant currency risk.

II) Cash flow and fair value interest rate risk

As the Group and the Parent Company have significant floating interest–bearing assets and liabilities exposed to interest rate risk, the Group's and the Parent Company`s financial income and operating cash flows are substantially dependent on changes in market interest rates.

During 2018, if euro interest rates had been 50 basis points higher with all other variables held constant, the Group's income from the cash reserves held at bank for the year would have been EUR 875 thousand higher (2017: EUR 994 thousand) and the Parent Company's income from the cash reserves held at bank for the year would have been EUR 860 thousand higher (2017: EUR 986 thousand).

The Group's and the Parent Company's cash flow interest rate risk mainly arises from long–term borrowings at variable rates. They expose the Group and the Parent Company to a risk that finance costs might increase significantly when interest rates rise up. The Group's policy is to maintain at least 35% of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between 2–4 years.

The Group and the Parent Company analyse their interest rate risk exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and hedging. Based on these scenarios, the Group and the Parent Company calculate the impact on profit and loss as well as on cash flows of a defined interest rate shift.

Generally, the Group and the Parent Company raise long–term borrowings at floating rates and based on the various scenarios, the Group and the Parent Company manage their cash flow interest rate risk by using floating–to–fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Thereby fixed rates are obtained that are lower than those available if the Group and the Parent Company borrowed at fixed rates directly. Under the interest rate swaps, the Group and the Parent Company agree with other parties to exchange, at specified intervals (primarily semi–annually), the difference between fixed contract rates and floating–rate interest amounts calculated by reference to the agreed notional amounts.

To hedge cash flow interest rate risk, the Group and the Parent Company have entered into interest rate swap agreements with total notional amount of EUR 225.1 million (2017: EUR 193.5 million) (Note 23 II). 53% of the total Group's and 54% the Parent Company's borrowings as of 31 December 2018 (31/12/2017: 54% and 55% respectively) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration was 2.1 years for the Group and the Parent Company (2017: 2.0 years for the Group and the Parent Company respectively).

If interest rates on euro denominated borrowings at floating base interest rate (after considering hedging effect) had been 50 basis points higher with all other variables held constant over the period until the next annual report, the Group's profit for the year would have been EUR 1,999 thousand lower (over the next 12 months period after 31/12/2017: EUR 1,750 thousand), the Parent Company's profit for the year would have been EUR 1,946 thousand lower (over the next 12 months period after 31/12/2017: EUR 1,690 thousand).

The borrowings with floating rates do not impose fair value interest rate risk. Derivatives such as interest rate swaps are the source of fair value interest rate risk.

As of 31 December 2018, if short and long term euro interest rates had been 50 basis points higher with all other variables held constant fair value of interest rate swaps would have been EUR 4,649 thousand higher (31/12/2017: EUR 51 thousand higher), which would have been attributable to the Statement of Comprehensive Income as hedge accounting item. However, if short and long term euro interest rates had been 50 basis points lower with all other variables held constant fair value of interest rate swaps would have been EUR 4,834 thousand lower (31/12/2017: EUR 51 thousand lower), which would have been attributable to the Statement of Comprehensive Income as hedge accounting item.

III) Price risk

Price risk is the risk that the fair value and cash flows of financial instruments will fluctuate in the future due to reasons other than changes in the market prices resulting from interest rate risk or foreign exchange risk. The purchase and sale of goods produced and the services provided by the Group and the Parent Company under the free market conditions, as well as the purchases of resources used in production is impacted by the price risk.

The most significant price risk is related to purchase of electricity and natural gas. To hedge the risk related to changes in the price of electricity and natural gas the Parent Company during 2018 and 2017 has purchased electricity forward and future contracts and during 2018 natural gas forward contracts (Note 23 III, IV).

b) Credit risk

Credit risk is managed at the Group level. Credit risk arises from cash and cash equivalents, favourable derivative financial instruments and at fair value through profit or loss (FVPL), deposits with banks, financial assets carried at amortised cost, including outstanding receivables. Credit risk exposure in connection with receivables is limited due to broad range of the Group's and the Parent Company's customers. The Group and the Parent Company have no significant concentration of credit risk with any single counterparty or group of counterparties having similar characteristics, except receivables from state for unsettled revenue on mandatory procurement PSO fee, loans to and receivables from subsidiaries and receivables from transmission system operator (Augstsprieguma tīkls AS). When assessing the credit risk for the loans to subsidiaries for the Parent Company, it is taken into account that Latvenergo AS has granted loans to subsidiaries in which it holds all the shares, and accordingly monitors the operations and financial situation of the subsidiaries (borrowers). Impairment loss has been deducted from gross amounts.

The maximum credit risk exposure related to financial assets (see table below) comprises of carrying amounts of cash and cash equivalents (Note 18), receivables from contracts with customers and other receivables (Note 17), derivative financial instruments (Note 23) and other financial investments previously classified as held–to–maturity financial assets (Note 21).

Assessment of maximum possible exposure to credit risk:

EUR'000

	Notes	Group		Parent Company	
		31/12/2018	31/12/2017	31/12/2018	31/12/2017
Receivables from contracts with customers	17 a	117,955	105,369	81,025	82,799
Other non-current financial receivables	17 b	30,920	3,229	331	284
Other current financial receivables	17 b	84,613	641,832	14,233	17,938
Loans to subsidiaries	28 e	–	–	765,815	1,098,781
Cash and cash equivalents	18	129,455	236,003	127,554	232,855
Derivative financial instruments	23	15,853	4,619	15,853	4,619
Other financial investments	21	16,935	–	16,935	–
Held-to-maturity financial assets	21	–	16,984	–	16,984
		395,731	**1,008,036**	**1,021,746**	**1,454,260**

In the prior year, the impairment of trade receivables was assessed based on the incurred loss model under IAS 39. Under IFRS 9 the Group and the Company measure the probability of default upon initial recognition of a receivable and at each balance sheet date consider whether there has been a significant increase of credit risk since the initial recognition (see Notes 2.16. and 2.17.)

For banks and financial institutions, independently rated parties with own or parent bank's minimum rating of investment grade are accepted. Otherwise, if there is no independent rating, management performs risk control to assess the credit quality of the financial counterparty, taking into account its financial position, past co–operation experience and other factors. After performed assessment individual credit limits are set based on internal ratings in accordance with principles set by the Financial Risk Management Policy. The basis for estimating the credit quality of individually significant financial assets not past due is credit ratings assigned by the rating agencies or, in their absence, the earlier credit behaviour of clients and other parties to the contract.

Credit risk related to cash and short–term deposits with banks is managed by balancing the placement of financial assets in order to maintain the possibility to choose the best offers and to reduce probability to incur losses.

The table below shows the balance of cash and cash equivalents by financial counterparties at the end of the reporting period:

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Investment level credit rating*	126,483	227,686	124,582	224,538
No or non-investment level credit rating	2,972	8,317	2,972	8,317
	129,455	**236,003**	**127,554**	**232,855**

* Investment level credit rating assigned for the parent companies of banks

Set limits of credit exposure to the financial counterparties were not exceeded during the reporting period, and the Group and the Parent Company management does not expect any losses arising from a potential default of financial counterparty, financial counterparties are in Stage 1.

The Group and the Parent Company invest only in listed debt instruments with very low probability of default (State Treasury bonds).

c) Liquidity risk

Latvenergo Group's liquidity and cash flow risk management policy is to maintain a sufficient amount of cash and cash equivalents (Note 18) and the availability of long and short-term funding through an adequate amount of committed credit facilities in order to meet existing and expected commitments and compensate for fluctuations in cash flows due to the occurrence of a variety of financial risks.

The table below analyses the Group's and the Parent Company's financial liabilities into relevant maturity groupings based on the settlement terms. The amounts disclosed in the table are the contractual undiscounted cash flows. Contractual undiscounted cash flows originated by the borrowings are calculated taking into account the actual interest rates at the end of the reporting period.

Liquidity analysis (contractual undiscounted gross cash flows)

EUR'000

	Group					Parent Company				
	Less than 1 year	From 1 to 2 years	From 3 to 5 years	Over 5 years	TOTAL	Less than 1 year	From 1 to 2 years	From 3 to 5 years	Over 5 years	TOTAL
As of 31 December 2018										
Borrowings from banks	116,989	159,053	250,342	214,090	**740,474**	114,241	154,751	246,134	212,846	**727,972**
Issued debt securities (bonds)	2,880	37,769	104,228	–	**144,877**	2,880	37,769	104,228	–	**144,877**
Derivative financial instruments	14,362	2,864	2,708	(1,145)	**18,789**	14,362	2,864	2,708	(1,145)	**18,789**
Trade and other current financial payables (Note 25) *	103,707	–	–	–	**103,707**	78,726	–	–	–	**78,726**
	237,938	**199,686**	**357,278**	**212,945**	**1,007,847**	**210,209**	**195,384**	**353,070**	**211,701**	**970,364**
As of 31 December 2017										
Borrowings from banks	113,285	119,074	313,149	191,748	**737,256**	109,727	117,985	310,411	194,733	**732,856**
Issued debt securities (bonds)	2,880	2,880	142,041	–	**147,801**	2,880	2,880	142,041	–	**147,801**
Derivative financial instruments	5,304	5,077	3,273	318	**13,972**	5,304	5,077	3,273	318	**13,972**
Trade and other current financial payables (Note 25) *	115,742	–	–	–	**115,742**	79,341	–	–	–	**79,341**
	237,211	**127,031**	**458,463**	**192,066**	**1,014,771**	**197,252**	**125,942**	**455,725**	**195,051**	**973,970**

* Excluding advances received, deferred income, tax related liabilities and other non–current or current non–financial payables

3.2. CAPITAL RISK MANAGEMENT

The Group's and the Parent Company's objectives when managing capital are to safeguard the Group's and Parent Company's ability to continue as a going concern as well as to ensure necessary financing for investment program and to avoid breaches of covenants (no breaches in 2018 nor 2017), which are linked to capital structure and are stipulated in the majority of loan agreements.

In order to maintain or adjust the capital structure, the Group and the Parent Company may evaluate the amount and timing of raising new debt due to investment programs or initiate new investments in the share capital by shareholder. Also asset revaluation directly influences the capital structure. To comply with loan covenants, the Group and the Parent Company monitor capital on the basis of the capital ratio.

This ratio is calculated by dividing the equity by the sum of total assets and nominal value of issued and outstanding financial guarantees. According to the Group's strategy and defined loan covenants as per loan agreements the capital ratio shall be maintained at least at 30% level.

The capital ratio figures were as follows:

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Total equity	2,320,065	2,846,891	1,993,823	2,382,638
Total assets	3,798,819	4,415,725	3,141,109	3,649,200
Capital Ratio	**61%**	**64%**	**63%**	**65%**

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgments are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group and the Parent Company make estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

a) Estimates concerning property, plant and equipment

I) Useful lives of property, plant and equipment

The Group and the Parent Company make estimates concerning the expected useful lives and residual values of property, plant and equipment. These are reviewed at the end of each reporting period and are based on the past experience as well as industry practice. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. Values of fully depreciated property, plant and equipment are disclosed in Note 14 a. Quantifying an impact of potential changes in the useful lives is deemed impracticable therefore sensitivity analysis is not disclosed.

II) Recoverable amount of property, plant and equipment

The Group and the Parent Company perform impairment tests for items of property, plant and equipment when the events and circumstances indicate a potential impairment. For the items of PPE the following separate cash–generating units are defined – the distribution system assets, transmission system assets, assets of HPPs (Riga, Plavinu, Keguma and Aiviekste HPPs) and assets of Latvenergo combined heat and power plants as disclosed in Note 14 d. According to these tests assets are written down to their recoverable amounts, if necessary. When carrying out impairment tests management uses various estimates for the cash flows arising from the use of the assets, sales, maintenance and repairs of the assets, as well as in respect of the inflation and discount rates. The estimates are based on the forecasts of the general economic environment, consumption and the estimated sales price of electricity. If the situation changes in the future, either additional impairment could be recognised, or the previously recognised impairment could be partially or fully reversed. Such factors as high maintenance and reconstruction costs, low load of several auxiliaries, comparatively substantial maintenance expense, limited facilities to sell property, plant and equipment in the market and other essential factors have an impact of decreasing of the recoverable amounts. Impairment charges recognised during the current reporting year are disclosed in Note 14 d.

III) Revaluation

Revaluation for part of the Group's and the Parent Company's property, plant and equipment is performed by independent, external and certified valuers by applying the depreciated replacement cost model or income method. Valuation has been performed according to international standards on property valuation, based on current use of property, plant and equipment that is estimated as the most effective and best use of these assets. As a result of valuation, depreciated replacement cost was determined for each asset. Depreciated replacement cost is difference between the cost of replacement or renewal of similar asset at the time of revaluation and the accumulated loss of an asset's value that encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence. Physical depreciation was determined proportionally to the age of the property, plant and equipment item. In assessment for property, plant and equipment items for which a reconstruction is planned in the near future additional functional depreciation was assessed. Remaining useful lives of property, plant and equipment items after revaluation were estimated according to estimated total depreciation. Income method is based on the identification and analysis of generation capacity, forecasting of electricity trade prices, analysis of historical generation and operating expenses and forecast of future costs, capital expenditure, net cash flows, as well calculation of discount and capitalisation rates, based on market data.

For detailed most recent revaluation results see Note 14 c.

b) Impairment of financial assets

Until 31 December 2017 the estimated collectability of accounts receivable was assessed under IAS 39 on the basis of receivables from contracts with customers aging analysis according to estimates defined by the Group entities management and the Parent Company's management based on the incurred loss model. In case individual assessment was not possible due to the large number of individual balances, receivables were classified into three groups of similar credit risk characteristics (electricity, natural gas trade and related services receivables, heating and other receivables from contracts with customers and receivables from subsidiaries) and were collectively assessed for impairment, using historical loss experience. Historical loss experience was 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 was based and to remove the effects of conditions in the historical period that did not exist currently. The circumstances indicating an impairment loss may include initiated insolvency of the debtor and inability to meet payment terms.

Since 1 January 2018 the Group and the Parent Company have six types of financial assets that are subject to the expected credit loss model:

- non-current and current loans to related parties (the Parent Company)
- other non-current receivables
- other financial investments
- receivables from contracts with customers
- other current receivables
- cash and cash equivalents.

The loss allowances for financial assets are based on assumptions about risk of default and expected loss rates. The Group and the Company uses judgement in making these assumptions and selecting the inputs to the impairment calculation, based on the Group's and the Company's past history, existing market conditions as well as forward looking estimates at the end of each reporting period.

The Group and the Parent Company apply two expected credit loss models: portfolio model and counterparty model (Note 2.16.)

Using the portfolio model the Group and the Parent Company apply the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for trade receivables of basic business activities (electricity, natural gas and heat and supporting services sales, IT and telecommunication services sales). To measure expected credit losses these receivables have been grouped based on shared credit risk characteristics and the days past due. The Group and the Parent Company therefore have concluded that the expected loss rates for these receivables are a reasonable approximation of the credit risk exposure. The expected loss rates are based on the payment profiles of sales over a period of 2 years before 1 January 2018 and the corresponding historical credit losses experienced within this period. There are no adjustments made to the historical loss rates that would reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables as the Group and the Parent Company have assumed that macroeconomic factors, such as GDP or the unemployment rates in Latvia have insignificant impact on expected credit loss as macroeconomic projections foresee stable outlook of these indicators.

Counterparty model is used on individual contract basis for non-current and current loans to subsidiaries, other financial investments and cash and cash equivalents. If no significant increase in credit risk is identified, the expected credit losses according to this model are based on assessment of the individual counterparty's or counterparty's industry risk of default and recovery rate assigned by *Moody's* credit rating agency for 12 months expected losses rates. The circumstances indicating a significant increase in credit risk is significant increase in *Moody's* default and recovery rates (by 1 percentage point) and counterpart's inability to meet payment terms (overdue 30 days or more, insolvency or bankruptcy, or

initiated similar legal proceedings and other indications on inability to pay). If significant increase in credit risk identified, calculated lifetime expected credit loss.

Counterparty model also used for non-current receivables, individually significant receivables, receivables of energy industry companies and related parties by calculating lifetime expected losses based on corporate default and recovery rates.

All of the Group's and the Parent Company's other financial investments measured at amortised cost (investments in State Treasury bonds) do not have significant increase in credit risk and are considered to have low credit risk (*Moody's* credit rating – A3) and are in Stage 1, the loss allowance therefore was immaterial and wasn't recognised.

While cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial, considering also fact that fact that almost all of cash and cash equivalents are held in financial institutions with the credit rating grade of the institution or its parent bank at investment grade credit rating (mostly 'A level' credit rating) (Stage 1).

c) Estimates concerning revenue recognition from contracts with customers

I) Recognition of mandatory procurement PSO fees

The Group and the Parent Company have applied significant judgement for use of agent principle for recognition of mandatory procurement PSO fee (see also Note 2.21.).

Management has considered following indicators that the Group and the Parent Company are acting as agents because:

- do not have control over the mandatory procurement PSO fee before transferring to the customer;
- have duty for including the mandatory procurement PSO fee in invoices issued to the end customers, but are not entitled for revenues from mandatory procurement PSO fee. These fees are determined by state support mechanism and are covered by all electricity end-users in proportion to their electricity consumption;
- have no discretion in establishing mandatory procurement PSO fees price, either directly or indirectly;
- do not have exposure to rewards associated with mandatory procurement PSO fees.

II) Recognition of distribution system services and transmission system services (Parent Company)

Management has evaluated that it does not have influence and control over distribution system services and transmission system services, therefore the Parent Company acts as an agent. In particular, Management has considered the following indicators that the Parent Company is acting as an agent because:

- does not control provision of distribution system and transmission system services;
- includes the distribution system and transmission system services in invoices issued to the customers on behalf of distribution system operator or transmission system operator and receives payment, but is not entitled to the respective revenues;
- has no discretion in distribution system or transmission system services price, either directly or indirectly (see also Note 2.21.).

III) Recognition of connection service fees to distribution system (Group)

Connection fees to distribution system are not considered as separate (distinct) performance obligations, as are not distinct individually or within the context of the contract. Sales of distribution services are provided after customers have paid for the network connection, therefore network connection fees and sales of distribution services are highly interdependent and interrelated.

Income from connection and other income for reconstruction of distribution system assets on demand of clients are deferred as an ongoing service is identified as part of agreement to provide distribution system services with customers (Note 2.21) and accounted as deferred income from contracts with customers under IFRS 15 (see Note 27). Connection fees are recognised as income over the estimated customer relationship period. Based on Management estimate, 20 years is the estimated customer relationship period, which is estimated as period after which requested power output for connection object could significantly change due to technological reasons.

