Latvenergo

2016

SUSTAINABILITY AND ANNUAL REPORT

The nature of Latvia is our pride. Its beauty is our joy. Its strength is our strength.
Power transmission follows along the connection points of threads, covering the entire network of nature.
Clean, *green* and natural energy is the precondition to sustainability.

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Dear Readers,

G4-1 The past year was a year of changes. It was characterised by dynamic business operations and events that will have a significant impact on the energy sector in the Baltic region. First, the highly anticipated *NordBalt* electricity interconnection was launched, furthering the integration of the Baltic states into the Nordic electricity market. Second, active preparatory work was carried out for the liberalisation of the natural gas market in spring 2017. Third, a step towards the development of an economically justified distribution network was made, promoted by the introduction of the new tariff structure of Sadales tīkls AS in the household segment.

Late in the year, the Latvenergo Group strategy for the period of 2017–2022 was approved, taking into account significant changes in the energy sector that the Group can use judiciously to further its growth.

Energy is a sustainable sector, and the decisions taken are important not only today, but also for future generations. This area requires continuous investment, the return on which can be expected for thirty years and beyond.

This is the moment when a boundary line is drawn between two Latvenergo Group strategy periods: the period of the 2013–2016 strategy, approved in 2012, has ended, and the next period, 2017–2022, which will determine Latvenergo Group's operations and way forward for the next six years, just started.

The performance results described in this report fully reflect the achievement of the Group's objectives set in the 2013–2016 strategy; the tasks for trade, generation and network development successfully completed. Consequently, last year Latvenergo Group was the most valuable company in Latvia and among the most valuable in the Baltics, the value of assets reaching close to EUR 4 billion.

When characterising the overall performance results, it should be emphasized that last year the market situation was favourable and Latvenergo Group operated accordingly. With a revenue volume comparable to 2015, i.e., EUR 931.6 million, the Group improved profitability significantly – to EUR 130.6 million – while its EBITDA increased by 28% to EUR 393.4 million.

In 2016, Latvenergo was the largest electricity supplier in the Baltics, with a total market share of approximately 30%, including 73% in Latvia, 14% in Lithuania, and 11% in Estonia. The achievement of this result required a targeted effort, considering that the share of the former monopoly Latvenergo Group would initially shrink on account of the opening of the electricity market and new market entrants. Through supplying electricity to neighbouring countries Lithuania and Estonia under the *Elektrum* brand, Latvenergo Group managed to more than recover the share lost to the competition. In 2016, the amount of electricity supplied outside Latvia exceeded the volume sold in Latvia by competing suppliers by 20%.

2016 was successful in the area of generation: by adjusting to the market flexibly and combining the operations of its generation facilities, Latvenergo Group generated 21% more electricity (a total of 4,707 GWh) and 11% more thermal energy (a total of 2,675 GWh) compared to 2015.

2016 was also outstanding for the operations of the Riga CHPPs; their electricity output increased by 9% to 2,206 GWh. Favourable conditions for electricity generation at the Riga CHPPs were created by the decrease in average natural gas prices of 24% compared to 2015. The modernisation of gas turbines at CHPP-2 through the implementation of the *Opflex Reserve Turndown/Autotune* system was economically justified. It is capable of operating the gas turbine at reduced capacity, and during low electricity demand periods this mode enables the continued operation of the gas turbine without a complete switch-off. The mode allows for optimised operation of the main equipment depending on fuel and electricity prices and demand.

The largest increase in the amount of electricity generated was observed at the Daugava HPP cascade: 36% compared to 2015 to a total of 2,449 GWh. This was facilitated by higher water inflow in the Daugava River in the second half of 2016. Through the optimal combination of generation at Latvenergo Group's Riga CHPPs and Daugava HPPs with import possibilities in the region, consumers in the Baltics benefited from both price approximation to the level of Nordic countries and price stability.

Improvement of efficiency at the generation facilities continues through implementation of the Daugava HPP reconstruction project at Riga HPP, Kegums HPP and Plavinas HPP; hydropower units nearing the end of their terms are being replaced. Reconstruction of the Daugava HPP cascade is expected to be completed by 2022. Upon completion, the total capacity and output volume of the Daugava HPPs will increase, ensuring operation of the hydropower units for another 40 years.