Thus period over which revenue is recognised is based on Management estimate, as it is reasonably certain that assets, whose costs are partly reimbursed by connection service fees, will be used to provide distribution system services for a longer period than the term stated in agreement with the customer (Note 2.21).

d) Recognition and reassessment of provisions

As of 31 December 2018, the Group had set up provisions for environmental protection, post–employment benefits and termination benefits totalling EUR 21.0 million (31/12/2017: EUR 25.3 million) and the Parent Company in amount of EUR 9.0 million (31/12/2017: EUR 9.7 million) (Note 26). The amount and timing of the settlement of these obligations is uncertain. A number of assumptions and estimates have been used to determine the present value of provisions, including the amount of future expenditure, inflation rates, and the timing of settlement of the expenditure. The actual expenditure may also differ from the provisions recognised as a result of possible changes in legislative norms, technology available in the future to restore environmental damages, and expenditure covered by third parties. For revaluation of provisions for post–employment obligations probabilities of retirement in different employees' aging groups as well as variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts) have been estimated. The probabilities and other factors are determined on the basis of previous experience. According to defined development directions per Strategy of Latvenergo Group for the period 2017-2022, the management of the Parent Company approved the Strategic Development and Efficiency Programme. Provisions for employees' termination benefits are recognised on a basis of Strategic Development and Efficiency Programme of Latvenergo Group for the period in which it is planned to implement the efficiency program (including Latvenergo AS and Sadales tīkls AS efficiency activities), by which it is intended to reduce gradually the number of employees by the year 2022. The key assumptions made to determine the amount of provisions are provided in Note 26.

e) Evaluation of effectiveness of hedging instruments

The Group and the Parent Company have concluded significant number of forward and future contracts and swap agreements to hedge the risk of the changes in prices of electricity and natural gas as well as interest rate fluctuations to which cash flow risk hedge accounting is applied and the gains and losses from changes in the fair value of the effective hedging instruments and items secured against risk are included in respective equity reserve. The evaluation of the effectiveness of the hedging is based on Management's estimates with regard to future purchase transactions of electricity and natural gas and signed variable interest loan agreements. When hedging instruments turn out to be ineffective, gains/losses from the changes in the fair value are recognised in the Statement of Profit or Loss (Note 24).

f) Lease classification

The Group has entered into the lease agreement with licenced transmission system operator for the lease of transmission system network infrastructure and land, buildings and facilities related to this infrastructure till the end of 2019. At the end of lease agreement the parties may review terms of the agreement. If the parties do not agree on a new lease agreement, the existing agreement is prolonged for further 5 years subject to transmission system operator having a valid licence for electricity transmission. Based on an evaluation of the terms of the agreement, such as rights of the ownership is not transferred as determined by Energy Law of the Republic of Latvia, the lessor retains all the significant risks and rewards of ownership of these assets, the Group accounts this agreement as operating lease. In making the judgement on lease classification the management assessed the criteria included in IAS 17 'Leases' and considered the following circumstances:

- The lease does not transfer ownership of the assets at the end of the lease term,
- The lessee has no option to purchase the assets at a price sufficiently lower than the fair value,
- The Group is entitled to lease payments ensuring the rate of return on assets approved by Public Utilities Commission (PUC) and bears risks and rewards related to ownership and the changes in the fair value of the leased assets,

- The lease agreement could be prolonged up to 2025, until when transmission system operator has valid licence for electricity transmission. The lease term does not cover the major part of the economic life of leased assets,
- The lease payments are determined by methodology for transmission system services approved by PUC, considering the rate of return on assets approved by PUC and the lease payments during the predictable lease term do not amount to substantially all of the estimated fair value of the leased assets,
- The assets can only be operated by a lessee holding the licence for electricity transmission. In accordance with the effective legislation, the Group cannot obtain the licence itself. Thus, after 2025 when the current licence for electricity transmission issued to transmission system operator expires, the Group will have to lease the transmission system assets to a company having the licence for electricity transmission. Analysing the current valid lease agreement and considering that PUC determines the rate of return on assets used for the calculation of lease payments and it is reset on a regular basis, the lease payments beyond 2025 will be on market terms. Thus, these periods need not to be taken into account when assessing the substance of the current lease agreement.

g) Recognition of connection service fees to transmission system (IAS 17)

Connection fees to transmission system are recognised as income over the estimated lease period. The estimated lease period is based on the Management estimate.

Income from connection to transmission system and other service fees is deferred as an ongoing service is identified as part of the agreement with the lessee. Operating lease agreement term is 5 years, the period over which revenue from connection fees is recognised is longer, as it is reasonably certain that assets, whose costs are partly reimbursed by connection fees will be leased for a longer period that defined original lease term.

h) Impact of sanctions applied to a supplier of hydroelectric units

Latvenergo AS has concluded contracts with PJSC Power Machines for reconstruction of Pļavinas HPP's hydroelectric units HA1 and HA3 and reconstruction of Ķeguma HPP's hydroelectric units HA5, HA6 and HA7 until the year 2020 with the total amount of contracts EUR 78,045 thousand. Of the total contracted amount, the Parent Company has received assets and services in total amount of EUR 50,521 thousand as at 31 December 2018 (31/12/2017: 49,807 EUR thousand) including assets under construction (not installed) of EUR 16,562 thousand as of 31 December 2018 (31/12/2017: EUR 35,473 thousand).

On 26 January 2018 U.S. Department of Treasury Office of Foreign Assets Control (hereinafter – OFAC) published a statement on persons subjected to sanctions of USA, according to this statement PJSC Power Machines is under abovementioned sanctions. As a result, the realisation of the project has been suspended. On 10 December 2018 Latvenergo AS submitted repeated the application to OFAC with a request to wind down of contractual relationship with PJSC Power Machines. In negative scenario there is possibility of mutual future claims, but the outcome cannot be determined at the moment of approval of the Financial Statements.

The Management has made assessment that there is no basis for recognition of impairment for the assets under construction and no provision related to resolution to this matter needs to be recognised. In reaching the above conclusions, the management has also used external independent expert assessment, including the possibility to use supplied, but not yet installed items for the reconstruction of hydroelectric units.

i) Recognition of one-off compensation in relation to cogeneration power plants

In October 2017, the Parent Company applied for a one-off compensation from the state, at the same time opting out of the receipt of 75% of the guaranteed annual payments for installed electrical capacity in combined heat and power plant CHPP-1 and CHPP-2. The one-off compensation was calculated as 75% of the discounted future guaranteed payments for installed electrical capacity. On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order on one–off compensation to Latvenergo AS on guaranteed support for the installed capacity of cogeneration power plants, therefore the Parent Company obtained a government grant in the amount of EUR 454,413 thousand.

The grant was divided into two parts and recognised in accordance with accounting policy stated in Note 2.15 a:

- an unconditional grant in amount of EUR 140,000 thousand recognised as 'Other income' (Note 7) in the Group's and the Parent Company's statement of profit or loss in 2017
- a conditional grant in amount of EUR 314,413 thousand recognised as deferred income in the Group's and the Parent Company's statement of financial position and to be allocated to income on a straight-line basis until fulfilling obligation till the end of the support period – 23 September 2028.

The decision on settlement of one-off compensation was made separately. Following the order No. 685 of the Cabinet of Ministers of the Republic of Latvia on 28 November 2017 a trilateral agreement was concluded between Republic of Latvia (represented by Ministry of Economics), the Parent Company and its subsidiary Enerģijas publiskais tirgotājs AS (public trader) on settlement of the one–off compensation. Accordingly, public trader recognised receivable from state for one-off compensation in the amount of EUR 454,413 thousand. This balance was recognised as government grant receivable in Group financial statements (Note 17 b). For Enerģijas publiskais tirgotājs AS to ensure financing of compensation, the Parent Company concluded agreement on loan issue in amount equal to the grant receivable (see Note 28 e).

On 20 March 2018 registered changes in share capital of the Parent Company by decreasing share capital in amount of EUR 454,413 thousand (Note 19).

On 26 March 2018, in accordance with the trilateral agreement, the Parent Company settled its liability towards Ministry of Economics for the capital release by netting off the balance with the respective grant receivable from the state and netted balances with public trader on the same date.

On 26 September 2018, the Cabinet of Ministers decided to change conditions for a part of the grant in the amount of EUR 51,700 thousand stipulating it as unconditional, by reducing the remaining part of the grant proportionally to this amount until the end of the support period. As a result, of this and the previous order, EUR 81 004 thousand were recognised as 'Other income' in the Group's and Parent Company's statement of profit or loss in 2018. Consequently, EUR 233,409 thousand remained recognised as deferred income as of 31 December 2018 and to be allocated to income on a straight-line basis until fulfilling obligation till the end of the support period – 23 September 2028.

j) Deferred tax recognition

The untaxed 2018 profits of the subsidiaries are subject to deferred tax charge in the Consolidated Financial Statements to the extent that the Parent Company as shareholder will decide in a foreseeable future on distribution of this profit through dividends which will be taxed on distribution with tax rate 20/80 (see Note 2.23.). The management of the Parent Company has made judgement on the expected timing and extent of the distribution of the 2018 profits of subsidiaries and as of 31 December 2018 recognised in the Group's Consolidated Financial Statements deferred tax liability in the amount of EUR 12,297 thousand related to year 2018 profit of its subsidiaries to be distributed.

5. OPERATING SEGMENT INFORMATION

OPERATING SEGMENTS

For segment reporting purposes, the division into operating segments is based on internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the operating segment decision maker – management of the Group's company operating in each of segments. The Management Board of the Parent Company reviews financial results of operating segments.

The profit measure monitored by the chief operating decision maker primarily is EBITDA, but it also monitors operating profit. In separate financial statements operating profit excludes the dividend income and interest income from subsidiaries. The subsidiaries operate independently from the Parent Company under

the requirements of EU and Latvian legislation and their businesses are different from that of the Parent Company. Therefore, the Parent Company's chief operating decision maker monitors the performance of the Parent Company and makes decisions regarding allocation of resources based on the operating results of the Parent Company.

The Group divides its operations into three main operating segments – generation and trade, distribution and lease of transmission system assets. The Parent Company divides its operations into one main operating segment – generation and trade.

In addition, corporate functions, that cover administration and other support services, are presented in the Group and the Parent Company as separate segment.

Corporate functions provide management services to subsidiaries as well as provides IT and telecommunication, rental services to external customers.

Generation and trade comprises the Group's electricity and thermal energy generation operations, which are organised into the legal entities: Latvenergo AS and Liepājas enerģija SIA; electricity and natural gas trade (including electricity and natural gas wholesale) in the Baltics carried out by Latvenergo AS, Elektrum Eesti OÜ and Elektrum Lietuva UAB, as well as administration of the mandatory procurement process provided by Enerģijas publiskais tirgotājs AS.

The operations of the distribution operating segment relate to the provision of electricity distribution services in Latvia and is managed by the subsidiary Sadales tīkls AS (the largest distribution system operator in Latvia).

The operations of the lease of transmission system assets operating segment is managed by Latvijas elektriskie tīkli AS – the owner of transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points), which provides financing of investments in these assets.

The following table presents revenue, financial results and profit information and segment assets and liabilities of the Group's and the Parent Company's operating segments. Inter–segment revenue is eliminated on consolidation and reflected in the 'adjustments and eliminations' column. All transactions between segments are made based on the regulated tariffs, where applicable, or on an arm's length principle.

EUR'000

	Group							Parent Company				
	Generation and trad	**Distribution**	**Lease of transmission system assets**	**Corporate functions**	**TOTAL segments**	**Adjust-ments and eliminations**	**TOTAL Group**	**Generation and trade**	**Corporate functions**	**TOTAL segments**	**Adjust-ments and elimina-tions**	**TOTAL Parent Company**
2018												
Revenue												
External customers	510,434	321,232	39,203	7,139	**878,008**	–	**878,008**	386,510	48,689	**435,199**	–	**435,199**
Inter-segment	1,390	1,730	2,991	45,451	**51,562**	(51,562)	**–**	459	22,366	**22,825**	(22,825)	**–**
TOTAL revenue	**511,824**	**322,962**	**42,194**	**52,590**	**929,570**	**(51,562)**	**878,008**	**386,969**	**71,055**	**458,024**	**(22,825)**	**435,199**
Results												
EBITDA	146,552	119,791	41,456	13,783	**321,582**	–	**321,582**	134,040	26,887	**160,927**	–	**160,927**
Amortisation, depreciation and intangible assets and PPE impairment loss	(110,490)	(77,432)	(25,856)	(12,042)	**(225,820)**	–	**(225,820)**	(107,397)	(19,727)	**(127,124)**	–	**(127,124)**
Profit before tax	36,062	42,359	15,600	1,741	**95,762**	(7,249)	**88,513**	26,643	7,160	**33,803**	178,957	**212,760**
Assets at the end of the year	1,329,274	1,669,710	579,327	86,350	**3,664,661**	134,158	**3,798,819**	1,212,681	161,577	**1,374,258**	1,766,851	**3,141,109**
Liabilities at the end of the year	295,168	192,016	95,123	6,535	**588,842**	889,912	**1,478,754**	298,328	7,882	**306,210**	841,076	**1,147,286**
Capital expenditure	28,909	95,117	87,136	12,411	**223,573**	(2,966)	**220,607**	26,921	14,429	**41,350**	–	**41,350**
2017												
Revenue												
External customers	554,489	318,851	44,415	7,872	**925,627**	–	**925,627**	448,660	49,920	**498,580**	–	**498,580**
Inter-segment	1,605	1,851	2,541	52,739	**58,736**	(58,736)	**–**	346	29,089	**29,435**	(29,435)	**–**
TOTAL revenue	**556,094**	**320,702**	**46,956**	**60,611**	**984,363**	**(58,736)**	**925,627**	**449,006**	**79,009**	**528,015**	**(29,435)**	**498,580**
Results												
EBITDA	372,829	111,599	45,305	11,963	**541,696**	–	**541,696**	362,534	24,566	**387,100**	–	**387,100**
Amortisation, depreciation and intangible assets and PPE impairment loss	(194,376)	(76,630)	(24,345)	(12,263)	**(307,614)**	–	**(307,614)**	(191,228)	(18,456)	**(209,684)**	–	**(209,684)**
Profit / (loss) before tax	178,453	34,969	20,960	(300)	**234,082**	(9,968)	**224,114**	171,306	6,110	**177,416**	8,490	**185,906**
Assets at the end of the year	1,956,888	1,641,318	500,863	85,584	**4,184,653**	231,072	**4,415,725**	1,286,478	192,435	**1,478,913**	2,170,287	**3,649,200**
Liabilities at the end of the year	393,759	188,025	67,502	6,551	**655,837**	912,997	**1,568,834**	383,708	8,695	**392,403**	874,159	**1,266,562**
Capital expenditure	74,021	107,683	63,085	10,815	**255,604**	(11,793)	**243,811**	73,150	16,128	**89,278**	–	**89,278**

The Group's and the Parent Company's revenue from external customers (Note 6):

EUR'000

	Group						Parent Company			
	Generation and trade	Distribution	Lease of transmission system assets	Corporate Functions	TOTAL segments	TOTAL Group	Generation and trade	Corporate Functions	TOTAL segments	TOTAL Parent Company
Year ended 31 December 2018										
Revenue from contracts with customers recognised over time:										
Trade of energy and related supply services	422,673	3,045	–	–	**425,718**	**425,718**	312,994	–	**312,994**	**312,994**
Distribution system services	1	303,438	–	–	**303,439**	**303,439**	–	–	**–**	**–**
Heat sales	78,489	86	–	5	**78,580**	**78,580**	66,258	5	**66,263**	**66,263**
Other revenue	9,271	14,548	–	5,681	**29,500**	**29,500**	7,258	32,697	**39,955**	**39,955**
TOTAL revenue from contracts with customers	**510,434**	**321,117**	**–**	**5,686**	**837,237**	**837,237**	**386,510**	**32,702**	**419,212**	**419,212**
Other revenue:										
Lease of transmission system assets (Note 14 e)	–	–	38,699	–	**38,699**	**38,699**	–	–	**–**	**–**
Lease of other assets	–	115	–	1,453	**1,568**	**1,568**	–	15,987	**15,987**	**15,987**
Other revenue	–	–	504	–	**504**	**504**	–	–	**–**	**–**
TOTAL other revenue	**–**	**115**	**39,203**	**1,453**	**40 771**	**40 771**	**–**	**15,987**	**15,987**	**15,987**
TOTAL revenue, including:	**510,434**	**321,232**	**39,203**	**7,139**	**878,008**	**878,008**	**386,510**	**48,689**	**435,199**	**435,199**
Latvia	331,617	321,232	39,203	6,790	**698,842**	**698,842**	311,921	47,395	**359,316**	**359,316**
Outside Latvia	178,817	–	–	349	**179,166**	**179,166**	74,589	1,294	**75,883**	**75,883**
Year ended 31 December 2017										
Revenue from contracts with customers recognised over time:										
Trade of energy and related supply services	464,030	3,096	–	–	**467,126**	**467,126**	370,626	–	**370,626**	**370,626**
Distribution system services	1	301,873	–	–	**301,874**	**301,874**	–	–	**–**	**–**
Heat sales	83,156	75	–	8	**83,239**	**83,239**	71,413	9	**71,422**	**71,422**
Other revenue	7,300	13,681	–	6,124	**27,105**	**27,105**	6,620	33,990	**40,610**	**40,610**
TOTAL revenue from contracts with customers	**554,487**	**318,725**	**–**	**6,132**	**879,344**	**879,344**	**448,659**	**33,999**	**482,658**	**482,658**
Other revenue:										
Lease of transmission system assets (Note 14 e)	–	–	43,911	–	**43,911**	**43,911**	–	–	**–**	**–**
Lease of other assets	2	126	–	1,740	**1,868**	**1,868**	1	15,921	**15,922**	**15,922**
Other revenue	–	–	504	–	**504**	**504**	–	–	**–**	**–**
TOTAL other revenue	**2**	**126**	**44,415**	**1,740**	**46,283**	**46,283**	**1**	**15,921**	**15,922**	**15,922**
TOTAL revenue, including:	**554,489**	**318,851**	**44,415**	**7,872**	**925,627**	**925,627**	**448,660**	**49,920**	**498,580**	**498,580**
Latvia	404,136	318,851	44,415	7,272	**774,674**	**774,674**	386,513	48,407	**434,920**	**434,920**
Outside Latvia	150,353	–	–	600	**150,953**	**150,953**	62,147	1,513	**63,660**	**63,660**

ADJUSTMENTS AND ELIMINATIONS

Finance income and expenses, fair value gains and losses on financial assets, financial instruments and deferred taxes are not allocated to individual segments as the underlying instruments are managed on a group basis. Taxes and certain financial assets and liabilities, including loans and borrowings are not allocated to those segments as they are also managed on a group basis.

Capital expenditure consists of additions of property, plant and equipment, intangible assets and investment properties including assets from the acquisition of subsidiaries.

Segment EBITDA is equal to total EBITDA, therefore reconciliation is not made.

Reconciliation of profit before tax

EUR'000

	Notes	Group		Parent Company	
		31/12/2018	31/12/2017	31/12/2018	31/12/2017
EBITDA		321,582	541,696	160,927	387,100
Amortisation, depreciation and intangible assets and PPE impairment loss		(225,820)	(307,614)	(127,124)	(209,684)
Segment profit before tax		**95,762**	**234,082**	**33,803**	**177,416**
Finance income	11 a	1,157	1,243	11,446	11,433
Finance costs	11 b	(8,406)	(11,211)	(10,135)	(12,054)
Dividends received from subsidiaries	15 a	–	–	177,646	9,111
Profit before tax		**88,513**	**224,114**	**212,760**	**185,906**

Reconciliation of assets

EUR'000

	Notes	Group		Parent Company	
		31/12/2018	31/12/2017	31/12/2018	31/12/2017
Segment operating assets		**3,664,661**	**4,184,653**	**1,374,258**	**1,478,913**
Connection usage rights		(39,744)	(26,652)	–	–
Non–current financial investments	15	40	40	830,542	817,048
Loans to subsidiaries	28 f	–	–	765,815	1,098,781
Held–to–maturity financial assets	21	–	16,984	–	16,984
Other financial investments	21	16,935	–	16,935	–
Derivative financial instruments	23	15,853	4,619	15,853	4,619
Prepayment for income and other taxes		11,619	78	10,152	–
Cash and cash equivalents	18	129,455	236,003	127,554	232,855
TOTAL assets		**3,798,819**	**4,415,725**	**3,141,109**	**3,649,200**

Reconciliation of liabilities

EUR'000

	Notes	Group		Parent Company	
		2018	2017	2018	2017
Segment operating liabilities		**588,842**	**655,837**	**306,210**	**392,403**
Deferred income tax liabilities	12	12,297	–	–	–
Current corporate income tax liabilities		2	27,725	–	24,739
Borrowings	22	814,343	826,757	802,268	814,772
Derivative financial instruments	23	10,204	8,084	10,204	8,084
Provisions and other payables		53,066	50,431	28,604	26,564
TOTAL liabilities		**1,478,754**	**1,568,834**	**1,147,286**	**1,266,562**

Non–current assets that consist of intangible assets, property, plant and equipment and investment properties are located in the Group's country of domicile – Latvia.

Revenue from major customer in 2018 for the Group amounted to EUR 66,454 thousand and for the Parent Company EUR 66,454 thousand (2017: EUR 72,788 thousand and 72,785 thousand) arising from sales by the generation and trade segment.

6. REVENUE

EUR'000

	IFRS or IAS applied	Group		Parent Company	
		2018	2017	2018	2017
Revenue from contracts with customers recognised over time:					
Trade of energy and related supply services	IFRS 15	425,718	467,126	312,994	370,626
Distribution system services	IFRS 15	303,439	301,874	–	–
Heat sales	IFRS 15	78,580	83,239	66,263	71,422
Other revenue	IFRS 15	29,500	27,105	39,955	40,610
TOTAL revenue from contracts with customers		**837,237**	**879,344**	**419,212**	**482,658**
Other revenue:					
Lease of transmission system assets (Note 14 e)	IAS 17	38,699	43,911	–	–
Lease of other assets (Note 14 e)	IAS 17	1,568	1,868	15,987	15,922
Other revenue	IAS 17	504	504	–	–
TOTAL other revenue		**40,771**	**46,283**	**15,987**	**15,922**
TOTAL revenue		**878,008**	**925,627**	**435,199**	**498,580**

The Group and the Parent Company derive revenue from contracts with customers from Latvia and outside Latvia – Estonia, Lithuania, Nordic countries.

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Latvia	658,071	728,391	343,329	418,998
Outside Latvia	179,166	150,953	75,883	63,660
TOTAL revenue from contracts with customers	**837,237**	**879,344**	**419,212**	**482,658**

Gross amounts invoiced to customers by applying agent accounting principle (see Note 4 c), recognised on net basis under trade of energy and related supply services:

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Mandatory procurement PSO fees	98,459	114,266	101,852	119,562
Distribution system services	10,576	10,125	208,304	217,999
Transmission system services	1,562	1,750	1,613	1,783
TOTAL revenue recognised applying agent accounting principle	**110,597**	**126,141**	**311,769**	**339,344**

Net effect in revenue from applying agent accounting principle is 0.

The Group has recognised the following liabilities from contracts with customers:

EUR'000

	31/12/2018	31/12/2017
Non–current contract liabilities on deferred income from connection fees (Note 27 I, a)	143,494	142,132
Current contract liabilities on deferred income from connection fees (Note 27 II, a)	12,984	12,247
Contract liabilities – deferred income from use of allowed effective electrical load (distribution system services) (Note 27 II, a)	287	253
TOTAL liabilities	**156,765**	**154,632**

Movement in deferred connection fees – contract liability from contracts with customers for the Group (non–current and current part):

EUR'000

	31/12/2018	31/12/2017
At the beginning of the year	**154,632**	**153,432**
Received fees (Note 27)	14,726	12,848
Credited to the Statement of Profit or Loss	(12,593)	(11,648)
At the end of the year	**156,765**	154,632

7. OTHER INCOME

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
One–off compensation from the state on state support for the installed capacity of CHPPs*	81,004	140,000	81,004	140,000
Fines and penalties	7,359	6,900	5,812	5,907
Net gain from sale of assets held for sale and PPE	1,254	254	3,763	929
Net gain from sale of current assets	91	–	2	–
Compensations and insurance claims	618	803	279	579
Other operating income	2,934	1,993	321	87
TOTAL other income	**93,260**	**149,950**	**91,181**	**147,502**

* Information about compensation is disclosed in Note 4 i)

8. RAW MATERIALS AND CONSUMABLES USED

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Electricity:				
Purchased electricity	196,660	124,637	78,747	27,187
Fair value loss on electricity forwards and futures (Note 23, I)	417	3,435	417	3,435
Electricity transmission services costs (Note 28 a)	71,368	71,044	1,015	845
TOTAL electricity costs	**268,445**	**199,116**	**80,179**	**31,467**
Energy resources costs	197,485	118,185	190,139	112,248
Raw materials, spare parts and maintenance costs	31,363	32,389	14,274	12,388
TOTAL raw materials and consumables used	**497,293**	**349,690**	**284,592**	**156,103**

9. PERSONNEL EXPENSES

EUR'000

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
Wages and salaries	73,523	74,453	31,164	31,233
State social insurance contributions	17,685	17,526	7,448	7,307
Expenditure of employment termination	6,078	15,086	1,199	3,845
Pension costs – defined contribution plan	2,256	2,225	893	901
Other benefits defined in the Collective Agreement	1,200	1,048	426	378
Life insurance costs	3,192	3,131	1,289	1,228
Capitalised personnel expenses	(172)	(180)	(23)	–
TOTAL personnel expenses, including remuneration to the management	**103,762**	**113,289**	**42,396**	**44,892**
Including remuneration to the management*:				
Wages and salaries	1,992	1,880	769	865
State social insurance contributions	499	451	186	206
Expenditure of employment termination	75	206	75	–
Pension costs – defined contribution plan	24	30	4	–
Life insurance costs	31	26	7	7
TOTAL remuneration to the management*	**2,621**	**2,593**	**1,041**	**1,078**

* Remuneration to the Group's management includes remuneration to the members of the Management Boards of the Group entities, the Supervisory Board and the Supervisory body (Audit Committee) of the Parent Company. Remuneration to the Parent Company's management includes remuneration to the members of the Parent Company's Management Board, the Supervisory Board and the Supervisory body (Audit Committee).

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
Number of employees at the end of the year	3,508	3,908	1,355	1,431
Average number of employees during the year	3,617	4,075	1,387	1,467

10. OTHER OPERATING EXPENSES

EUR'000

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
Selling expenses and customer services	6,154	6,093	4,788	4,723
Information technology maintenance	5,115	5,143	4,771	4,931
Transportation expenses	6,411	6,204	2,164	2,185
Environment protection and work safety	7,858	11,900	8,125	11,205
Real estate maintenance and utilities expenses	7,448	8,261	6,992	7,825
Telecommunications services	2,049	2,224	2,275	2,552
Real estate tax	1,095	1,086	1,083	1,074
Public utilities regulation fee	1,993	1,996	932	932
Subsidised energy tax (SET)	–	15,087	–	14,859
Audit fee*	100	93	45	38
Other expenses	10,886	12,815	7,526	7,663
TOTAL other operating expenses	**49,109**	**70,902**	**38,701**	**57,987**

* Audit fee consists from audit of the Group's entities financial statements in the amount of EUR 96 thousand; Parent Company - EUR 41 thousand (2017: EUR 85 thousand; Parent Company - EUR 30 thousand) and audit of The Group's Sustainability report and financial covenants - EUR 4 thousand (2017: EUR 8 thousand)

11. FINANCE INCOME AND COSTS

a) Finance income

EUR'000

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
Interest income on bank accounts and deposits	36	16	36	16
Interest income on loans to related parties	–	–	10,289	10,189
Interest income from held–to–maturity financial assets	–	1,085	–	1,085
Interest income from other financial investments	1,076	–	1,076	–
Net gain on issued debt securities (bonds)	44	120	44	120
Net gain from currency exchange rate fluctuations	–	22	–	23
Income on financing component	1	–	1	–
TOTAL finance income	**1,157**	**1,243**	**11,446**	**11,433**

b) Finance costs

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Interest expense on borrowings	6,276	7,643	8,029	8,505
Interest expense on issued debt securities (bonds)	2,880	4,753	2,880	4,753
Net losses on redemption of held–to–maturity financial assets	–	50	–	50
Net losses on redemption other financial investments	49	–	49	–
Capitalised borrowing costs (Note 14 a)	(889)	(1,359)	(889)	(1,359)
Net losses on currency exchange rate fluctuations	2	–	2	–
Other finance costs	88	124	64	105
TOTAL finance costs	**8,406**	**11,211**	**10,135**	**12,054**

12. INCOME TAX

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Current income tax for the year	261	51,199	27	45,097
Deferred income tax changes	12,297	(20,083)	–	(20,187)
Reversal of deferred tax	–	(129,023)	–	10,105
TOTAL income tax	**12,558**	**(97,907)**	**27**	**35,015**

The movement on the deferred income tax balances:

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Deferred tax liabilities at the beginning of the year	**–**	**315,759**	**–**	**126,260**
Attributable to non–current assets revaluation reserve in equity (Note 20 a)	–	3,325	–	3,325
Changes recognised in the Statement of Profit or Loss	12,297	(20,083)	–	(20,187)
Deferred tax liabilities at the end of the year before reversal	**12,297**	**299,001**	–	**109,398**
Reversed to the Statement of comprehensive income	–	(169,978)	–	(119,503)
Reversed in the Statement of Profit or Loss	–	(129,023)	–	10,105
Deferred tax liabilities at the end of the year	**12,297**	**–**	**–**	**–**

The Group has recognised deferred tax liability for the year 2018 profit of its subsidiaries as in a foreseeable future will be decided on distribution of this profit through dividends which will be taxed on distribution.

Actual corporate income tax charge for the reporting year, if compared with theoretical calculations:

EUR'000

	Group	Parent Company
	2017	2017
Profit before tax	**224,114**	**185,906**
Tax at the applicable tax rate of 15%	33,617	27,886
Permanent differences:		
Received dividends from subsidiaries	–	(1,367)
Non-operating expenses	272	120
Other expenses	17,310	18,458
Deferred income tax changes	(20,083)	(20,187)
Actual corporate income tax for the reporting year	**31,116**	**24,910**
Reversal of deferred tax	(129,023)	10,105
TOTAL income tax	**(97,907)**	**35,015**
Effective income tax rate	**13.9%**	**13.4%**

13. INTANGIBLE ASSETS

a) Intangible assets

EUR'000

	Group					Parent Company				
	Usage rights and licences	Greenhouse gas emission allowances	Software	Assets under development	TOTAL	Usage rights and licences	Greenhouse gas emission allowances	Software	Assets under development	TOTAL
As of 31 December 2016										
Cost	2,507	–	45,631	1,512	**49,650**	10,796	–	43,912	567	**55,275**
Accumulated amortisation	(2,070)	–	(33,046)	–	**(35,116)**	(3,835)	–	(32,671)	–	**(36,506)**
Net book amount	**437**	**–**	**12,585**	**1,512**	**14,534**	**6,961**	**–**	**11,241**	**567**	**18,769**
Year ended 31 December 2017										
Additions	–	–	468	2,120	**2,588**	–	–	468	2,063	**2,531**
Transfers	–	–	3,536	(3,536)	**–**	–	–	2,589	(2,589)	**–**
Disposals	(212)	–	–	–	**(212)**	(656)	–	–	–	**(656)**
Amortisation charge	–	–	(3,497)	–	**(3,497)**	–	–	(3,183)	–	**(3,183)**
Closing net book amount	**225**	**–**	**13,092**	**96**	**13,413**	**6,305**	**–**	**11,115**	41	**17,461**
As of 31 December 2017										
Cost	225	–	49,635	96	**49,956**	6,305	–	46,969	41	**53,315**
Accumulated amortisation	–	–	(36,543)	–	**(36,543)**	–	–	(35,854)	–	**(35,854)**
Net book amount	**225**	**–**	**13,092**	**96**	**13,413**	**6,305**	**–**	**11,115**	**41**	**17,461**
Year ended 31 December 2018										
Additions	–	17,789	2,641	88	**20,518**	–	17,789	2,439	124	**20,352**
Transfers	(80)	–	–	–	**(80)**	(525)	–	(26)	–	**(551)**
Disposals	–	(11,066)	–	–	**(11,066)**	–	(11,066)	–	–	**(11,066)**
Amortisation charge	–	–	(3,706)	–	**(3,706)**	–	–	(3,383)	–	**(3,383)**
Closing net book amount	**145**	**6,723**	**12,027**	**184**	**19,079**	**5,780**	**6,723**	**10,145**	**165**	**22,813**
As of 31 December 2018										
Cost	145	6,723	48,135	184	**55,187**	5,780	6,723	45,242	165	**57,910**
Accumulated amortisation	–	–	(36,108)	–	**(36,108)**	–	–	(35,097)	–	**(35,097)**
Net book amount	**145**	**6,723**	**12,027**	**184**	**19,079**	**5,780**	**6,723**	**10,145**	**165**	**22,813**

b) Greenhouse gas emission allowances:

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
	Number of allowances	Number of allowances	Number of allowances	Number of allowances
At the beginning of the year	206,631	795,153	(13,778)	546,409
Allowances allocated free of charge	265,465	314,160	250,091	295,942
Purchased allowances	1,425,000	–	1,425,000	–
Used allowances	(802,286)	(871,982)	(782,746)	(855,429)
Sold allowances	(72,000)	(30,700)	–	(700)
At the end of the year	**1,022,810**	**206,631**	**878,567**	**(13,778)**

The number of allowances in the Group received in 2018 from the Government free of charge, in accordance with the law "On Pollution" and Directives of the Ministry of Environmental Protection and Regional Development of the Republic of Latvia, was 265,465 (2017: 314,160), the number of allowances Latvenergo AS received in 2018 from the Government free of charge was 250,091 (2017: 295,942). Therefore, their carrying amount as of 31 December 2018 was nil (31/12/2017: nil). Received European Union Allowances (EUA) must be used until the end of 2020.

14. PROPERTY, PLANT AND EQUIPMENT

a) Property, plant and equipment

Net book amounts and movements of property, plant and equipment by groups, including groups of revalued categories (see Note 2.8.) are as follows: EUR'000

	Group								Parent Company					
	Land, buildings and facilities	**Assets of Hydro Power Plant**	**Distribution system electrical lines and electrical equipment**	**Transmission system electrical lines and electrical equipment**	**Technology equipment and machinery**	**Other PPE**	**Assets under construction and advance payments**	**Property, plant and equipment TOTAL**	**Land, buildings and facilities**	**Assets of Hydro Power Plant**	**Technology equipment and machinery**	**Other PPE**	**Assets under construction and advance payments**	**Property, plant and equipment TOTAL**
As of 31 December 2016														
Cost or valuation	464,503	1,855,929	2,826,157	932,444	625,712	156,039	153,890	**7,014,674**	318,262	1,855,929	600,721	135,062	119,350	**3,029,324**
Accumulated depreciation and impairment	(137,778)	(1,146,091)	(1,357,781)	(534,495)	(370,284)	(106,458)	(5,990)	**(3,658,877)**	(91,253)	(1,146,091)	(362,168)	(101,436)	(5,858)	**(1,706,806)**
Net book amount	**326,725**	**709,838**	**1,468,376**	**397,949**	**255,428**	**49,581**	**147,900**	**3,355,797**	**227,009**	**709,838**	**238,553**	**33,626**	**113,492**	**1,322,518**
Year ended 31 December 2017														
Increase due PPE revaluation recognised in OCI (Note 20 a)	–	22,167	–	–	–	–	–	**22,167**	–	22,167	–	–	–	**22,167**
Decrease due PPE revaluation recognised in profit or loss	–	(2,260)	–	–	–	–	–	**(2,260)**	–	(2,260)	–	–	–	**(2,260)**
Additions	–	–	–	–	–	–	241,220	**241,220**	–	–	–	–	84,373	**84,373**
Transfers	18,797	18,855	81,113	11,400	20,717	15,147	(166,029)	**–**	15,513	18,855	20,679	9,624	(64,671)	**–**
Reclassified to investment property	(1,182)	–	–	–	–	–	–	**(1,182)**	(1,059)	–	–	–	–	**(1,059)**
Reclassified from investment property	–	–	–	–	–	–	–	**–**	8,335	–	–	–	–	**8,335**
Disposals	(82)	–	(4,000)	(355)	(108)	(21)	(334)	**(4,900)**	(45)	–	(73)	(33)	(334)	**(485)**
Impairment charge	(261)	–	–	–	(116,799)	–	814	**(116,246)**	(261)	–	(116,799)	–	803	**(116,257)**
Depreciation	(13,807)	(25,991)	(66,979)	(23,055)	(40,471)	(15,308)	–	**(185,611)**	(9,653)	(25,991)	(38,971)	(11,263)	–	**(85,878)**
Closing net book amount as of 31 December 2017	**330,190**	**722,609**	**1,478,510**	**385,939**	**118,767**	**49,399**	**223,571**	**3,308,985**	**239,839**	**722,609**	**103,389**	**31,954**	**133,663**	**1,231,454**
As of 31 December 2017														
Cost or valuation	479,605	2,014,626	2,857,242	926,403	640,568	161,992	228,748	**7,309,184**	345,246	2,014,626	615,648	135,708	138,718	**3,249,946**
Accumulated depreciation and impairment	(149,415)	(1,292,017)	(1,378,732)	(540,464)	(521,801)	(112,593)	(5,177)	**(4,000,199)**	(105,407)	(1,292,017)	(512,259)	(103,754)	(5,055)	**(2,018,492)**
Net book amount	**330,190**	**722,609**	**1,478,510**	**385,939**	**118,767**	**49,399**	**223,571**	**3,308,985**	**239,839**	**722,609**	**103,389**	**31,954**	**133,663**	**1,231,454**
Year ended 31 December 2018														
Additions	–	–	–	–	–	–	217,389	**217,389**	–	–	–	–	38,300	**38,300**
Invested in share capital (Note 19)*	469	–	20	–	–	–	–	**489**	469	–	20	–	–	**489**
Transfers	8,615	90,796	89,681	33,687	1,143	14,368	(238,290)	**–**	8,075	90,796	1,133	6,570	(106,574)	**–**
Reclassified to investment property	(44)	–	–	–	–	–	–	**(44)**	(2,374)	–	–	–	–	**(2,374)**
Disposals	(931)	(36)	(4,904)	(841)	(709)	(90)	(101)	**(7,612)**	(2,158)	(36)	(1,279)	(10,442)	(95)	**(14,010)**
Impairment charge	146	–	–	–	(33,400)	–	(187)	**(33,441)**	146	–	(33,400)	–	–	**(33,254)**
Depreciation	(15,959)	(24,859)	(65,638)	(24,615)	(42,807)	(14,795)	–	**(188,673)**	(10,231)	(24,859)	(41,336)	(10,293)	–	**(86,719)**
Closing net book amount as of 31 December 2018	**322,486**	**788,510**	**1,497,669**	**394,170**	**42,994**	**48,882**	**202,382**	**3,297,093**	**233,766**	**788,510**	**28,527**	**17,789**	**65,294**	**1,133,886**
As of 31 December 2018														
Cost or valuation	485,098	2,055,572	2,889,265	933,079	637,706	147,744	207,746	**7,356,210**	349,581	2,055,572	612,253	103,877	70,349	**3,191,632**
Accumulated depreciation and impairment	(162,612)	(1,267,062)	(1,391,596)	(538,909)	(594,712)	(98,862)	(5,364)	**(4,059,117)**	(115,815)	(1,267,062)	(583,726)	(86,088)	(5,055)	**(2,057,746)**
Net book amount	**322,486**	**788,510**	**1,497,669**	**394,170**	**42,994**	**48,882**	**202,382**	**3,297,093**	**233,766**	**788,510**	**28,527**	**17,789**	**65,294**	**1,133,886**

* In June 2018, in accordance with the Directive No. 765 of the Cabinet of Ministers of the Republic of Latvia, dated 19 December 2017 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 489 thousand was invested in the share capital of Latvenergo AS

Impairment charge is included in the Statement of Profit or Loss under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

As of 31 December 2018 cost of fully depreciated PPE which are still in use for the Group amounted to EUR 312,028 thousand (31/12/2017: EUR 237,692 thousand) and for the Parent Company amounted to EUR 241,396 thousand (31/12/2017: EUR 194,531 thousand).