Balanced development of distribution networks – making them more efficient while improving their technical condition – was an important process in 2016. Compared to 2012, the frequency and duration of power outages were reduced significantly (SAIDI by 55% and SAIFI by 35%). A new and balanced tariff structure was introduced in 2016, serving as the basis for an economically justified development of the distribution network and ensuring connection capacities where they are needed and utilised. While capacities available

for new connections were previously insufficient, especially for enterprises, those reserved but not utilised have now been freed up. Therefore, this is an investment in the development of a balanced network, which is a significant objective for the national economy in the long term.

Evidence of the Group's successful strategic development can be seen not only in its performance results; in February 2017, the international credit rating agency Moody's Investors Service reaffirmed the Baa2 credit rating of Latvenergo AS with a stable outlook. This demonstrates that Latvenergo AS is a stable and reliable borrower and facilitates access to bank loans on favourable terms.

In April 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million with a record-high total demand. Thus, the second bond programme has been completed with a total of EUR 100 million bonds issued. Moody's assigned the highest grade of GB1 (excellent), the first time the agency has assessed *green* bonds in Eastern Europe, no less assigned them an excellent grade in Eastern Europe.

The Group's efforts in the area of corporate responsibility are also worth mentioning, since in 2016, for the fourth year in a row, Latvenergo AS received the Platinum category (the highest) from the Sustainability Index, proof of its long-term and sustainable solutions in energy generation and trade. More than 80 Latvian companies participated in the Sustainability Index this year. The overall Sustainability Index of Latvenergo AS is over 90%. This means that the company has fully integrated corporate responsibility into its operations, appointing responsible persons on both the Management Board and the operational level.

The past year was marked by an important event for the Group: following the recommendations of the Organisation for Economic Co-operation and Development (OECD), a Supervisory Board for Latvenergo AS consisting of five members was appointed by the Shareholder's decision. The main goal of the Supervisory Board is to enhance the efficiency of company asset management, which is an important element of corporate governance. The Group has experienced the need for structured corporate governance in the past, especially during the bond issue process, where, along with the Group's efficiency ratios, many potential investors evaluated the compliance of corporate governance with standards of good practice.

With regard to corporate social responsibility, the Group's contribution to education and science should be highlighted. We believe that today's education is the foundation for Latvia as we wish to see it in the future – a smart and prosperous country. The *Experiment* knowledge contest for schoolchildren marked its 21st anniversary, the FIZMIX portal is gaining in popularity, and together with sharp-witted children from Latvian schools we participated in the "Smart, Even Smarter" game show. We continued cooperation with higher educational institutions, not only awarding the Annual Prize in Power Engineering to accomplished scientists, but also paying special attention to new talents.

It was a year of achievements for Latvenergo Group, and each and every employee helped make this possible. At the same time, we must bear in mind that an open market means competition, and the competition will only continue to grow; therefore, the Group's new strategic framework marks new challenges not only for the Group as a whole, but for every one of us.

Dr. sc. ing. **Āris Žīgurs,**
Chairman of the Management Board
of Latvenergo AS

LATVENERGO GROUP PROFILE

1.1 Report Overview

	Reporting period	2016 (1 January–31 December)
G4-22	Reporting frequency	Annually, since 2009, in accordance with the Global Reporting Initiative (GRI) guidelines.
G4-23	Publication date	19 April 2017
G4-28	Global Reporting Initiative	The Sustainability Report 2016 is prepared in accordance with GRI Guidelines G4, Core (see table GRI G4 Application Requirements).
G4-29	Report framework	The report discloses information about Latvenergo Group (see Section 1.2: Group Profile).
G4-30	Principles for defining report content	In the report, Latvenergo Group discloses information about material aspects and indicators for its operations and sustainable development. General Standard Disclosures about the operations of Latvenergo Group are fully covered in the report, and, on the basis of assessed materiality, 22 material sustainability aspects and 34 Specific Standard Disclosure indicators are disclosed (see the GRI Index table on page 79). A detailed description of the report preparation process is provided in Section 1.9: Materiality Assessment. The methods for measuring data included in this report have not been significantly altered compared to earlier reports.
G4-31	Independent auditor's confirmation report	The auditor's report on the Sustainability Report 2016 has been provided by Ernst & Young Baltic SIA.
	Report format	A PDF version of the report is available: • on the Latvenergo website: www.latvenergo.lv (in Latvian and English) • in the GRI Sustainability Disclosure Database: database.globalreporting.org/ (in English)
	Contact us	E-mail address for suggestions and questions regarding the Sustainability Report: sustainability@latvenergo.lv.