In 2018 the Group and the Parent Company have capitalised borrowing costs in the amount of EUR 889 thousand (2017: EUR 1,359 thousand) (see Note 11 b). Rate of capitalised borrowing costs was of 0.93% (2017: 1.23%).

Information about the pledged property, plant and equipment is disclosed in Note 22 I.

b) Investment property

The Group and the Parent Company apply the cost model in valuation of investment properties. Land or a building or part of a building held by the Group or the Parent Company as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business, after decision of the Group's or the Parent Company's management are initially recognised as investment properties at cost and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses (Note 2.7.).

EUR'000

	Group		Parent Company					
	Investment property held for capital appreciation		Investment properties for lease		Investment property held for capital appreciation		TOTAL Investment property	
	2018	2017	2018	2017	2018	2017	2018	2017
Cost at the beginning of the year	2,297	855	96,174	104,272	2,244	782	98,418	105,054
Accumulated depreciation and impairment at the beginning of the year	(1,544)	(292)	(32,067)	(31,937)	(1,544)	(284)	(33,611)	(32,221)
Net book amount at the beginning of the year	**753**	**563**	**64,107**	**72,335**	**700**	**498**	**64,807**	**72,833**
Reclassified to investment property held for capital appreciation	44	–	(13)	(125)	44	125	31	–
Reclassified from property, plant and equipment to investment property	–	1,183	3,734	2,373	–	1,060	3,734	3,433
Reclassified to property, plant and equipment	–	–	(1,360)	(8,334)	–	–	(1,360)	(8,334)
Disposal	–	(2)	(1,259)	(34)	–	(2)	(1,259)	(36)
Sold	(341)	(284)	(78)	–	(322)	(275)	(400)	(275)
Impairment charge	17	(685)	–	–	17	(685)	17	(685)
Depreciation	(6)	(22)	(3,768)	(2,108)	(6)	(21)	(3,774)	(2,129)
Cost at the end of the year	1,638	2,297	94,626	96,174	1,604	2,244	96,230	98,418
Accumulated depreciation and impairment at the end of the year	(1,171)	(1,544)	(33,263)	(32,067)	(1,171)	(1,544)	(34,434)	(33,611)
Net book amount at the end of the year	**467**	**753**	**61,363**	**64,107**	**433**	**700**	**61,796**	**64,807**

c) Property, plant and equipment revaluation

Assets of Hydropower plants were revalued in 2017. The revaluation was performed by an independent, external and certified valuer by applying the income method or the replacement cost model. Income method is based on average perennial water inflow in each HPP, power exchange (Nordpool spot) forecasts of electricity prices, analysis of historical generation and operating expenses, forecast of expenses based on public available state statistics, forecast of capital expenditure, forecast of net cash flows, as well as discount and capitalisation rate calculation using the weighted average cost of capital (WACC) formula based on market data.

Considering that the estimated replacement cost of the assets exceeded the value determined by using income method, the value of each of the hydropower plant assets item was reduced to recognise the economic depreciation. The replacement cost was determined according to technical characteristics of property, plant and equipment, current technical requirements and the cost of replacement of functional analogue less physical, functional and economic depreciation.

As a result of revaluation in 2017 the carrying amounts of property, plant and equipment of hydropower plants increased by EUR 19,907 thousand. Increase of property, plant and equipment in the amount of EUR 22,167 thousand, less deferred income tax, is included in the equity as non-current assets revaluation reserve (see Note 20 a), while impairment charge due to property, plant and equipment revaluation in the amount of EUR 2,260 thousand – in the Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

The nominal pre-tax discount rate used in valuation is 7.5%. If the pre-tax rate would be increased by 0.1% then the value of the revalued assets of hydropower plants would decrease by EUR 17 283 thousand. If the pre-tax rate would be decreased by 0.1%, the value of the revalued assets of hydropower plants would increase by EUR 17,945 thousand. If electricity price would increase by 1%, the value of assets would increase by EUR 18,467, if the prices would be by 1% less, the value of assets would decrease by EUR 18,462.

Distribution system electrical lines and electrical equipment was revalued in 2016. The revaluation was performed by an external valuer valuating the replacement or renewing costs for each item of property, plant and equipment considering actual costs of construction or purchase of analogue or similar property, plant and equipment shortly before the revaluation as based on the Sadales tīkls AS accounting. Estimated replacement or renewal value for each item of property, plant and equipment was reduced by its functional and physical depreciation as assessed by external valuer.

Transmission system electrical lines and electrical equipment was revalued in 2016. The revaluation was performed by an external valuer valuating the replacement or renewing costs for each item of property, plant and equipment considering actual costs of construction or purchase of analogue or similar property, plant and equipment shortly before the revaluation as based on Latvijas elektriskie tīkli AS accounting. For property, plant and equipment invested as a property investment in Latvijas elektriskie tīkli AS share capital in 2011 external valuer at the moment of the revaluation evaluated how have changed the components of the replacement or renewal costs of the same property, plant and equipment items since they were invested in the Latvijas elektriskie tīkli AS share capital, adjusting the values of individual sub-categories of property, plant and equipment with changes of material costs and indexing the wage component on the basis of publicly available national statistics on wage increases over the relevant period. Estimated replacement or renewal value for each item of property, plant and equipment was reduced by its functional and physical depreciation as assessed by external valuer.

The management has evaluated changes in the input data used in valuation since revaluation and has estimated that their changes do not have a significant impact on the value of revalued property, plant and equipment groups.

The carrying amounts of revalued categories of property, plant and equipment groups (see Note 2.8.) at revalued amounts and their cost basis are as follows:

EUR'000

	Group		Parent Company	
	Revalued property, plant and equipment groups			
	Assets of Hydropower plants (the Parent Company)	Distribution system electrical lines and electrical equipment	Transmission system electrical lines and electrical equipment	TOTAL revalued PPE
At revalued amounts				
As of 31 December 2018				
Revalued	2,055,572	2,889,265	933,079	5,877,916
Accumulated depreciation	(1,267,062)	(1,391,596)	(538,909)	(3,197,567)
Revalued net book amount	**788,510**	**1,497,669**	**394,170**	**2,680,349**
As of 31 December 2017				
Revalued	2,014,626	2,857,242	926,403	5,798,271
Accumulated depreciation	(1,292,017)	(1,378,732)	(540,464)	(3,211,213)
Revalued net book amount	**722,609**	**1,478,510**	**385,939**	**2,587,058**
At amounts stated on historicalcost basis				
As of 31 December 2018				
Cost	396,519	1,377,374	446,760	2,220,653
Accumulated depreciation	(171,043)	(458,211)	(168,374)	(797,628)
Net book amount	**225,476**	**919,163**	**278,386**	**1,423,025**
As of 31 December 2017				
Cost	311,854	1,289,349	418,917	2,020,120
Accumulated depreciation	(170,115)	(371,348)	(161,275)	(702,738)
Net book amount	**141,739**	**918,001**	**257,642**	**1,317,382**

d) Impairment

I) Latvenergo AS combined heat and power plants (Latvenergo AS CHPPs)

Impairment review performed for Latvenergo AS CHPPs is based on value in use calculations. The cash–generating unit is defined as the assets of Latvenergo AS CHPPs.

In October 2017, Latvenergo AS applied for a one-off compensation from the state, at the same time opting out of the receipt of 75% of the annual electrical capacity payments for cogeneration power plants CHPP–1 and CHPP–2 (Note 4 i). On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order which supports the reduction of the guaranteed support payments during the remaining support period for the installed capacity of Latvenergo CHPPs. According to the order, Latvenergo AS obtained a government grant in the amount of EUR 454,413 thousand that was divided into two parts, with the stipulation that EUR 140,000 thousand should be recognised in the Group's and Parent Company's statement of profit or loss in 2017, while EUR 314,413 thousand should be recognised as deferred income in even distribution over the coming reporting periods and fulfilling obligations until the end of the support period.

On 26 September 2018, the Cabinet of Ministers decided to change conditions for a part of the grant in the amount of EUR 51,700 thousand stipulating it as unconditional, by reducing the remaining part of the grant proportionally to this amount until the end of the support period. As a result of this and the previous order, EUR 81 004 thousand were recognised as 'Other income' in the Group's and Parent Company's statement of profit or loss in 2018. Consequently, EUR 233,409 thousand remained recognised as deferred income as of 31 December 2018.

Taking into account the assessment that the future cash flows generated by the operation of Latvenergo AS CHPPs are approximately equal to nil (see below), the value of Latvenergo CHPPs assets is estimated equal to the deferred income as of 31 December 2018 – EUR 233,409 thousand.

As a result of the above transactions, additional impairment in the amount of EUR 33,400 thousand was recognised for Latvenergo AS CHPPs in 2018 (2017: EUR 116,799 thousand). The recognised impairment charge is included in the Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

In addition to the above, to ensure the carrying value is in line with recognised impairment, the future cash flows expected to be derived from the operation of Latvenergo AS CHPPs were evaluated. Forecasted period is 2019 – 2028 and the terminal value appraisal, evaluated as a fraction of the balance sheet's assets value, is included. Revenue stream forecast mainly corresponds to the remaining intensity of electrical capacity payments and the support period till September 23, 2028, as it is set out in regulations by Cabinet of Ministers of the Republic of Latvia No. 221, dated 10 March 2009. The forecast of expenses is based on historical data, the budget approved by the management for 2019, the service maintenance agreements and assumed inflation. As a result of calculation, the future revenue stream is close to the amount of expenses – the future cash flows generated by Latvenergo AS CHPPs are approximately equal to nil. Nominal pre–tax discount rate used to determine value in use of cash–generating unit by discounting cash flows is 7.5% (2017: 7.5%). The calculation is not discount rate sensitive. If the annual electrical capacity payments for cogeneration power plants CHPP–1 and CHPP–2 would be discontinued, then impairment of approximately EUR 80 million would be recognised. Impairment is estimated by assuming that capacity payment revenue decrease would be partly offset by a higher revenues from electricity production.

The accumulated impairment as of 31 December 2018 amounted to EUR 254,109 thousand (31/12/2017: EUR 220,709 thousand).

II) Distribution system assets (Group)

Impairment review based on value in use calculations is performed for electricity distribution system assets and is performed to ensure that no additional economic depreciation has to be recognised. As a result of impairment test there is no impairment loss to be recognised (2017: nil). The cash–generating unit is defined as all distribution system assets. In 2018 nominal pre–tax discount rate used to determine value in use of cash–generating units by discounting cash flows is 4.2% (2017: 5.3%) as included in the electricity distribution system service tariff calculation methodology. Revenue stream forecasts are based on the tariff calculation methodology and assumptions related investment plans. The forecast of expenses and investments is based on historical data, the budgets approved by the management and assumed inflation. The growth rate used for the terminal value appraisal is in line with the assumed distributed electricity growth.

III) Transmission system assets (Group)

Impairment review based on value in use calculations is performed for electricity transmission system assets and is performed to ensure that no additional economic depreciation has to be recognised. As a result of impairment test there is no impairment loss to be recognised (2017: nil). The cash–generating unit is defined as all transmission system assets. In 2018 nominal pre–tax discount rate used to determine value in use of cash–generating units by discounting cash flows is 4.2% (2017: 5.3%) as included in electricity transmission system service tariff calculation methodology. Revenue stream forecasts are based on the tariff calculation methodology and assumptions related investment plans. The forecast of expenses and investments is based on historical data, the budgets approved by the management and assumed inflation. The growth rate used for the terminal value appraisal is in line with the assumed transmitted electricity growth.

IV) Daugava hydropower plants (HPPs)

Impairment review based on value in use calculations is performed for Daugava HPPs at the end of reporting period assets and is performed to ensure that no additional economic depreciation has to be recognised. No impairment loss has to be recognised in addition to impairment already recognised as part of HPPs revaluation (Note 14 c). The cash–generating unit is defined as Daugava HPPs assets. In 2018 nominal pre–tax discount rate used to determine value in use of cash–generating units by discounting cash flows is 7.5% (2017: 9.0%). Revenue stream forecasts are based on the most recent long-term forecasts of electricity prices and long-term output of electricity. The forecast of expenses and investments is based on historical data, the budget approved by the management for 2019 and assumed inflation. The growth rate used for the terminal value appraisal is in line with the assumed inflation.

e) Leases

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
Rental income (the Group or the Parent Company is the lessor) (Note 6)	**40,267**	**45,779**	**15,987**	**15,922**
of which, Transmission system assets lease	38,699	43,911	–	–
Rental expense (the Group or the Parent Company is the lessee)	**1,248**	**1,577**	**1,149**	**1,267**

Future minimum lease payments receivable under operating lease contracts by due dates (the Group and the Parent Company are the lessor):

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
– < 1 year	38,579	39,781	7,673	15,355
– 1–5 years	158,650	193,775	48,424	40,167
– > 5 years	41,325	3,220	2,793	3,220
TOTAL rental income	**238,554**	**236,776**	**58,890**	**58,742**

Transmission system assets had been leased out by the Group to Augstsprieguma tīkls AS under non–cancellable operating lease agreement.

Future minimum lease payments under operating lease contracts by due dates (the Group and the Parent Company are the lessee):

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
– < 1 year	1,447	1,350	1,509	1,566
– 1–5 years	3,804	3,919	5,909	6,252
– > 5 years	4,280	6,497	14,320	10,299
TOTAL rental expense	**9,531**	**11,766**	**21,738**	**18,117**

15. NON–CURRENT FINANCIAL INVESTMENTS

The Parent Company's participating interest in subsidiaries and other non–current financial investments:

Name	Country of incorporation	Business activity held	31/12/2018		31/12/2017	
			Interest held, %	EUR'000	Interest held, %	EUR'000
Subsidiaries:						
Latvijas elektriskie tīkli AS	Latvia	Lease of transmission system assets	100%	185,624	100%	185,624
Sadales tīkls AS	Latvia	Electricity distribution	100%	641,150	100%	627,656
Enerģijas publiskais tirgotājs AS*	Latvia	Administration of mandatory electricity procurement process	100%	40	100%	40
Elektrum Eesti OÜ	Estonia	Electricity and natural gas trade	100%	35	100%	35
Elektrum Lietuva, UAB	Lithuania	Electricity and natural gas trade	100%	98	100%	98
Liepājas enerģija SIA	Latvia	Thermal energy generation and trade in Liepaja, electricity generation	51%	3,556	51%	3,556
Other non–current financial investments:						
Pirmais Slēgtais Pensiju Fonds AS	Latvia	Management of pension plans	46.30%	36	46.30%	36
Rīgas siltums AS	Latvia	Thermal energy generation and trade in Riga, electricity generation	0.0051%	3	0.0051%	3
TOTAL financial investments of the Parent Company				**830,542**		**817,048**

The Group's non–current financial investments:

Name	Country of incorporation	Business activity held	31/12/2018		31/12/2017	
			Interest held, %	EUR'000	Interest held, %	EUR'000
Other non–current financial investments (Group):						
Pirmais Slēgtais Pensiju Fonds AS	Latvia	Management of pension plans	48.15%	37	48.15%	37
Rīgas siltums AS	Latvia	Thermal energy generation and trade in Riga, electricity generation	0.0051%	3	0.0051%	3
TOTAL financial investments of the Group				**40**		**40**

The Group owns 48.15% of the shares of the closed pension fund Pirmais Slēgtais Pensiju Fonds AS (Latvenergo AS – 46.30%). However, the Group and the Parent Company are only a nominal shareholder as all risks and benefits arising from associate's activities will accrue to the employees who are members of the pension fund.