GRI G4 Application Requirements

	Core	Comprehensive
General Standard Disclosures	At least 34 defined indicators	All 58 indicators
Specific Standard Disclosures		
Generic Disclosures on Management Approach	For material Aspects only	For material Aspects only
Indicators	At least one indicator related to each identified material Aspect	All indicators related to each identified material Aspect
Specific Standard Disclosures for Sectors	Required, if available for the organization's sector and if material	Required, if available for the organization's sector and if material

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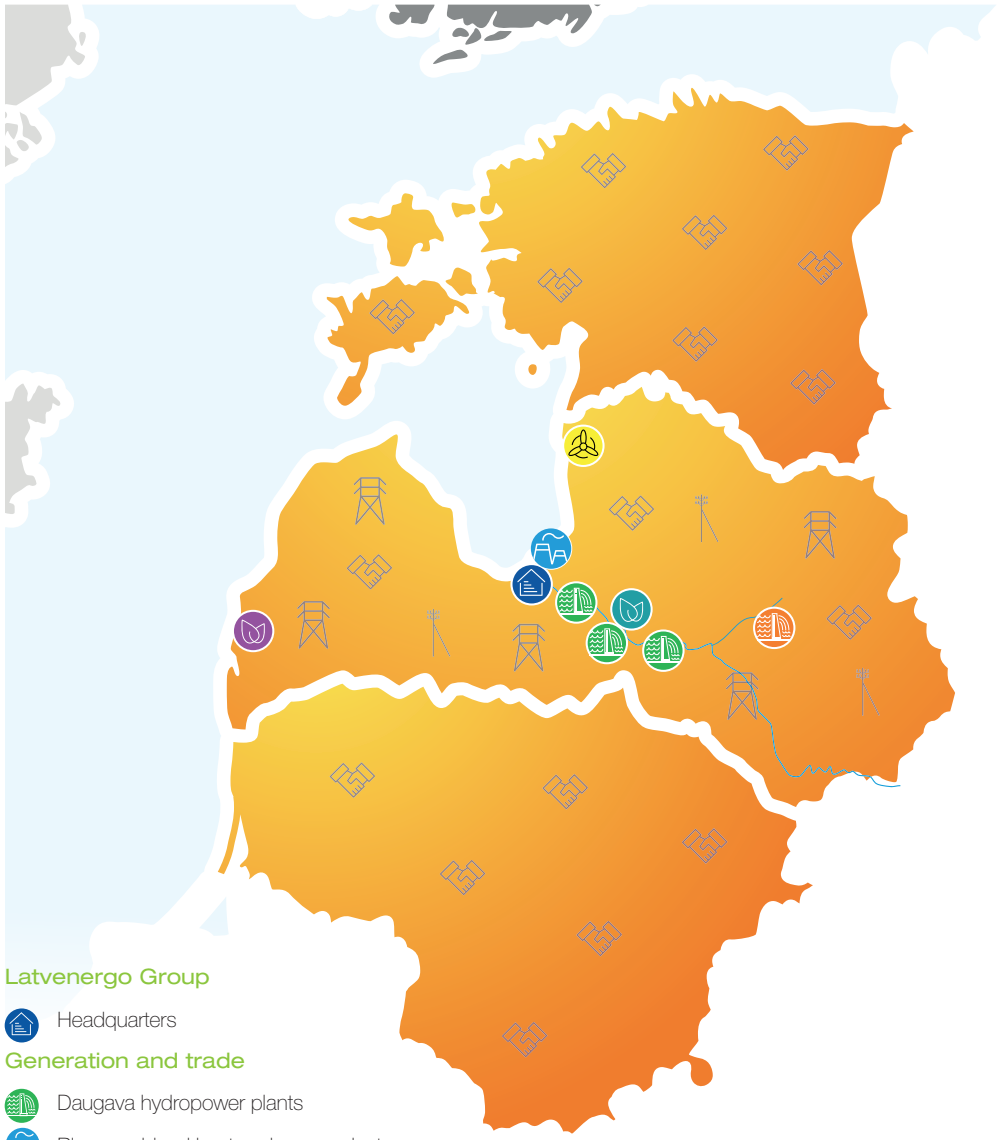