Movement in non–current investments:

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**40**	**40**	**817,048**	**817,048**
Invested in share capital*	–	–	13,494	–
At the end of the year	**40**	**40**	**830,542**	**817,048**

* In 2018, the Parent Company invested property, plant and equipment in the share capital of Sadales tīkls AS. In the Statement of Financial Position of the Parent Company investment is recognised at cost of disposed PPE in the amount of EUR 13,494 thousand, while share capital of Sadales tīkls AS increased by fair value of invested property, plant and equipment in the amount of EUR 19,143 thousand

Summarised financial information for subsidiaries:

EUR'000

	Equity		Net profit for the year		Dividends from subsidiaries*		Carrying amount of interest from investment	
Subsidiaries	31/12/2018	31/12/2017	2018	2017	2018	2017	31/12/2018	31/12/2017
Latvijas elektriskie tīkli AS	232,759	269,801	13,394	50,463	50,463	6,852	185,624	185,624
Sadales tīkls AS	922,421	993,329	33,743	124,268	124,268	3	641,150	627,656
Enerģijas publiskais tirgotājs AS	40	40	–	–	–	–	40	40
Elektrum Eesti OÜ	922	904	250	232	232	264	35	35
Elektrum Lietuva, UAB	925	859	548	481	481	542	98	98
Liepājas enerģija SIA	17,262	16,413	5,167	4,799	2,202	1,450	3,556	3,556
	1,174,329	**1,281,346**	**53,102**	**180,243**	**177,646**	**9,111**	**830,503**	**817,009**

* In 2018 dividends from subsidiaries received in cash in the amount of EUR 53,378 thousand and with non-cash offset in the amount of EUR 124,268 thousand (2017: EUR 9,111 thousand received in cash)

16. INVENTORIES

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Raw materials and materials	14,865	16,547	1,286	1,583
Natural gas	49,757	53,079	49,757	53,078
Other inventories	8,292	8,115	8,070	8,075
Prepayments for inventories	198	81	33	80
Allowance for raw materials and other inventories	(1,137)	(1,494)	(736)	(992)
TOTAL inventories	**71,975**	**76,328**	**58,410**	**61,824**

Changes in the allowance for raw materials and materials at warehouses are included in the Statement of Profit or Loss position 'Raw materials and consumables used'.

Movement on the allowance for inventories:

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**1,494**	**1,659**	**992**	**1,060**
Inventories written off	(287)	(62)	(260)	–
Charged to the Statement of Profit or Loss	(70)	(103)	4	(68)
At the end of the year	**1,137**	**1,494**	**736**	**992**

17. RECEIVABLES FROM CONTRACTS WITH CUSTOMERS AND OTHER RECEIVABLES

Receivables from contracts with customers grouped by the expected credit loss (ECL) assessment model, net:

EUR'000

	Group			Parent Company		
	31/12/2018	01/01/2018	31/12/2017*	31/12/2018	01/01/2018	31/12/2017*
Individually assessed significant receivables (counterparty model)	7,051	4,383	4,389	7,915	12,486	12,497
Receivables with lifetime ECL assessment by simplified approach (portfolio model)	110,904	100,864	100,980	73,110	70,198	70,302
TOTAL receivables from contracts with customers	**117,955**	**105,247**	**105,369**	**81,025**	**82,684**	**82,799**

* By IAS 39

a) Receivables from contracts with customers, net

EUR'000

	Group			Parent Company		
	31/12/2018	01/01/2018	31/12/2017*	31/12/2018	01/01/2018	31/12/2017*
Receivables from contracts with customers:						
– Electricity, natural gas trade and related services customers	138,308	134,699	134,699	102,154	105,257	105,257
– Heating customers	14,715	10,922	10,922	11,955	8,851	8,851
– Other receivables from contracts with customers (portfolio model)	5,675	4,221	4,221	3,331	1,062	1,062
– Other receivables from contracts with customers (counterparty model)	7,060	4,389	4,389	3,203	3,093	3,093
– Subsidiaries	–	–	–	4,719	9,404	9,404
	165,758	**154,231**	**154,231**	**125,362**	**127,667**	**127,667**
Provisions for impaired receivables from contracts with customers:						
– Electricity, natural gas trade and related services customers	(44,953)	(45,785)	(45,561)	(43,968)	(44,559)	(44,472)
– Heating customers	(342)	(351)	(329)	(334)	(331)	(310)
– Other receivables from contracts with customers (portfolio model)	(2,499)	(2,842)	(2,972)	(28)	(82)	(86)
– Other receivables from contracts with customers (counterparty model)	(9)	(6)	–	(4)	(4)	–
– Subsidiaries	–	–	–	(3)	(7)	–
	(47,803)	**(48,984)**	**(48,862)**	**(44,337)**	**(44,983)**	**(44,868)**
Receivables from contracts with customers, net:						
– Electricity, natural gas trade and related services customers	93,355	88,914	89,138	58,186	60,698	60,785
– Heating customers	14,373	10,571	10,593	11,621	8,520	8,541
– Other receivables from contracts with customers (portfolio model)	3,176	1,379	1,249	3,303	980	976
– Other receivables from contracts with customers (counterparty model)	7,051	4,383	4,389	3,199	3,089	3,093
– Subsidiaries	–	–	–	4,716	9,397	9,404
	117,955	**105,247**	**105,369**	**81,025**	**82,684**	**82,799**

* By IAS 39

Receivables from contracts with customers with lifetime expected credit losses (ECL) assessed on the portfolio model basis and grouped by past due days:

EUR'000

Late payment delay in days by IFRS 9	ECL rate	Group 31/12/2018 Receivables	Group 31/12/2018 Impairment loss	Group 31/12/2018 TOTAL	Group 01/01/2018 Receivables	Group 01/01/2018 Impairment loss	Group 01/01/2018 TOTAL	Parent Company 31/12/2018 Receivables	Parent Company 31/12/2018 Impairment loss	Parent Company 31/12/2018 TOTAL	Parent Company 01/01/2018 Receivables	Parent Company 01/01/2018 Impairment loss	Parent Company 01/01/2018 TOTAL
On time	0.20%	106,194	(230)	**105,964**	91,644	(183)	**91,461**	69,557	(160)	**69,397**	65,637	(156)	**65,481**
Less 30 days	3%	2,953	(88)	**2,865**	6,552	(197)	**6,355**	1,947	(59)	**1,888**	2,175	(68)	**2,107**
Past due 30 - 59 days	20%	1,334	(265)	**1,069**	1,768	(353)	**1,415**	1,213	(241)	**972**	1,573	(315)	**1,258**
Past due 60 - 89 days	50%	535	(267)	**268**	879	(440)	**439**	503	(251)	**252**	757	(380)	**377**
Past due 90 - 179 days	60%	812	(486)	**326**	1,506	(904)	**602**	697	(417)	**280**	1,236	(742)	**494**
Past due 180 - 359 days	75%	1,638	(1,226)	**412**	2,361	(1,769)	**592**	1,283	(962)	**321**	1,896	(1,422)	**474**
Past due more than 360 days	100%	17,890	(17,890)	**–**	18,261	(18,261)	**–**	15,123	(15,123)	**–**	15,279	(15,279)	**–**
Insolvent debtors*	100%	27,342	(27,342)	**–**	26,871	(26,871)	**–**	27,117	(27,117)	**–**	26,617	(26,617)	**–**
		158,698	**(47,794)**	**110,904**	**149,842**	**(48,978)**	**100,864**	**117,440**	**(44,330)**	**73,110**	**115,170**	**(44,979)**	**70,191**

* Receivables under insolvency process and with an established payment schedule

The expected loss rates are based on the payment profiles of sales over a period of 2 years before 1 January 2018 and the corresponding historical credit losses experienced within this period. As of 31 December 2018 assessment of expected credit losses is based on the same ECL rates.

Receivables from contracts with customers by IAS 39 grouped by past due days:

EUR'000

Late payment delay in days by IAS 39:	ECL rate	Group 31/12/2017 Receivables	Group 31/12/2017 Impairment loss	Group 31/12/2017 TOTAL	Parent Company 31/12/2017 Receivables	Parent Company 31/12/2017 Impairment loss	Parent Company 31/12/2017 TOTAL
Electricity, natural gas trade and related services receivables:							
Fully performing receivables	0%	70,290	–	**70,290**	46,956	–	**46,956**
Past due 1 - 45 days	0%	7,183	–	**7,183**	3,134	–	**3,134**
Past due 46 - 90 days	50%	743	(371)	**372**	657	(329)	**328**
Past due 91 - 180 days	75%	1,173	(880)	**293**	1,110	(833)	**277**
Past due more than 181 days	100%	17,623	(17,623)	**–**	16,780	(16,780)	**–**
Individually impaired receivables with scheduled payments*		37,687	(26,687)	**11,000**	36,620	(26,530)	**10,090**
TOTAL		**134,699**	**(45,561)**	**89,138**	**105,257**	**(44,472)**	**60,785**
Heating and other receivables from contracts with customers:							
Fully performing receivables	0%	16,029	–	**16,029**	12,549	–	**12,549**
Past due 1 - 30 days	0%	143	–	**143**	55	–	**55**
Past due 31 - 90 days	50%	118	(59)	**59**	12	(6)	**6**
Past due more than 91 days	100%	3,160	(3,160)	**–**	390	(390)	**–**
Individually impaired receivables with scheduled payments*		82	(82)	**–**	–	–	**–**
TOTAL		**19,532**	**(3,301)**	**16,231**	**13,006**	**(396)**	**12,610**
Receivables from subsidiaries:							
Fully performing receivables	0%	–	–	**–**	9,404	–	**9,404**
TOTAL		**–**	**–**	**–**	**9,404**	**–**	**9,404**
TOTAL receivables from contracts with customers		**154,231**	**(48,862)**	**105,369**	**127,667**	**(44,868)**	**82,799**

* Receivables under insolvency process and other individually impaired receivables

Receivables from contracts with customers with lifetime expected credit losses (ECL) assessed on the counterparty model basis:

EUR'000

	Group			Parent Company		
	31/12/2018	01/01/2018	31/12/2017*	31/12/2018	01/01/2018	31/12/2017*
Other receivables from contracts with customers	7,060	4,389	4,389	3,203	3,093	3,093
Impairment loss on other receivables from contracts with customers	(9)	(6)	–	(4)	(4)	–
Receivables from subsidiaries (Note 28 b)	–	–	–	4,398	9,390	9,390
Accrued income from subsidiaries (Note 28 c)	–	–	–	321	14	14
Impairment loss on subsidiaries receivables (Note 28 b)	–	–	–	(3)	(7)	–
	7,051	**4,383**	**4,389**	**7,915**	**12,486**	**12,497**

* By IAS 39

Allowances for impairment loss are calculated based on *Moody's* credit rating agency corporate default and debt recovery rate assigned for credit rating level - Baa2 (stable) (for receivables from related parties) and corporate default and debt recovery rate assigned for energy utilities industry.

There is no significant concentration of credit risk with respect to receivables from contracts with customers as the Group and the Parent Company have a large number of customers except major heating customer the net debt of which as of 31 December 2018 amounted to EUR 11,626 thousand (31/12/2017: EUR 8,627 thousand).

The Management assumptions and methodology for estimation of impairment for receivables from contracts with customers and evaluation of impairment risk are described in Note 4 b.

Movements in loss allowances for impaired receivables from contracts with customers:

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**48,862**	**48,100**	**44,868**	**44,177**
Receivables written off during the year as uncollectible	(2,549)	(1,710)	(2,074)	(1,343)
Effect of IFRS 9 'Financial instruments' adoption	122	–	115	–
Allowance for impaired receivables	1,368	2,472	1,428	2,034
At the end of the year	**47,803**	**48,862**	**44,337**	**44,868**

b) Other financial receivables

EUR'000

	Group			Parent Company		
	31/12/2018	01/01/2017	31/12/2017	31/12/2018	01/01/2017	31/12/2017
Other non-current receivables*	30,960	3,229	3,229	331	284	284
Loss allowances for expected credit loss	(40)	(4)	–	–	–	–
TOTAL non-current receivables	**30,920**	**3,225**	**3,229**	**331**	**284**	**284**
Current financial receivables:						
Receivable of guaranteed fee for the installed electrical capacity of cogeneration power plants CHPP-1 and CHPP-2**	–	454,413	454,413	–	–	–
Unsettled revenue on mandatory procurement PSO fee recognised as assets***	74,497	164,365	164,365	–	–	–
Receivables for lease	7,646	3,535	3,535	49	–	–
Receivables for lease from subsidiaries (Note 28 b)	–	–	–	1,061	1,727	1,727
Other financial receivables from subsidiaries (Note 28 b)	–	–	–	6,745	6,317	6,317
Other accrued income from subsidiaries (Note 28 c)	–	–	–	4,358	5,063	5,063
Other accrued income	872	3,572	3,572	883	872	872
Other current financial receivables	4,146	17,529	17,529	2,930	5,214	5,214
Loss allowances for expected credit loss on subsidiaries receivables (Note 28 b)	–	–	–	(6)	(6)	–
Loss allowances for expected credit loss	(2,548)	(1,746)	(1,582)	(1,787)	(1,248)	(1,255)
TOTAL current financial receivables	**84,613**	**641,668**	**641,832**	**14,233**	**17,939**	**17,938**
TOTAL other financial receivables	**115,533**	**644,893**	**645,061**	**14,564**	**18,223**	**18,222**

* Other non-current receivables of the Group as of 31 December 2018 include financing for capital expenditure project "Construction of the 330 kV Kurzemes loks" in the amount of EUR 30,617 thousand (31/12/2017: EUR 2,941 thousand)

** On 21 November 2017, the Cabinet of Ministers of the Republic of Latvia accepted an order on one–off compensation to Latvenergo AS on guaranteed support for the installed capacity of cogeneration power plants in the amount of EUR 454,413 thousand (see Note 4 i)

*** By applying agent principle unsettled revenue on mandatory procurement PSO fee is recognised as assets in net amount as difference between revenue from sale of electricity in *Nord Pool* power exchange by market price, received mandatory procurement PSO fees, received government grant for compensating the increase of mandatory procurement costs and costs of purchased electricity under the mandatory procurement from electricity generators who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants (over 4 MW)

There is no significant concentration of credit risk with respect to other financial receivables except the transmission system operator – Augstsprieguma tīkls AS the net debt of which to the Group as of 31 December 2018 including receivables from contracts with customer amounted to 42,218 thousand EUR (31/12/2017: 20,014 thousand EUR) (see Note 28 b) and receivable from State of guaranteed fee for the installed electrical capacity of cogeneration power plants and unsettled revenue on mandatory procurement PSO fee recognised as assets. Loss allowance for these financial receivables assessed individually and based on counterparty's model (see Note 4 b).

c) Other non-financial receivables

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Current non-financial receivables:				
Pre-tax and overpaid taxes	108	3,703	105	22
Other current receivables	109	1,226	107	119
TOTAL current non-financial receivables	**217**	**4,929**	**212**	**141**

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

18. CASH AND CASH EQUIVALENTS

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Cash at bank	95,094	233,624	93,193	230,476
Short–term bank deposits	30,000	–	30,000	–
Restricted cash and cash equivalents*	4,361	2,379	4,361	2,379
TOTAL cash and cash equivalents	**129,455**	**236,003**	**127,554**	**232,855**

* Restricted cash and cash equivalents as of 31 December 2018 consist of the financial security for participating in NASDAQ OMX Commodities Exchange. Financial security is fully recoverable after termination of participation without any penalties, therefore restricted cash is considered as cash equivalent

In existing rate environment, cash at bank balances practically don`t earn any interests. Short–term deposits are placed for different periods between several days and three months depending on the immediate cash needs of the Group and the Parent Company and cash flow forecasts. During 2018 the average annual effective interest rate earned on short–term cash deposits was 0.102% (2017: 0.175%). See also Note 3.1.b.

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

19. SHARE CAPITAL

As of 31 December 2018, the registered share capital of the Latvenergo AS is EUR 834,791 thousand (31/12/2017: EUR 1,288,715 thousand) and consists of 834,791 thousand ordinary shares (31/12/2017: 1,288,715 thousand) with the nominal value of EUR 1 per share (31/12/2017: EUR 1 per share). All shares have been fully paid.

In March 2018 a decrease of share capital in the amount of EUR 454,413 thousand was registered, related to the trilateral agreement between Republic of Latvia, Latvenergo AS and Enerģijas publiskais tirgotājs AS (EPT) on mutual settlement of the receivable of the grant from the Republic of Latvia by EPT as disclosed in Note 4 i).

In June 2018, in accordance with the Directive No. 765 of the Cabinet of Ministers of the Republic of Latvia, dated 19 December 2017 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 489 thousand was invested in the share capital of Latvenergo AS. (Note 14 a).

20. RESERVES, DIVIDENDS AND EARNINGS PER SHARE

a) Reserves

EUR'000

	Notes	Group					Parent Company			
		Non–current assets revaluation reserve	Hedge reserve	Post–employment benefit plan revaluation reserve	Other reserves	TOTAL	Non–current assets revaluation reserve	Hedge reserve	Post–employment benefit plan revaluation reserve	TOTAL
As of 31 December 2016		**946,373**	**(9,409)**	**(3,615)**	**110**	**933,459**	**659,429**	**(9,409)**	**(1,086)**	**648,934**
Increase of non–current assets revaluation reserve as a result of revaluation	14 a	22,167	–	–	–	**22,167**	22,167	–	–	**22,167**
Disposal of non–current assets revaluation reserve net of deferred tax		(4,377)	–	–	–	**(4,377)**	(1,762)	–	–	**(1,762)**
Deferred tax related to non–current assets revaluation reserve	12	(3,325)	–	–	–	**(3,325)**	(3,325)	–	–	**(3,325)**
Reversed deferred corporate income tax	12	169,560	–	(638)	–	**168,922**	119,384	–	(192)	**119,192**
Gains on re–measurement on defined post–employment benefit plan	26 a	–	–	3,460	–	**3,460**	–	–	1,053	**1,053**
Gains from fair value changes in derivative financial instruments	23	–	5,422	–	–	**5,422**	–	5,422	–	**5,422**
As of 31 December 2017		**1,130,398**	**(3,987)**	**(793)**	**110**	**1,125,728**	**795,893**	**(3,987)**	**(225)**	**791,681**
Disposal of non–current assets revaluation reserve		(10,229)	–	–	–	**(10,229)**	(6,549)	–	–	**(6,549)**
Gains / (losses) on re–measurement on defined post–employment benefit plan	26 a	–	–	436	–	**436**	–	–	(108)	**(108)**
Gains from fair value changes in derivative financial instruments	23	–	9,531	–	–	**9,531**	–	9,531	–	**9,531**
As of 31 December 2018		**1,120,169**	**5,544**	**(357)**	**110**	**1,125,466**	**789,344**	**5,544**	**(333)**	**794,555**

Non–current assets revaluation reserve, currency translation, post–employment benefit plan revaluation and hedge reserves cannot be distributed as dividends. Other reserves are maintained with the aim to maintain stability in the operations of the Group entities.

b) Dividends

The dividends declared to equity holders of the Parent Company for 2017 were EUR 156,418 thousand or EUR 0.17183 per share (2016: EUR 90,142 thousand or EUR 0.06995 per share) and to non–controlling interests – EUR 2,116 thousand or EUR 0.619 per share (2016: EUR 1,393 thousand or EUR 0.408 per share).