Latvenergo Group

- Headquarters

Generation and trade

- Daugava hydropower plants
- Riga combined heat and power plants
- Ainazi wind power plant
- Liepaja plants
- Kegums boiler house
- Aiviekste hydropower plant
- Electricity trade

Distribution

- Sadales tīkls AS

Lease of transmission system assets

- Latvijas elektriskie tīkli AS

1.2 Group Profile

The most valuable company in Latvia and one of the most valuable companies in the Baltics

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

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

Latvenergo Group divides its operations into three operating segments: generation and trade, distribution, and lease of transmission system assets. More information on the operating segments of Latvenergo Group is disclosed in Section 1.10: Operating Segments.

VISION

To be one of the leading and primary customer-chosen providers of sustainable and high-quality power supply services in the Baltic markets

MISSION

To ensure high-quality, safe and environmentally friendly energy generation and supply to customers sustainably, thus promoting an increase in the long-term value of the Group.

VALUES

RESPONSIBILITY
We are reliable
EFFICIENCY
We strive for excellence
OPENNESS
We are transparent and open to new ideas

2016

General facts

Financial Figures

	2016	2015
Revenue	931.6	929.1 MEUR
Profit	130.6	85.0 MEUR
Assets	3,901.2	3,517.4 MEUR
Investments	200.7	190.5 MEUR
Credit rating	Baa2 (stable)	Baa2 Moody's (stable)

Generation and trade

	2016	2015
Retail electricity supply	7,580	7,869 GWh
Market share in the Baltics	30	32 %
Retail customers	855	865 thsd.
Electricity generation	4,707	3,882 GWh
Thermal energy generation	2,675	2,408 GWh
Installed electrical capacity	2,569	2,569 MW
Installed thermal energy capacity	1,842	1,844 MW

Distribution

	2016	2015
SAIDI	286	350 min
SAIFI	3.1	3.2 number

(more on page 65)

Line length	93,813 km
Transformer capacity	5,892 MVA

Employees

TOTAL 4,131
2015 4,177

- Corporate functions: 613
- Lease of transmission system assets: 10
- Generation and trade: 987
- Distribution: 2,521

Lease of transmission system assets

Line length	5,237 km
Transformer capacity	8,950 MVA

Customer satisfaction index

	2016	2015
Business customers	3.7	3.9
Households	4.0	4.2

(more on page 64)

Different resources used in electricity generation

- Natural gas: 47.6 %
- Biomass: 0.3 %
- Wind: 0.03 %
- Water: 52.1 %

(more on page 68)

Generation efficiency figures

	2016	2015
Daugava HPPs	18.9	18.8 m³/kWh
Riga CHPPs	83	79 %

(more on page 57)

1.3 Group Strategy

2013–2016

The objectives of the strategy have been fulfilled

2016 was the final year of the Latvenergo Group Strategy for 2013-2016. Looking back at this period, it can be concluded that the operational goals have been achieved successfully:

- As regards the goal of **strengthening of the market position in the Baltics,** Latvenergo Group has indeed acquired the Baltics as a core market. The Group is the biggest electricity trader on the Baltic retail electricity market and has an economically sound market share of approximately 30%. In 2016, the amount of electricity supplied outside Latvia increased by 50% compared to 2012, constituting close to 1/3 of the total amount of retail electricity supply. A new electricity trade brand, *Elektrum*, was also introduced during the strategy period, and at the end of 2016 its recognition in Latvia reached 92%. This was achieved in conditions of increasing and constantly changing competition and amidst significant changes in the Baltic market environment.

  A gradual opening of the Baltic electricity market took place during the strategy period; the market opened fully in Estonia in 2013 and in Latvia in 2015. With the establishment of the Nord Pool power market in the Baltic bidding areas and new interconnections, the integration of the Baltic states into the Nordic electricity market continued. A second interconnection between Estonia and Finland was completed in 2014, while in 2015 interconnections between Lithuania and Sweden as well as Lithuania and Poland were completed. The launch of the interconnections has contributed to the convergence of electricity prices in the Baltic region to the Nordic level.

- The goal of achieving the **diversification of electricity generation sources** has resulted in the modernisation of a balanced, flexible and environmentally friendly generation portfolio. The total installed electrical capacity of Latvenergo Group is over 2.5 GW, while its total thermal capacity is 1.8 GW. The Group's existing generation portfolio allows for successful operation in both base and peak modes, by adjusting flexibly to any developments in the electricity market.

  During the strategy period, the Group carried out the most ambitious energy project of the past few decades in the Baltics: the reconstruction of Riga CHPP-2. The new Riga CHPP-2 replaces power generation units that had been in operation for over 30 years, increasing the reliability of energy supply, improving electricity generation efficiency figures and ensuring compliance with environmental requirements. The Daugava HPP reconstruction programme, which will last until 2022, was also launched during the strategy period. The programme is aimed at increasing the efficiency, safety and competitiveness of the Daugava HPPs. Along with these major projects, the Group continues to evaluate new electricity generation projects and to develop its competences in potential project areas.

- Regarding the goal of **balanced development of the networks,** a significant improvement of distribution service quality and safety was achieved during the strategy period. At the beginning of the period, the greatest challenges in terms of electricity distribution were the rapid ageing of the electricity distribution infrastructure and the poor electricity availability and quality indicators resulting from continuous underinvestment. A comprehensive development plan for Sadales tīkls AS was created during the period to define the distribution system quality indicators to be achieved in the long term and the measures and investments required for their achievement. As a result of consistent implementation of the development plan, at the end of the period electricity availability indicators improved significantly. Compared to 2012, the system average interruption duration index (SAIDI) was reduced by 55%, while the system average interruption frequency index (SAIFI) was reduced by 35%. This was promoted by the replacement of overhead electricity lines with cable lines. Compared to 2012, the length of cable lines increased by 22%.

  During the strategy period, development of a smart electricity network was also initiated, in order to improve the traceability of energy consumption and the load of the electricity network and to increase energy efficiency for end users. More than 270 thousand smart electricity meters or 25% of the total number of meters were installed during the strategy period.

  The most important result of the transmission system development during the strategy period was the completion of two stages of the *Kurzeme Ring* project and the attraction of European Union (EU) co-financing for the final stage of the project in the amount of 45% of the construction costs of the project. As a key element of the Lithuania-Sweden and Latvia-Estonia interconnections, the project is important for ensuring uninterrupted electricity flows from Finland, Sweden and Poland through the Baltics. At the same time, the project will contribute significantly to increasing the reliability of electricity supply in the western part of Latvia.

The achievement of the 2013-2016 strategy goals is an important precondition for the development of the next period strategy.

Provide energy sector goods and services important for the competitiveness and growth of the national economy in a sustainable, responsible and economically sound manner, and manage the resources and infrastructure of strategic importance for national development and security in an efficient manner, contributing to the reliability of energy supply.

(The overall strategic target of Latvenergo AS set by the Cabinet of Ministers)

Main events of the previous strategy period

2013

- Opening of the household electricity market in Estonia
- Creation of a Latvian bidding area in the Nord Pool power market
- The CHPP reconstruction programme concludes with the commissioning of the second power unit at Riga CHPP-2

2014

- Latvenergo AS starts selling all its electricity at the Nord Pool power market
- Launch of the Estlink-2 interconnection between Finland and Estonia
- Implementation of the Sadales tīkls AS development plan is started
- Completion of the 330 kV power transmission line *Grobiņa–Ventspils* of the *Kurzeme Ring* project
- Founding of Enerģijas publiskais tirgotājs AS

2015

- The electricity market in Latvia is fully liberalised
- Latvenergo AS is the first state-owned company in Eastern Europe to issue *green* bonds

2016

- Launch of the interconnections NordBalt, between Sweden and Lithuania, and LitPol, between Lithuania and Poland
- Latvenergo Group develops its Consolidated Medium-Term Strategy for 2017–2022
- Introduction of a balanced distribution system tariff

Strategy for the next period (2017–2022) is developed

Sustainable market position

To ensure continuity, Latvenergo Group already started developing its strategy for the next period at the end of 2015. The Latvenergo Group Strategy 2017–2022 was approved at the Shareholder's Meeting on 19 October 2016.

The Latvenergo Group Strategy 2017–2022 is based on the overall strategic target set for Latvenergo AS by the Cabinet of Ministers and takes account of challenges expected in the industry and business environment:

- A changing business environment underpinned by new technologies and user requirements, necessitating new approaches and services;
- Construction of interconnections has opened up new market opportunities;
- Development of smart networks contributes to the development of new products;
- Markets for other types of energy are opening for competition.