Fulfilling the requirements of the Article No. 45 of the law "On the State budget 2019" that determines the amount of dividends payable in the year 2019, the Management Board of Latvenergo AS proposes to pay out in dividends EUR 132.9 million. The distribution of net profit and amount of dividends payable is subject to a resolution of the Latvenergo AS Shareholders Meeting. Net profit of the year 2018 is EUR 212.7 million.

c) Earnings per share

Basic earnings per share are calculated by dividing profit attributable to the equity holders of the Parent Company by the weighted average number of ordinary shares outstanding (Note 19). As there are no potential ordinary shares, diluted earnings per share are equal to basic earnings per share in all comparable periods.

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
Profit attributable to the equity holder of the Parent Company (in thousand EUR)	73,423	319,670	212,733	150,891
Weighted average number of shares (thousand)	910,323	1,288,715	910,323	1,288,715
Basic earnings per share (in euros)	0.081	0.250	0.234	0.117
Diluted earnings per share (in euros)	0.081	0.250	0.234	0.117

21. OTHER FINANCIAL INVESTMENTS

OTHER FINANCIAL INVESTMENTS PREVIOUSLY CLASSIFIED AS HELD–TO–MATURITY FINANCIAL ASSETS (2017)

Carrying (amortised) amount of other financial investments: EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Financial investments in Latvian State Treasury bonds: – non–current	16,935	16,984	16,935	16,984
TOTAL other financial investments	**16,935**	**16,984**	**16,935**	**16,984**

As of 31 December 2018 the entire Group's and the Parent Company's other financial investments, till 31 December 2017 classified as held–to–maturity financial assets, were Latvian State Treasury bonds with 5–year and 10–year maturity, which were purchased with the purpose to invest liquidity reserve in the low risk financial instruments with higher yield. During 2018 in connection with the amortisation of other financial investments are recognised net losses from changes in the value of the purchased bonds in the amount of EUR 49 thousand (2017: EUR 50 thousand) (Note 11 b). All other financial investments are denominated in euros. The maximum exposure to credit risk at the reporting date is the carrying amount of other financial investments.

In 2018 the fair value of other financial investments is greater than the carrying amount by EUR 3,132 thousand (2017: EUR 4,108 thousand). Other financial investments in Latvian State Treasury bonds are listed. The fair value of other financial investments is calculated by discounting their future cash flows and using as discount factor the market quoted yield to maturity rates of the respective bonds as of the end of the reporting period (Level 2).

22. BORROWINGS

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Non–current borrowings from financial institutions	564,711	583,313	555,251	574,764
Issued debt securities (bonds)	135,317	135,361	135,317	135,361
TOTAL non–current borrowings	**700,028**	**718,674**	**690,568**	**710,125**
Current portion of non–current borrowings from financial institutions	112,102	105,931	109,512	102,522
Accrued interest on non–current borrowings	529	468	504	441
Accrued coupon interest on issued debt securities (bonds)	1,684	1,684	1,684	1,684
TOTAL current borrowings	**114,315**	**108,083**	**111,700**	**104,647**
TOTAL borrowings	**814,343**	**826,757**	**802,268**	**814,772**

Movement in borrowings: EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**826,757**	**791,566**	**814,772**	**778,323**
Borrowings received	93,500	186,500	90,000	185,000
Borrowings repaid	(105,931)	(80,976)	(102,522)	(78,221)
Change in accrued interest on borrowings	61	(126)	62	(123)
Repaid issued debt securities (bonds)	–	(70,000)	–	(70,000)
Changes in outstanding value of issued debt securities (bonds)	(44)	(207)	(44)	(207)
At the end of the year	**814,343**	**826,757**	**802,268**	**814,772**

Borrowings by categories of lenders: EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Foreign investment banks	374,864	426,102	374,864	426,102
Commercial banks	302,478	263,610	290,403	251,625
Issued debt securities (bonds)	137,001	137,045	137,001	137,045
TOTAL borrowings	**814,343**	**826,757**	**802,268**	**814,772**

Borrowings by contractual maturity, excluding the impact of derivative instruments to the interest rate: EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Fixed rate non–current and current borrowings:				
– < 1 year (current portion of non–current borrowings)	19,910	51,733	19,910	51,733
– 1–5 years	185,317	203,543	185,317	203,543
– > 5 years	–	–	–	–
TOTAL fixed rate borrowings	**205,227**	**255,276**	**205,227**	**255,276**
Floating rate non–current and current borrowings:				
– < 1 year (current borrowings)	–	–	–	–
– < 1 year (current portion of non–current borrowings)	94,405	56,350	91,790	52,915
– 1–5 years	313,404	338,240	305,158	330,119
– > 5 years	201,307	176,891	200,093	176,462
TOTAL floating rate borrowings	**609,116**	**571,481**	**597,041**	**559,496**
TOTAL borrowings	**814,343**	**826,757**	**802,268**	**814,772**

Borrowings by repricing of interest, including the impact of derivative instruments: EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
– < 1 year	385,765	379,854	373,690	367,869
– 1–5 years	353,578	396,903	353,578	396,903
– > 5 years	75,000	50,000	75,000	50,000
TOTAL borrowings	**814,343**	**826,757**	**802,268**	**814,772**

As of 31 December 2018 and as of 31 December 2017 all of the Group's and the Parent Company's borrowings were denominated in euros.

The fair value of current and non–current borrowings with floating interest rates and twelve–month–fixed interest rates approximate their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group and the Parent Company, i.e., the floating part of the interest rate corresponds to the money market price while the added part of the interest rate corresponds to the risk premium the lenders in financial and capital markets require from companies of similar credit rating level; therefore, the effect of fair value revaluation is not significant.

I) Pledges

As of 31 December 2018 the Group's and the Parent Company's assets are not pledged to secure the borrowings, except the pledge on assets of Liepājas Enerģija SIA of maximum secured claims in the amount of EUR 28 million (31/12/2017: EUR 32.3 million) to secure its current and non–current borrowings. As of the end of the reporting year there has been pledged the property, plant and equipment in the net book amount of EUR 25 million and the claims on the receivables accounts in the amount of EUR 3 million (31/12/2017: EUR 27 million and EUR 5.3 million, respectively).

II) Un–drawn borrowing facilities

As of 31 December 2018 the un–drawn committed non–current credit facilities amount to EUR 130 million (31/12/2017: EUR nil).

As of 31 December 2018 the Group had entered into four overdraft agreements with total notional amount of EUR 38.2 million (31/12/2017: EUR 34 million) of which three overdraft agreements were entered by the Parent Company with total notional amount of EUR 34 million (31/12/2017: EUR 34 million). In respect of all the overdraft agreements all conditions precedent had been met. At the end of the reporting year overdrafts were not used.

III) Weighted average effective interest rate

During the reporting year the weighted average effective interest rate (including interest rate swaps) on non–current borrowings was 1.37% (2017: 1.73%), weighted average effective interest rate for current borrowings was 0.87% (2017: 0.87%). At 31 December 2018 interest rates for non–current borrowings in euros were 6 and 12 month EURIBOR+ 0.99% (31/12/2017: +0.96%) for the Group and 6 and 12 month EURIBOR+ 0.98% (31/12/2017: +0.95%) for Latvenergo AS. At 31 December 2018 the total notional amount of interest rate swap agreements concluded by the Group amounts to EUR 225.1 million (31/12/2017: EUR 193.4 million) and the interest rate was fixed for the initial periods from 7 to 10 years.

IV) Bonds outstanding

The Parent Company (Latvenergo AS) in 2013 issued bonds in the amount of EUR 35 million with maturity date – 22 May 2020 (ISIN code – LV0000801165) with the annual coupon rate of 2.8%. In 2015 and in 2016, Latvenergo AS issued green bonds in the total amount of EUR 100 million with the maturity date 10 June 2022 (ISIN code – LV0000801777) with the annual coupon rate of 1.9%. The total nominal amount of outstanding bonds as of 31.12.2018 and 31.12.2017 amount to EUR 135 million. All issued bonds are quoted in NASDAQ Baltic Stock Exchange. The issued debt securities (bonds) are measured at amortised cost at the end of reporting year.

As of 31 December 2018 the fair value of issued debt securities (bonds) exceeds their carrying amount by EUR 4,532 thousand (31/12/2017: EUR 5,546 thousand). The fair value of debt securities (bonds) issued is calculated by discounting their future cash flows and using the market quoted yield to maturity rates of the respective bonds as of the end of the reporting year as discount factor (Level 2).

23. DERIVATIVE FINANCIAL INSTRUMENTS

I) Outstanding fair values of derivatives and their classification

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

EUR'000

		Group				Parent Company			
		31/12/2018		31/12/2017		31/12/2018		31/12/2017	
	Notes	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate swaps	23 II	–	(7,375)	31	(8,061)	–	(7,375)	31	(8,061)
Electricity forwards and futures	23 III	15,853	–	4,588	(23)	15,853	–	4,588	(23)
Natural gas forwards	23 IV	–	(2,829)	–	–	–	(2,829)	–	–
TOTAL outstanding fair values of derivatives		**15,853**	**(10,204)**	**4,619**	**(8,084)**	**15,853**	**(10,204)**	**4,619**	**(8,084)**

EUR'000

	Group				Parent Company			
	31/12/2018		31/12/2017		31/12/2018		31/12/2017	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Non–current	–	(3,923)	–	(4,914)	–	(3,923)	–	(4,914)
Current	15,853	(6,281)	4,619	(3,170)	15,853	(6,281)	4,619	(3,170)
TOTAL fair values of derivative financial instruments	**15,853**	**(10,204)**	**4,619**	**(8,084)**	**15,853**	**(10,204)**	**4,619**	**(8,084)**

Gains / (losses) on fair value changes as a result of realised hedge agreements:

EUR'000

		Group		Parent Company	
	Notes	2018	2017	2018	2017
Included in the Statement of Profit or Loss					
Electricity forwards and futures	8	(417)	(3,435)	(417)	(3,435)
		(417)	**(3,435)**	**(417)**	**(3,435)**
Included in the Statement of Comprehensive Income (Note 20 a)					
Interest rate swaps	23 II	655	3,533	655	3,533
Electricity forwards and futures	23 III	11,705	1,889	11,705	1,889
Natural gas forwards	23 IV	(2,829)	–	(2,829)	–
TOTAL gains on fair value changes		**9,531**	**5,422**	**9,531**	**5,422**

II) Interest rate swaps

As of 31 December 2018 the Group and the Parent Company had interest rate swap agreements with total notional amount of EUR 225.1 million (31/12/2017: EUR 193.4 million). Interest rate swaps are concluded with 7 to 10 year initial maturities and hedged floating rates are 6 month EURIBOR. As of 31 December 2018 fixed interest rates vary from 0.315% to 2.5775% (31/12/2017: from 0.315% to 2.5775%).

At the end of the year all of outstanding interest rate swap agreements are designated to comply with hedge accounting and were assessed prospectively and retrospectively to test whether they are effective within the hedging period (31/12/2018: 100% with notional amount of EUR 225.1 million). All contracts are designed as cash flow hedges. It was established that they are fully effective and therefore there is no ineffective portion to be recognised within profit or loss in the Statement of Profit or Loss.

Fair value changes of interest rate swaps:

EUR'000

	Group				Parent Company			
	2018		2017		2018		2017	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year	**31**	**(8,061)**	**–**	**(11,563)**	**31**	**(8,061)**	**–**	**(11,563)**
Included in Statement of Comprehensive Income (Note 20 a)	(31)	686	31	3,502	(31)	686	31	3,502
Outstanding fair value at the end of the year	**–**	**(7,375)**	**31**	**(8,061)**	**–**	**(7,375)**	**31**	**(8,061)**

The main interest rate hedging criteria stated in the Financial Risk Management policy is to ensure average fixed rate duration from 2 to 4 years and fixed rate portion at more than 35% of borrowings. As of 31 December 2018 53% (31/12/2017: 54%) of the Group's and 54% (2017: 55%) of the Parent Company's borrowings had fixed interest rates (taking into account the effect from the interest rate swaps), and average remaining time to interest re–pricing was 2.1 years (2017: 2.0 years) for the Group and 2.1 years (2017: 2.0 years) for the Parent Company.

III) Electricity forwards and futures

As of 31 December 2018 the Group and the Parent Company have entered into electricity forward and future contracts with total outstanding electricity purchase volume of 1,689,784 MWh (31/12/2017: 1,838,732 MWh) and notional value of EUR 40 million (31/12/2017: EUR 29.0 million). Electricity forward and future contracts are concluded for the maturities from one quarter to one year during the period from 1 January 2019 to 31 December 2020.

The Group and the Parent Company enters into electricity future contracts in the Nasdaq Commodities power exchange, as well as concludes electricity forward contracts with other counterparties. Electricity forward and future contracts are intended for hedging of the electricity price risk and are used for fixing the price of electricity purchased in the *Nord Pool* AS power exchange.

Electricity forward and future contracts with total outstanding volume of 1,689,784 MWh as of 31 December 2018 are designated to comply with hedge accounting treatment (31/12/2017: 1,829,972) and were reassessed prospectively and retrospectively to test whether they are effective within the hedging period. All contracts are designed as cash flow hedges. For the contracts which are fully effective contracts fair value gains are included in other comprehensive income (Note 20 a).

Fair value changes of electricity forward and future contracts:

EUR'000

	Group				Parent Company			
	2018		2017		2018		2017	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year	**4,588**	**(23)**	**6,134**	**(23)**	**4,588**	**(23)**	**6,134**	**(23)**
Included in the Statement of Profit or Loss (Note 8)	(440)	23	(3,435)	–	(440)	23	(3,435)	–
Included in Statement of Comprehensive Income (Note 20 a)	11,705	–	1,889	–	11,705	–	1,889	–
Outstanding fair value at the end of the year	**15,853**	**–**	**4,588**	**(23)**	**15,853**	**–**	**4,588**	**(23)**

IV) Natural gas forwards

The Group and the Parent Company have entered into natural gas price swap contracts with total outstanding natural gas purchase volume of 990,000 MWh (31/12/2017: 0 MWh) and notional value of EUR 23 million (31/12/2017: nil). Natural gas swap contracts are concluded for the maturities from one month to one quarter during the period of 1 July 2019 to 1 October 2019. The Group and the Parent Company have concluded natural gas swap contracts with other counterparties. Natural gas swap contracts are intended for hedging of the natural gas price risk and are used for fixing the price of natural gas purchased in wholesale gas market. Natural gas swap contracts with total outstanding volume of 990,000 MWh as of 31 December 2018 are designated to comply with hedge accounting treatment (31/12/2017: nil) and were reassessed prospectively and retrospectively to test whether they are effective within the hedging period.

Fair value changes of natural gas forward contracts:

EUR'000

	Group				Parent Company			
	2018		2017		2018		2017	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Included in Statement of Comprehensive Income (Note 20 a)	–	(2,829)	–	–	–	(2,829)	–	–
Outstanding fair value at the end of the year	**–**	**(2,829)**	**–**	**–**	**–**	**(2,829)**	**–**	**–**

24. FAIR VALUES AND FAIR VALUE MANAGEMENT

In this Note are disclosed the fair value measurement hierarchy for the Group's and the Parent Company's financial and non-financial assets and liabilities.

Quantitative disclosures of fair value measurement hierarchy for assets at the end of the year:

EUR'000

	Group				Parent Company			
	Fair value measurement using				Fair value measurement using			
Type of liability	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**TOTAL**	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**TOTAL**
As of 31 December 2018								
Revalued property, plant and equipment (Note 14 c)	–	–	2,680,349	**2,680,349**			788,510	**788,510**
Non-current financial investments (Note 15)	–	–	40	**40**	–	–	39	**39**
Derivative financial instruments, including:								
Electricity forwards and futures (Note 23)	–	15,853	–	**15,853**	–	15,853	–	**15,853**
Assets for which fair values are disclosed								
Investment properties (Note 14 b)	–	–	467	**467**	–	–	61,796	**61,796**
Other financial investments (Note 21)	–	16,935	–	**16,935**	–	16,935	–	**16,935**
Floating rate loans to subsidiaries (Note 28 e)	–	–	–	**–**	–	171,858	–	**171,858**
Fixed rate loans to subsidiaries (Note 28 e)	–	–	–	**–**	–	593,957	–	**593,957**
Non-current financial receivables (Note 17 b)	–	–	30,920	**30,920**		–	331	**331**
Current financial receivables (Note 17 a, b)	–	–	202,568	**202,568**	–	–	95,258	**95,258**
Cash and cash equivalents	–	129,455	–	**129,455**	–	127,554	–	**127,554**
As of 31 December 2017								
Assets measured at fair value								
Revalued property, plant and equipment (Note 14 c)	–	–	2,587,058	**2,587,058**	–	–	722,609	**722,609**
Non-current financial investments (Note 15)	–	–	40	**40**	–	–	39	**39**
Derivative financial instruments, including:								
Electricity forwards and futures (Note 23)	–	4,588	–	**4,588**	–	4,588	–	**4,588**
Interest rate swaps (Note 23)	–	31	–	**31**	–	31	–	**31**
Assets for which fair values are disclosed								
Investment properties (Note 14 b)	–	–	753	**753**	–	–	64,807	**64,807**
Other financial investments (Note 21)	–	16,984	–	**16,984**	–	16,984	–	**16,984**
Floating rate loans to subsidiaries (Note 28 e)	–	–	–	**–**	–	714,165	–	**714,165**
Fixed rate loans to subsidiaries (Note 28 e)	–	–	–	**–**	–	384,616	–	**384,616**
Non-current financial receivables (Note 17 b)	–	–	3,229	**3,229**	–	–	284	**284**
Current financial receivables (Note 17 a, b)	–	–	747,201	**747,201**	–	–	100,737	**100,737**
Cash and cash equivalents	–	236,003	–	**236,003**	–	232,855	–	**232,855**

There have been no transfers for assets between Level 1, Level 2 and Level 3 during the reporting period.

Quantitative disclosures of fair value measurement hierarchy for liabilities at the end of the year:

EUR'000

Type of liability	Group				Parent Company			
	Fair value measurement using				Fair value measurement using			
	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	TOTAL	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	TOTAL
As of 31 December 2018								
Liabilities measured at fair value								
Derivative financial instruments, including:								
Interest rate swaps (Note 23)	–	7,375	–	**7,375**	–	7,375	–	**7,375**
Electricity and natural gas forwards and futures (Note 23)		2,829		**2,829**		2,829		**2,829**
Liabilities for which fair values are disclosed								
Issued debt securities (bonds) (Note 22)	–	137,001	–	**137,001**	–	137,001	–	**137,001**
Floating rate borrowings (Note 22)	–	677,342	–	**677,342**	–	665,267	–	**665,267**
Trade and other financial current payables (Note 25)	–	–	103,707	**103,707**	–	–	78,726	**78,726**
As of 31 December 2017								
Liabilities measured at fair value								
Derivative financial instruments, including:								
Interest rate swaps (Note 23, II)	–	8,061	–	**8,061**	–	8,061	–	**8,061**
Electricity and natural gas forwards and futures (Note 23)	–	23	–	**23**	–	23	–	**23**
Liabilities for which fair values are disclosed 7								
Issued debt securities (bonds) (Note 22)	–	137,045	–	**137,045**	–	137,045	–	**137,045**
Floating rate borrowings (Note 22)	–	689,712	–	**689,712**	–	677,727	–	**677,727**
Trade and other financial current payables (Note 25)	–	–	115,742	**115,742**	–	–	79,341	**79,341**

There have been no transfers for liabilities between Level 1, Level 2 and Level 3 during the reporting period.