Given these challenges, three main operational objectives have been defined in the strategy:

1. Strengthen a sustainable and economically sound market position in core markets (in the Baltics) while considering geographical and/or product/service expansion. This objective also includes commencement of retail gas trading in core markets and potential development of new, complementary products, such as energy efficiency products, microgeneration, demand-side management, etc. The objective is to focus on the operational excellence and cost efficiency of the trade segment.

2. Develop a generation portfolio adequate for synergy with trade and increasing the Group's value. With deeper integration of the Baltics into the Nordic market, the risk of electricity price fluctuations will increase during the strategy period. Consequently, the positive economic synergy effect of the generation and trade portfolios will also increase. Therefore, the objective is to complete the reconstruction of Daugava HPP generation facilities to ensure their sustainable and reliable operation. Furthermore, the aim is to move towards diversification of the existing generation capacities and the development of new ones in line with the criteria for diversification of primary generation resources and "low" emission projects.

3. Develop a functional, safe and efficient network corresponding to customer needs. The fulfilment of this objective includes increasing both operational and cost efficiency of the distribution network and the quality and safety of distribution services. Considering the emergence of smart technologies not only on the operator's side, but also on the user's side, and the expected increase in consumer know-how, the Group plans to digitalise the distribution network as well, adapting it to modern requirements.

Successful achievement of the operational objectives will also ensure achievement of the financial targets, which are divided into three target groups: profitability, capital structure, and dividend policy. The financial targets have been 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 the capital structure targets.

Strategy development included a detailed analysis of the industry and operating environment, an evaluation of business opportunities, and discussions with industry experts and stakeholders.

During the strategy's preparation process, the requirements of the following were met: the OECD Guidelines on Corporate Governance of State-Owned Enterprises; the Law on Governance of Capital Shares of a Public Person and Capital Companies; and the Guidelines for Drawing Up a Medium-Term Operational Strategy for State-Owned Enterprises, approved by the Cross-Sectoral Coordination Centre.

By implementing the strategy, Latvenergo Group helps meet the public's needs and increases the Group's value while respecting the principles of sustainability.

The strategy defines the following financial targets:

Target group	Indicator	2022
Profitability	Return on equity	> 6%
Capital structure	Net debt to equity	< 50%
	Net debt to EBITDA	< 3 times
Dividend Policy	Dividend payout ratio	> 80%

Pillars of Sustainability

1.4 Corporate Social Responsibility

A Baltic example of responsible business conduct

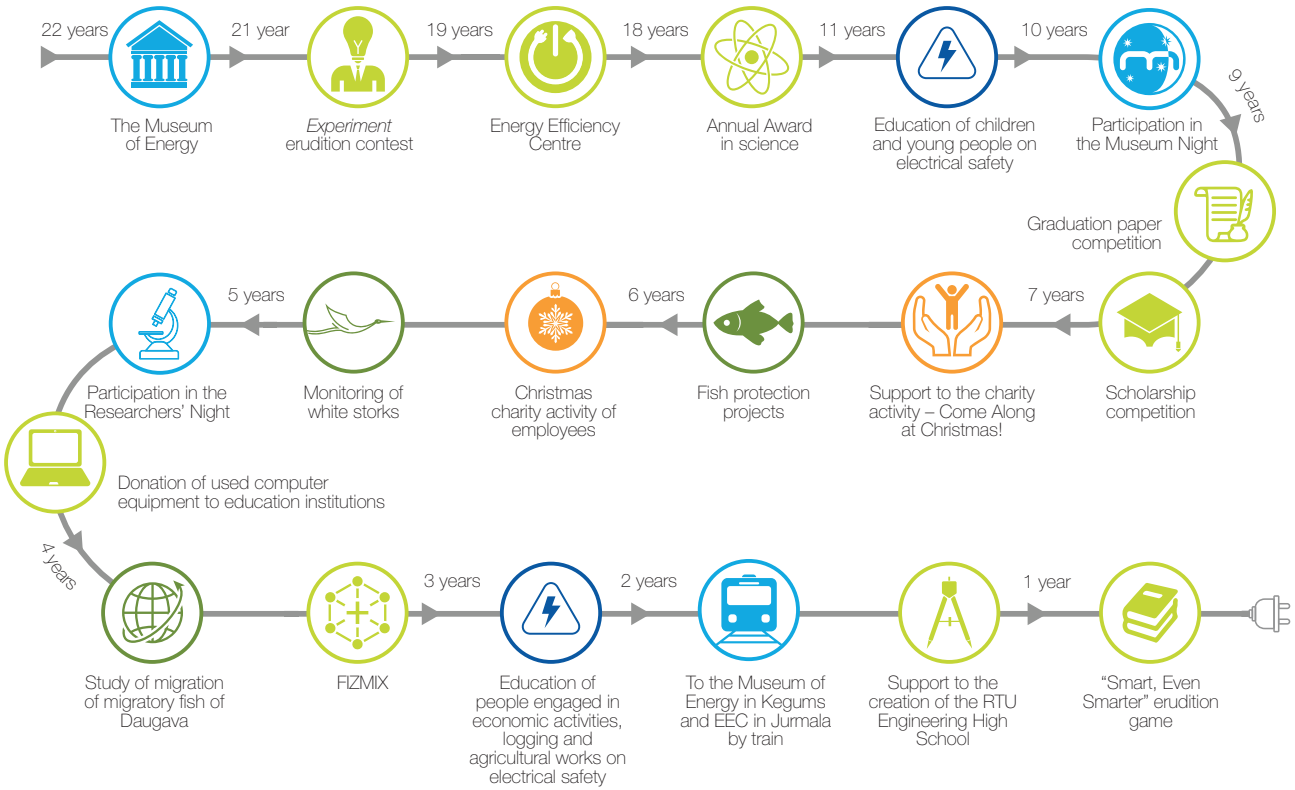
Latvenergo Group not only complies with statutory requirements, but also undertakes voluntary responsibility for its impact on society, the environment and the national economy, thus contributing to sustainable development of the Group. By providing value added products and services, the Group aspires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

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

The Latvenergo Group Strategy 2017–2022 sets the following tasks, which are crucial for doing business in a responsible manner:

- Generate and supply energy in a socially responsible manner, and demonstrate the Group's good governance practice through voluntary activities aimed at sustainable economic growth, improvement of the environment and public welfare;
- Support education, which triggers curiosity for engineering sciences, by promoting the education system in the exact sciences and the engagement of students and teachers in the improvement of the Group's competences;
- Through continuous work with stakeholders, engage them in the handling of important sustainability issues.

CSR activities of Latvenergo Group in 2016 by the duration of Group's involvement



Directions of Corporate Social Responsibility activities

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

In 2016, Latvenergo Group reviewed its social responsibility practice. The Group's previous CSR practice was acknowledged in an internal survey and external expert interviews about the Group's CSR directions and activities. The highest rating in this evaluation was given to the following CSR directions:

- Electrical safety;
- The environment;
- Science and education;
- Energy efficiency.

Based on the survey and international CSR practice, in 2016, the Group developed its CSR policy further and consolidated its CSR directions.

In a corporate reputation study conducted by TNS Latvia SIA in 2016 it was found that the majority of industry experts and representatives of the general population, the business environment, and the media believe that the companies of Latvenergo Group conduct business responsibly. 2016 saw an increase in the share of the population that is aware of or has heard about Latvenergo Group's CSR activities devoted to education and science and the preservation of industrial heritage. More than half of the population is also aware of our cultural, sports and energy efficiency activities. The majority of the population, industry experts and media representatives think that Latvenergo Group should continue to support education and science. CSR activities aimed at environmental protection, energy efficiency and electrical safety were also greatly appreciated.

Science and education

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

- Promoting young people's interest in science-related subjects and engineering professions;
- Supporting young people's excellence in the field of science;
- Supplementing teaching materials for teachers;
- Supporting researchers' and teachers' scientific work in the field of energy that promotes the education of youth;
- Raising public awareness of energy efficiency.

In cooperation with the Latvian Academy of Sciences, for more than 15 years Latvenergo Group has awarded its Annual Award for outstanding and significant contributions to the energy industry and achievements of young researchers in the field. Each year, the Group announces competitions for students of higher educational institutions, awarding the best graduation papers on topical issues in the energy sector, and organises a scholarship competition for students. The Group also provides students from various educational institutions with internship opportunities. Latvenergo Group employees participate in the bachelor's and master's thesis defence committees of Riga Technical University (RTU) and Latvia University of Agriculture (LUA). The Group also participates annually in publishing books related to the energy industry. In 2016, Latvenergo Group continued to support the Engineering High School of RTU.