The fair value hierarchy for the Group's and the Parent Company's financial instruments that are measured at fair value, by using specific valuation methods, is disclosed above.

Set out below, is a comparison by class of the carrying amounts and fair value of the Group's and the Parent Company's financial instruments, other than those with carrying amounts which approximates their fair values:

EUR'000

	Group				Parent Company			
	Carrying amount		Fair value		Carrying amount		Fair value	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Financial assets								
Fixed rate loans to subsidiaries	–	–	–	–	593,957	384,616	618,046	399,215
Other financial investments	16,935	16,984	20,067	21,092	16,935	16,984	20,067	21,092
Financial liabilities								
Interest–bearing liabilities, including:								
– issued debt securities (bonds)	137,001	137,045	141,532	142,591	137,001	137,045	141,532	142,591

The management assessed that cash and short–term deposits, receivables, trade payables, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short–term maturities of these instruments. The fair value of the financial assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The following methods and assumptions were used to estimate the fair values:

a) The fair values of borrowings with floating interest rates approximate their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group and the Parent Company, i.e., the floating part of the interest rate corresponds to the money market price while the added part of the interest rate corresponds to the risk premium the lenders in financial and capital markets require from companies of similar credit rating level (Level 2);

b) The fair value of loans to subsidiaries with fixed rates calculations are based on discounted cash flows using discount factor of respective maturity EUR swap rates increased by average market margin of short term financing;

c) The Group and the Parent Company enter into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. The derivative financial instruments are determined by using various valuation methods and models with market observable inputs. The models incorporate the credit quality of counterparties, foreign exchange spot and forward rates. The fair values of interest rate swaps are obtained from corresponding bank's revaluation reports and in financial statements fair values of financial instruments as specified by banks are disclosed. To make sure the fair values of interest rate swaps are accurate in any material aspect, the Group and the Parent Company makes its own interest rate swaps fair value calculations by discounting financial instruments future contractual cash flows using euro annual bond 6 months Euribor forward starting interest rate swap curve. The fair value of electricity forward and future contracts is calculated as discounted difference between actual market and settlement prices for the volume set in the agreements. If counterparty is a bank, calculated fair values of financial instruments are compared to bank's revaluation reports and the bank's calculated fair values of the financial instruments are used in the financial reports;

d) The fair value of the bonds issued and financial investments in government bonds are calculated by discounting their future cash flows using the market quoted yield to maturity rates of the respective bonds as of the end of the reporting year as discount factor.

e) The fair value of investment properties is determined using the income method, by discounting expected future cash flows. In 2018, the nominal pre–tax discount rate used to determine the fair value of investments is 4.2% (2017: 5.3%) as included in the electricity distribution and transmission system service tariff calculation methodology.

25. TRADE AND OTHER PAYABLES

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Financial liabilities:				
Payables for materials and services	63,198	75,395	63,009	68,820
Payables for electricity and natural gas	22,869	21,094	2,197	933
Accrued expenses	7,817	10,093	4,142	4,722
Other financial current liabilities	9,823	9,160	9,378	4,866
TOTAL financial liabilities	**103,707**	**115,742**	**78,726**	**79,341**
Non–financial liabilities:				
State social security contributions and other taxes	15,624	15,919	7,353	9,025
Advances received	12,024	11,784	4,399	4,993
Other current payables	3,653	3,627	1,584	1,330
TOTAL non–financial liabilities	**31,301**	**31,330**	**13,336**	**15,348**
TOTAL trade and other current payables	**135,008**	**147,072**	**92,062**	**94,689**

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

26. PROVISIONS

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
Non-current:				
– post–employment benefits (recognised in profit or loss)	12,411	12,928	5,536	5,687
– post–employment benefits (recognised in equity)	356	793	332	224
– termination benefits	6,191	5,925	1,537	1,704
– environmental provisions	1,220	2,264	1,220	1,220
	20,178	**21,910**	**8,625**	**8,835**
Current:				
– termination benefits	**779**	**3,390**	**342**	**903**

a) Provisions for post–employment benefits

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**13,721**	**16,428**	**5,911**	**6,733**
Current service cost	1,238	1,392	523	572
Interest cost	261	304	112	124
Post–employment benefits paid	(2,017)	(943)	(786)	(465)
(Gains) / losses as a result of changes in actuarial assumptions (Note 20 a)	(436)	(3,460)	108	(1,053)
At the end of the year	**12,767**	**13,721**	**5,868**	**5,911**

Total charged / (credited) provisions are included in the Statement of Profit or Loss position 'Personnel expenses' within state social insurance contributions and other benefits defined in the Collective agreement (Note 9), while gains / (losses) as a result on re–measurement on defined post–employment benefit plan is included in the Statement of Comprehensive Income, according to IAS 19 *Employee Benefits:*

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**13,721**	**16,428**	**5,911**	**6,733**
(Charged) / credited to the Statement of Comprehensive Income less of deferred income tax (Note 20 a)	(436)	(3,460)	108	(1,053)
(Charged) / credited to the Statement of Profit or Loss	(518)	753	(151)	231
At the end of the year	**12,767**	**13,721**	**5,868**	**5,911**

Weighted average discount rate used for discounting benefit obligations was 1.90% (2017: 1.85%), considering the market yields on government bonds at the end of the reporting year. The Group's Collective Agreement provides indexation of employees' wages at least at the level of inflation. Long–term inflation determined at the level of 3.0% (2017: 3.0%) when calculating long–term post–employment benefits. In calculation of these liabilities also the probability, determined on the basis of previous experience, of retirement in different employees' aging groups was also considered.

A quantitative sensitivity analysis for significant assumptions on provisions for post–employment benefits as of the end of the year is as shown below:

EUR'000

Assumptions	Date of valuation	Group						Parent Company					
		Discount rate		Future salary changes		Retirement probability changes		Discount rate		Future salary changes		Retirement probability changes	
		1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease
Impact on provisions for post–employment benefits	31/12/2018	1,519	(1,252)	1,479	(1,247)	1,646	(1,366)	610	(501)	593	(499)	661	(547)
	31/12/2017	1,508	(1,246)	1,468	(1,240)	1,634	(1,360)	594	(488)	578	(486)	644	(533)

The sensitivity analysis above has been determined based on a method that extrapolates the impact on defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

Contributions are monitored on an annual basis and the current agreed contribution rate is 5%. The next valuation is due to be completed as at 31 December 2019. Expected contributions to post-employment benefit plan for the year ending 31 December 2019 are EUR 2,389 thousand.

The weighted average duration of the defined benefit obligation is 20.47 years (2017 – 19.32 years).

EUR'000

	Date of valuation	Group				Parent Company			
		Less than 1 year	From 1 to 5 years	Over 5 years	TOTAL	Less than 1 year	From 1 to 5 years	Over 5 years	TOTAL
Defined benefit obligation	31/12/2018	2,481	1,745	8,541	**12,767**	1,676	955	3,237	**5,868**
	31/12/2017	3,105	2,060	8,556	**13,721**	1,854	827	3,230	**5,911**

b) Termination benefits

Termination benefits paid out in 2017 are included in the Statement of Profit or Loss position 'Personnel expenses' within expenditure of employment termination (Note 9), while termination benefits and projected future liability values for years 2018 to 2022 is recognised as a liability in the Statement of Financial Position and as accrued costs within expenditure of employment termination (Note 9):

EUR'000

	Group		Parent Company	
	2018	**2017**	**2018**	**2017**
At the beginning of the year	**9,315**	**–**	**2,607**	**–**
Termination benefits paid	(8,136)	(3,974)	(1,478)	(407)
Changes in provisions	5,795	13,289	749	3,014
At the end of the year	**6,974**	**9,315**	**1,878**	**2,607**

According to defined development directions per Strategy of Latvenergo Group for the period 2017-2022, the management of the Parent Company approved the Strategic Development and Efficiency Programme. Provisions for employees' termination benefits are recognised on a basis of Strategic Development and Efficiency Programme of Latvenergo Group for the period in which it is planned to implement the efficiency program (including Latvenergo AS and Sadales tīkls AS efficiency activities), by which it is intended to reduce gradually the number of employees by the year 2022.

Assumptions used in calculation of termination benefits are as follows – average employee earnings at the time of termination - average earnings per year, with projected increase (salary indexation) in the in the year 2019 by 9.6% (2018: 3.0%) and in the following years by 3.0% for Latvenergo AS and in the year 2019 by 2.6% (2018: 2.5%) and in the following years by 3.0% for Sadales tīkls AS, average employee length of service at the time of termination, the State Social Insurance Contributions rate is 24.09% in 2019 and in subsequent years.

The amount of provisions at the end of reporting year is estimated in accordance with the estimated future liability value as of 31 December 2018, using the fixed discount rate of 0.855% as adopted by the Latvenergo Group (31/12/2017: 1.093%). The discount rate is comprised of a 4-year EUROSWAP rate of 0.040% and a corporate risk premium of 0.815% (determined on the basis of interest rate on Latvenergo AS issued bonds yield spreads above the market rate) (31/12/2017: 5-year EUROSWAP rate – 0.314%, corporate risk premium – 0.779%).

A quantitative sensitivity analysis for significant assumptions used for calculation of termination benefits as of the end of the year is as shown below:

EUR'000

Assumptions	Date of valuation	Group						Parent Company					
		Discount rate		Future salary changes		Average employee length of service		Discount rate		Future salary changes		Average employee length of service	
		1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease
Impact on provisions for termination benefits	31/12/2018	(192)	201	147	(145)	39	39	(47)	49	47	(46)	11	(11)
	31/12/2017	(134)	138	261	(254)	53	(53)	(68)	71	69	(67)	15	(15)

c) Environmental provisions

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**2,264**	**2,215**	**1,220**	**1,191**
Charged to the Statement of Profit or Loss	(1,044)	49	–	29
At the end of the year	**1,220**	**2,264**	**1,220**	**1,220**

The environmental provision in the amount of EUR 1,220 thousand (31/12/2017: EUR 2,264 thousand) for the Group represents the estimated cost for Latvenergo AS of cleaning up TEC–1 combined heat and power plant ash–fields in accordance with the requests made by the regional Environmental Authority of Riga and feasibility study on this project in the amount of EUR 1,220 thousand (31/12/2017: EUR 1,220 thousand and Liepājas Enerģija SIA provision for the environmental recovery measures in the amount of EUR 1,044 thousand). The amount of the provisions is calculated taking into account the construction cost index (data from the Central Statistical Bureau of the Republic of Latvia).

27. DEFERRED INCOME

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
I) Non-current deferred income				
a) from contracts with customers				
Deferred income from connection fees	143,494	142,132	–	–
	143,494	**142,132**	**–**	**–**
b) from lease				
Deferred income from connection fees	3,852	4,319	–	–
Deferred income on transmission system assets reconstruction	984	995	–	–
Other deferred income	403	423	403	423
	5,239	**5,737**	**403**	**423**
c) other				
Deferred income on grant for the installed electrical capacity of CHPPs*	209,419	285,109	209,419	285,109
Deferred income on financing from European Union funds	57,851	45,090	18	270
Deferred income on financing receivable from European Union funds	30,617	14,707	–	–
Deferred income from plant and equipment received free of charge	393	283	265	283
	298,280	**345,189**	**209,702**	**285,662**
TOTAL non-current deferred income	**447,013**	**493,058**	**210,105**	**286,085**

EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
II) Current deferred income				
a) from contracts with customers				
Deferred income from connection fees	12,984	12,247	–	–
Deferred income from use of allowed effective electrical load (distribution system services)	287	253	–	–
	13,271	**12,500**	**–**	**–**
b) from lease				
Deferred income from connection fees	449	449	–	–
	449	**449**	**–**	**–**
c) other				
Other deferred income	58	121	20	20
Deferred income on grant for the installed electrical capacity of CHPPs*	23,990	29,304	23,990	29,304
Deferred income on financing from European Union funds	1,941	1,854	12	34
	25,989	**31,279**	**24,022**	**29,358**
TOTAL current deferred income	**39,709**	**44,228**	**24,022**	**29,358**
TOTAL deferred income	**486,722**	**537,286**	**234,127**	**315,443**

* See Note 4. i)

The Group and the Parent Company ensures the management, application of internal controls and accounting for the Group's and the Parent Company's projects financed by the European Union funds, according to the guidelines of the European Union and legislation of the Republic of Latvia.

Accounting of the transactions related to the projects financed by the European Union is ensured using separately identifiable accounts. The Group and the Parent Company ensure separate accounting of financed projects with detailed income and expense, non–current investments and value added tax in the relevant positions of the Statement of Profit or Loss and Statement of Financial Position.

Movement in deferred income (non–current and current part):

EUR'000

	Group		Parent Company	
	2018	2017	2018	2017
At the beginning of the year	**537,286**	**209,429**	**315,443**	**1,114**
Received deferred non–current income (financing)	31,537	14,707	–	–
Received connection fees	14,726	12,848	–	–
Received income from compensation for the installed electrical capacity of CHPPs*	–	314,413	–	314,413
Compensation for the installed electrical capacity of CHPPs credited to the Statement of Profit or Loss*	(81,004)	–	(81,004)	–
Credited to the Statement of Profit or Loss (in Note 6 as "Other revenue")	(15,823)	(14,111)	(312)	(84)
At the end of the year	**486,722**	**537,286**	**234,127**	**315,443**

* See Note 4. i)

28. RELATED PARTY TRANSACTIONS

The Parent Company and, indirectly, its subsidiaries are controlled by the Latvian state. Related parties of the Latvenergo Group and the Parent Company are Shareholder of the Parent Company who controls over the Parent Company in accepting operating business decisions, members of Latvenergo Group entities' management boards, members of the Supervisory board of the Parent Company, members of Supervisory body of the Parent Company – the Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence.

Trading transactions taking place under normal business activities with the Latvian government including its departments and agencies and transactions between state–controlled entities and providers of public utilities are excluded from the scope of related party disclosures. The Group and the Parent Company enters into transactions with many of these bodies on an arm's length basis. Transactions with government related entities include sales of energy and related services and does not contain individually significant transactions and quantitative disclosure of transactions with those related parties is impossible due to broad range of the Latvenergo Group's and the Parent Company's customers, except for transactions with transmission system operator – Augstsprieguma tīkls AS.

a) Income and expenses from transactions with related parties: EUR'000

	Group		Parent Company			
	2018	2017	2018		2017	
	Government related entities*		Subsidiaries	Government related entities*	Subsidiaries	Government related entities*
Income:						
– Trade of energy and related services	10,724	2,605	25,370	10,656	101,227	2,535
– Lease of transmission system assets	38,699	43,911	–	–	–	–
– Other revenue from corporate services	–	–	28,505	–	29,741	–
– Other revenue	3,175	3,249	–	3,024	–	3,118
– Lease of assets	372	645	14,534	372	14,181	645
– Interest income	–	–	10,289	–	10,189	–
– Other income	1,036	271	–	196	–	–
TOTAL income from transactions with related parties	**54,006**	**50,681**	**78,698**	**14,248**	**155,338**	**6,298**
Expenses:						
– Distributions system services	–	–	207,096	–	217,735	–
– Public service obligation fees	–	–	98,623	–	114,957	–
– Purchased electricity and heat	4,131	4,253	37,461	4,131	4,198	4,253
– Electricity transmission services costs (Note 8)	71,368	71,044	–	1,015	–	845
– Construction services for leased assets	–	–	1,867	–	5,391	–
– Other expenses	864	793	1,594	276	1,773	269
TOTAL expenses from transactions with related parties	**76,363**	**76,090**	**346,641**	**5,422**	**344,054**	**5,367**
including gross expenses from transactions with subsidiaries recognised in net amount through profit or loss:						
– Sadales tīkls AS	–	–	305,719	–	332,172	–
– Enerģijas publiskais tirgotājs AS	–	–	–	–	520	–
	–	**–**	**305,719**	**–**	**332,692**	**–**

* Transmission system operator – Augstsprieguma tīkls AS

b) Balances at the end of the period arising from sales/purchases of goods and services: EUR'000

	Group			Parent Company		
	31/12/2018	01/01/2018	31/12/2017	31/12/2018	01/01/2018	31/12/2017
Receivables from related parties:						
– Subsidiaries (Note 17 a, b)	–	–	–	12,204	17,434	17,434
– Government related and other related parties*	42,273	20,014	20,014	3,365	1,211	1,211
– Loss allowances for expected credit loss from receivables of subsidiaries (Note 17 a, b)	–	–	–	(9)	(13)	–
– Loss allowances for expected credit loss	(55)	(26)	–	(4)	(1)	–
	42,218	**19,988**	**20,014**	**15,556**	**18,631**	**18,645**
Payables to related parties:						
– Subsidiaries	–	–	–	30,865	30,994	30,994
– Government related and other related parties*	12,262	17,293	**17,293**	1,044	1,019	1,019
	12,262	**17,293**	**17,293**	**31,909**	32,013	**32,013**

* Transmission system operator – Augstsprieguma tīkls AS and Pirmais Slēgtais Pensiju Fonds AS

c) Accrued income raised from transactions with related parties: EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
– For goods sold / services provided for subsidiaries (Note 17 a, b)	–	–	2,859	3,202
– For interest received from subsidiaries (Note 17 b)	–	–	1,820	1,875
	–	**–**	**4,679**	**5,077**

d) Accrued expenses raised from transactions with related parties: EUR'000

	Group		Parent Company	
	31/12/2018	31/12/2017	31/12/2018	31/12/2017
– For purchased goods / received services from subsidiaries	–	–	5,657	1,176
	–	**–**	**5,657**	**1,176**

The Group and the Parent Company have not incurred write–offs of trade payables and receivables from transactions with related parties, as all debts are recoverable.

Receivables and payables with related parties are current balances for services and goods. None of the amounts at the end of the reporting year are secured.

Remuneration to the Latvenergo Group's management includes remuneration to the members of the Management Boards the Group entities, the Supervisory Board and the Supervisory body (Audit Committee) of the Parent Company. Remuneration to the Parent Company's management includes remuneration to the members of the Parent Company's Management Board, the Supervisory Board and the Supervisory body (Audit Committee). Information disclosed in Note 9.

Dividend payments to Shareholder of the Parent Company and share capital contributions are disclosed in Note 20 b and Note 19, respectively.

Dividends received from subsidiaries are disclosed in note 15.

e) Loans to related parties (Parent Company)

Non–current and current loans to related parties: EUR'000

	Parent Company		
	31/12/2018	01/01/2018	31/12/2017
Non–current loans to subsidiaries			
Sadales tīkls AS	442,728	312,582	312,582
Latvijas elektriskie tīkli AS	152,681	85,394	85,394
Impairment for expected credit loss	(405)	(271)	–
TOTAL non–current loans	**595,004**	**397,705**	**397,976**
Current portion of non–current loans			
Sadales tīkls AS	49,854	50,914	50,914
Latvijas elektriskie tīkli AS	8,175	8,490	8,490
Impairment for expected credit loss	(39)	(40)	–
Current loans to subsidiaries			
Latvijas elektriskie tīkli AS	18,541	1,294	1,294
Sadales tīkls AS	6,502	28,157	28,157
Elektrum Eesti OÜ	7,882	5,134	5,134
Elektrum Lietuva, UAB	11,740	2,172	2,172
Enerģijas publiskais tirgotājs AS	68,233	604,644	604,644
Impairment for expected credit loss	(77)	(204)	–
TOTAL current loans	**170,811**	**700,561**	**700,805**
TOTAL loans to subsidiaries	**765,815**	**1,098,266**	**1,098,781**

Counterparty model is used on individual contract basis for assessment of expected credit risk for non-current and current loans to subsidiaries. The expected credit losses according to this model are based and impairment for expected credit loss is recognised on assessment of the individual counterparty's risk of default and recovery rate assigned by *Moody's* credit rating agency for 12 months expected losses (Note 4 b). Credit risk of subsidiaries is assessed at the same level as Latvenergo AS credit risk considering that they are 100% controlled by Latvenergo AS. Since the initial recognition of loans, credit risk has not changed significantly.

All current loans to related parties as of 31 December 2018 will be settled in 2019.

Movement in loans: EUR'000

	Parent Company	
	2018	2017
At the beginning of the year	**1,098,781**	**622,704**
Change in current loans in cash (net)	323,539	268,218
Change in current loans by non-cash offsetting of operating receivables and payables (net)	(720,848)	268,084
Issued non–current loans by non-cash offset with dividends (Note 15)	124,268	–
Reduction of non–current loans by non-cash offsetting of operating receivables and payables	(59,404)	(60,225)
Effect of IFRS 9 'Financial instruments' adoption (Note 2.28.)	(515)	–
Impairment for expected credit loss	(6)	–
At the end of the year	**765,815**	**1,098,781**

Interest received from related parties: EUR'000

	Parent Company	
	2018	2017
Interest received	2,103	1,682
	2,103	**1,682**

l) Non–current loans, including current portion

Concluded non–current loan agreements with Latvijas elektriskie tīkli AS: EUR'000

Agreement conclusion date	Principal amount of the loan	Outstanding loan amount		Interest rate	Maturity date
		31/12/2018	31/12/2017		
1 April 2011	97,467	12,826	15,801	6 months EURIBOR + fixed rate	1 April 2025
3 September 2013	44,109	27,568	33,082	fixed rate	10 September 2023
10 June 2016	156,500	120,462	45,000	fixed rate	10 June 2028
TOTAL	**298,076**	**160,856**	**93,883**		

As of 31 December 2018 total outstanding amount of non–current loans to Latvijas elektriskie tīkli AS amounted to EUR 160,856 thousand (31/12/2017: EUR 93,883 thousand), including current portion of the loan repayable in 2019 – EUR 8,176 thousand (31/12/2017: EUR 8,490 thousand). As of 31 December 2018 for 8% (31/12/2017: 17%) of the loans issued to Latvijas elektriskie tīkli AS was set floating interest rate, which was influenced by 6 months EURIBOR interbank rate fluctuations. During 2018 the effective average interest rate of non–current loans was 1.81% (2017: 2.36%). As of 31 December 2018 is recognised impairment for expected credit loss of non–current loans to Latvijas elektriskie tīkli AS in the amount of 109 thousand EUR (31/12/2017: nil; 01/01/2018: 64 thousand EUR). Non–current loans are not secured with a pledge or otherwise.

Non–current loans to Latvijas elektriskie tīkli AS by maturity: EUR'000

	Parent Company	
	31/12/2018	31/12/2017
Non–current loan:		
– < 1 year (current portion)	8,176	8,490
– 1 – 5 years	109,724	64,790
– > 5 years	42,957	20,603
	160,856	**93,883**

Concluded non–current borrowing agreements with Sadales tīkls AS: EUR'000

Agreement conclusion date	Principal amount of the loan	Outstanding loan amount		Interest rate	Maturity date
		31/12/2018	31/12/2017		
29 September 2011	316,271	47,966	58,676	6 months EURIBOR + fixed rate	1 September 2025
6 February 2013	42,686	14,940	19,209	fixed rate	10 September 2022
18 September 2013	42,686	21,343	25,612	fixed rate	10 August 2023
29 October 2014	90,000	60,000	70,000	fixed rate	10 September 2024
20 October 2015	90,000	70,000	80,000	fixed rate	21 October 2025
22 August 2016	60,000	53,333	60,000	fixed rate	22 August 2026
22 August 2016	50,000	45,000	50,000	fixed rate	14 June 2027
14 December 2018	260,000	180,000	–	fixed rate	14 December 2028
TOTAL	**951,643**	**492,582**	**363,497**		

As of 31 December 2018 total outstanding amount of non–current loans with Sadales tīkls AS amounted to EUR 492,582 thousand (31/12/2017: EUR 363,497 thousand), including current portion of the loan repayable in 2019 – EUR 49,853 thousand (31/12/2017: EUR 50,915 thousand). As of 31 December 2018 for 10% of the loans issued to Sadales tīkls AS (31/12/2017: 16%) was set floating interest rate, which was influenced by 6 months EURIBOR interbank rate fluctuations. During 2018 the effective average interest rate of non–current loans was 1.65% (2017: 1.84%). As of 31 December 2018 is recognised impairment for expected credit loss of non–current loans to Sadales tīkls AS in the amount of 335 thousand EUR (31/12/2017: nil; 01/01/2018: 247 thousand EUR). Non–current loans are not secured with a pledge or otherwise.

Non–current loans to Sadales tīkls AS by maturity:

EUR'000

	Parent Company	
	31/12/2018	**31/12/2017**
Non–current loan:		
– < 1 year (current portion)	49,853	50,915
– 1 – 5 years	322,786	238,425
– > 5 years	119,943	74,157
	492,582	363,497

II) Current loans

To ensure efficiency and centralised management of Latvenergo Group companies' financial resources and using the functionality of Group accounts and possibility for non-cash offsetting of mutual invoices between the parties, short term credit funds are provided. In the reporting period Latvenergo AS issued loans to subsidiaries in accordance with mutually concluded agreement 'On provision of mutual financial resources', allowing the subsidiaries to borrow and to repay the loan accordingly to daily operating needs and including non-cash offsetting of operating receivables and payables. In 2018 the effective average interest rate was 0.51% (2017: 0.52%).

In the reporting period Enerģijas publiskais tirgotājs AS received current loan from Latvenergo AS in accordance with mutually concluded agreement 'On provision of mutual financial resources', using Group accounts.

On 29 March 2018 an agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS for issue of the current loan in amount of EUR 150,000 thousand to ensure Enerģijas publiskais tirgotājs AS financial resources for the fulfilment of public supplier duties and mandatory procurement process administration. Maturity date of the loan is 31 March 2019. An agreement concluded on 31 March 2017 with amount of EUR 200,000 thousand and maturity date - 31 March 2018 is repaid. Loan annual interest rate is fixed at 0.730% (2017: 1.000%). As of 31 December 2018, issued, but unpaid net amount of current loan is EUR 68,233 thousand (31/12/2017: EUR 150,231 thousand).

On 29 November 2017 an agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS for issue a short term loan in amount of EUR 454,413 thousand. Loan amount equalled to the government grant receivable and loan was intended to ensure Enerģijas publiskais tirgotājs AS financial resources for financing of one-off compensation. On 26 March 2018 the loan was settled with mutual non–monetary offset (see Note 4 i).

As of 31 December 2018 is recognised impairment for expected credit loss of current loans to related parties in the amount of 77 thousand EUR (31/12/2017: nil; 01/01/2018: 204 thousand EUR).

f) Current borrowings from related parties

Financial transactions between related parties have been carried out by using current loans with a target to effectively and centrally manage Latvenergo Group companies' financial resources, using Group accounts. In the reporting period Latvenergo AS has received borrowings from subsidiaries in accordance with mutually concluded agreement 'On provision of mutual financial resources'. In 2018 the effective average interest rate was 0.51% (2017: 0.52%). At the end of the reporting year Latvenergo AS has no borrowings from related parties (31/12/2017: nil).

EUR'000

	Parent Company	
	2018	**2017**
Interest paid	37	41
	37	**41**

29. COMMITMENTS AND CONTINGENT LIABILITIES

As of 31 December 2018 the Group had commitments amounting to EUR 189.8 million (31/12/2017: EUR 225.6 million) and the Parent Company had commitments amounting to EUR 58.5 million (31/12/2017: EUR 105.2 million) for capital expenditure contracted but not delivered at the end of the reporting period.

On 5 March 2019 Latvenergo AS has issued support letters to its subsidiaries Enerģijas publiskais tirgotājs AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS acknowledging that its position as the shareholder is to ensure that subsidiaries are managed so that they have sufficient financial resources and are able to carry their operations and settle their obligations.

30. EVENTS AFTER THE REPORTING YEAR

On 19 March 2019 *Moody's* credit rating for Latvenergo AS affirmed at the Baa2 level with a stable future outlook.

On 31 March 2019 a loan agreement was concluded between Latvenergo AS and Enerģijas publiskais tirgotājs AS in the amount till EUR 110 million with the maturity 31 March 2020.

There have been no other significant events subsequent to the end of the reporting year that might have a material effect on the Financial Statements for the year ended 31 December 2018.

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Kaspars Cikmačs
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

16 April 2019

INDEPENDENT AUDITOR'S REPORT

To the shareholder of Latvenergo AS

Report on the audit of the separate and consolidated financial statements

Our opinion

In our opinion, the separate and consolidated financial statements give a true and fair view of the separate and consolidated financial position of Latvenergo AS (the Company) and its subsidiaries (the Group) as at 31 December 2018, and of its separate and consolidated financial performance and its separate and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Our opinion is consistent with our additional report to the Audit Committee dated 3 April 2019.

What we have audited

The financial statements presented on pages 11 to 68 which consist of the separate financial statements of the Company and the consolidated financial statements of the Group (together "the financial statements") comprise:

- the separate and consolidated statement of financial position as at 31 December 2018;
- the separate and consolidated statement of profit or loss for the year then ended;
- the separate and consolidated statement of comprehensive income for the year then ended;
- the separate and consolidated statement of changes in equity for the year then ended;
- the separate and consolidated statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

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

Independence

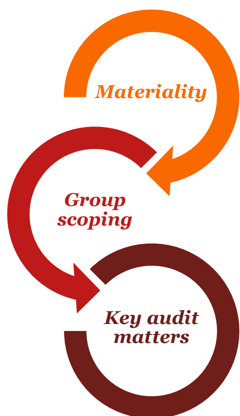
We are independent of the Company and the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) and the ethical requirements of the Law on Audit Services that are relevant to our audit of the financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code and the ethical requirements of the Law on Audit Services.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Company and the Group are in accordance with the applicable law and regulations in Latvia and that we have not provided non-audit services that are prohibited under Article 37.6 of Law on Audit Services of the Republic of Latvia.

The non-audit services that we have provided to the Company and the Group, in the period from 1 January 2018 to 31 December 2018, are disclosed in Note 10 to the financial statements.

Our audit approach

Overview



Materiality

- Overall Company and Group materiality: EUR 7,600 thousand.

Audit scope

- Full scope audit was conducted for all seven Group entities, five of them are in Latvia (including the Company), one in Estonia and one in Lithuania.
- The Group audit team performed the work on all five Latvian entities.
- Estonian and Lithuanian subsidiaries were audited by component audit teams located in the respective countries.

Key audit matters

- Impact of USA sanctions applied to a supplier of hydroelectric units.
- Implications of changes in the tax law on deferred tax recognition.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Company and Group materiality separately for the separate and consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall Company and Group materiality	Overall materiality applied to the Company and the Group was EUR 7,600 thousand.
How we determined it	5% of average profit before tax for the recent three years.
Rationale for the materiality benchmark applied	We chose profit before tax as the base benchmark because, in our view, it is the benchmark against which the performance of the Company and the Group is most commonly measured by users of the financial statements, and it is a generally accepted benchmark. We decided to use average profit for the recent three years (2016-2018) due to significant volatility in profit before tax during these years due to fluctuations in the market price of electricity, arising mainly from unstable weather conditions in Latvia and Nordic countries. We chose 5%, which is within the range of acceptable quantitative materiality thresholds.

We agreed with the Audit Committee that we would report to them the misstatements identified during our audit above EUR 760 thousand, both with respect to the Company and the Group, as well as the misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters are addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters	How our audit addressed the key audit matter
Impact of USA sanctions applied to a supplier of hydroelectric units	
Refer to Note 4 to the financial statements on page 35.	
In January 2018 USA applied sanctions to a Russia based supplier who has been contracted by the Group to reconstruct five hydroelectric units of the Hydro Power plants of the Group for a total amount of EUR 78,045 thousand. By 31 December 2018 only a part of the contracted equipment and works have been completed and further supplies have been suspended due to the sanctions against the supplier. The most significant judgements made by the management in respect of this matter relate to: - assessment whether there is an impairment of the construction in progress within property, plant and equipment of EUR 16,562 thousand as at 31 December 2018, including the machinery supplied and not yet installed, related to the above contract; - assessment whether there is a need to recognise a provision or disclose a contingent liability related to the resolution of the matter as at 31 December 2018. The management has engaged external independent experts to advise in assessing the impact and determining the course of action. The management has concluded that no impairment of the construction in progress has incurred and no provision needs to be recognised as at 31 December 2018. We focused on this area because the sanctions applied by USA to a supplier who is responsible for delivering and installing hydroelectric units may have a material impact on the financial statements and the assessment of the impact is subject to management's judgement.	We discussed the matter with the management and the Company's internal lawyers. We examined the detailed written assessment made by the management in respect of the impact of the matter on the financial statements. We also obtained and read the contract with the supplier and other evidence serving as a basis for the management's judgement, including the reports prepared by the external independent experts and the Company's correspondence with the USA Department of Treasury Office of Foreign Assets Control which is an institution publishing the list of the companies subject to the USA sanctions. We also performed detailed tests and examined the work papers of predecessor auditor to obtain evidence on the opening balances of the construction in progress within property, plant and equipment related to this matter. Based on the audit evidence obtained we exercised our judgement in assessing the appropriateness of the management's assessment of the impact of the matter on the financial statements. We also assessed whether the information disclosed in the financial statements adequately describes the circumstances and basis for the management's judgement.

Implications of changes in the tax law on deferred tax recognition	
Refer to Notes 4 and 12 to the financial statements on pages 35 and 41, respectively. Following the changes in Latvian tax legislation from 1 January 2018 corporate income tax is levied on profit generated after 2017 only if it is distributed to the shareholders. The tax becomes payable when the shareholders declare dividends. Accordingly, the profits of the Company and its subsidiaries (except Lithuanian subsidiary whose annual profit is subject to income tax in the same year) generated in 2018 will be subject to taxation when and to the extent distributed to the shareholders. The profits of the subsidiaries generated in 2018 are subject to recognition of deferred tax liability and expense in the consolidated financial statements unless it is probable that the profit will not be distributed in a foreseeable future. The management had to make judgement on the expected timing and extent of the distribution of the profits of the subsidiaries. The Group has recognised deferred tax liability of EUR 12,297 thousand related to the 2018 profit of its subsidiaries in the consolidated financial statements as at 31 December 2018. We focused on this area because 2018 is the first year of application of the amended tax legislation and the management had to make the judgement as described above.	We examined the Group's accounting policy on deferred tax recognition applicable to the amended tax legislation. We discussed with the management the basis for their judgement on the timing and extent of the distribution of profits of the Group's subsidiaries. We performed detailed tests of the calculation of the deferred tax liability in the consolidated financial statements as at 31 December 2018 by applying statutory tax rate to the 2018 profit of subsidiaries expected by the Company's management to be distributed in a foreseeable future. We also assessed whether the information disclosed in the financial statements adequately describes the circumstances and meets the requirements of the respective standard.

How we tailored our Group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Full scope statutory audit was performed for the Company and all its subsidiaries by us or by other PwC network firms. Where work was performed by component auditors, we determined the level of involvement we needed to have to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole. We also audited the consolidation process.

Reporting on other information including the Management Report

Management is responsible for the other information. The other information comprises

- Latvenergo Group Key Figures, Latvenergo AS Key Figures and Management Report as set out on pages 3 to 10 of the accompanying Annual Report,
- Non-financial Report included in the Management Report as set out on page 8 of the accompanying Annual Report, and
- the Corporate Governance Report, set out in separate statement prepared by the Company's management and available on the Company's website http://www.latvenergo.lv section Investors as at the date of this audit report,

(but does not include the financial statements and our auditor's report thereon), which we obtained prior to the date of this auditor's report.

Our opinion on the financial statements does not cover the other information identified above.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

With respect to the Management Report, we also performed the procedures required by Law on Audit Services. Those procedures include considering whether the Management Report is prepared in accordance with the requirements of the applicable legislation.

In accordance with the Law on Audit Services of the Republic of Latvia with respect to the Corporate Governance Report, our responsibility is to consider whether the Corporate Governance Report includes the information required by section (3) of Article 56.[2] of the Financial Instruments Market Law.

Based on the work undertaken in the course of our audit, in our opinion, in all material respects:

- the information given in the other information identified above for the financial year for which the financial statements are prepared is consistent with the financial statements;
- the Management Report has been prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports; and
- the Statement of Corporate Governance, available on the Company's website http://www.latvenergo.lv as at the date of this audit report, includes the information required by section (3) of Article 56.[2] of the Financial Instruments Market Law.

In addition, in light of the knowledge and understanding of the Company and the Group and their environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the Management Report and the other information listed above that we obtained prior to the date of this auditor's report. We have nothing to report in this respect.

Furthermore, in accordance with the Law on Audit Services with respect to the Non-financial Report, our responsibility is to report whether the Group has prepared Non-financial Report and whether the Non-financial Report is included in the Management Report or prepared as a separate element of the Annual Report.

We hereby report that the Group has prepared a Non-financial Report, and it is included in the Management Report.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's and the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's and the Group's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's and the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company or the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

Appointment

We were appointed as auditors of the Company and the Group for the year ended 31 December 2018 by resolution of general meeting of shareholders dated 9 May 2018. This is our first year of the appointment.

PricewaterhouseCoopers SIA
Certified audit company
License No. 5

Juris Lapše
Certified auditor in charge
Certificate No.116
Persona per procura

Riga, Latvia
16 April 2019