Since 2013, Latvenergo AS has developed and maintained the FIZMIX physics portal (www.fizmix.lv) to encourage young people to study physics, provide teachers with an idea base and auxiliary materials, and raise the prestige of mastering physics. The FIZMIX team not only publishes physics experiments on the *fizmix.lv* portal, but also demonstrates them during lectures at schools in Latvia, on the game show "Smart, Even Smarter", and at various events, such as Researchers' Night at the Museum of Energy and the *Elektrum* Energy Efficiency Centre or the Technical Innovation Festival.

For more than 20 years, Latvenergo Group has organised the knowledge contest *Experiment* for 8th and 9th-graders. The contest offers insight into safe use of theoretical knowledge in practice and encourages primary school final-grade students' interest in physics, natural phenomena and the environment. To encourage young people's erudition, in 2016, Latvenergo Group participated in the production of the 4th season of the game show "Smart, Even Smarter" on Latvian national television (LTV1).

Continuing the practice of previous years, in 2016, Latvenergo Group donated computers to educational institutions in Latvia.

The opening of the electricity market has raised the importance of energy efficiency issues among the general population and motivated customers to evaluate and improve their energy usage

habits. For almost 20 years, the *Elektrum* Energy Efficiency Centre has hosted free-of-charge education on energy efficiency for various groups of society. The topics of the lectures, workshops, field trips and consultations have included efficient ways to use energy in everyday life and business and the latest electric appliances, their selection criteria and energy efficient use. Since September 2016, the first new-generation electric charging station in the Baltics can be viewed and tested at the Centre. Simple tips for using electricity more efficiently are available on the *Elektrum* website: www.elektrum.lv/lv/majai/energoefektivitate/energoefektivitate/video-padomi/.

Raising public awareness of electrical safety

Raising public awareness of electrical safety is one of the CSR priorities of the Group's subsidiary Sadales tīkls AS. To reduce the number of electrical injuries due to insufficient knowledge, a number of projects aimed at electrical safety among children and young people are implemented each year in cooperation with educational institutions and experts. Particular attention is paid to the level of knowledge of each age group. In 2016, Latvenergo Group implemented the following projects dedicated to electrical safety among children and young people:

- A new electrical safety campaign, "Don't take risks with electricity! Survive!", was launched, calling on children and young people to act with caution when near electric appliances;
- To raise awareness of electrical safety in the virtual environment, maintenance and improvement of the Electrical Safety page on the *draugiem.lv* social networking site was continued;
- Electrical safety training sessions were conducted at around 500 educational institutions throughout Latvia;
- 10th year of participation in making the movie "Long Live the Children!";
- Participation in various events, such as the sports and knowledge competition "ZZ Championship", the "Children's World 2016" exhibition, the "Summer of Adventures 2016" safety festival for families organised by the State Police and the Riga City Council, the State Police "Hand in Hand" vocational education and safety project, and children's summer camps and regional safety days.

In 2016, Sadales tīkls AS continued to educate people engaged in economic activities, logging and agricultural work, encouraging them to take care of their own safety and the safety of those around them and to follow electrical safety rules while working near electricity lines. They are also encouraged to coordinate their work in electrical line protection zones, and not to operate machinery the height of which exceeds 4.5 meters from the ground surface in the vicinity of overhead lines without coordination. Education on electrical safety takes place during seminars organised by the Latvian Rural Advisory and Training Centre and at the "Tractor Day 2016" event in Tērvete District. Particularly active communication on electrical safety is ensured before the beginning of the agricultural work season.

Environmental protection

Voluntary care for the environment is one of the basic operating principles of Latvenergo Group.

Latvenergo AS was among the first energy companies in Latvia to introduce and certify an energy management system in 2016, as evidenced by the ISO 50001:2011 certificate issued by the international company DNV GL.

Another important activity in 2016 was the promotion of the basic principles of *green* procurement and their integration into procurement procedures.

Taking care of the preservation of biodiversity, in 2016, Latvenergo Group continued cooperation with associations for the protection and replenishment of bird and fish populations. Latvenergo AS is carrying out a research project on fish migration and natural replenishment possibilities in the Daugava River. More information on the Group's environmental protection activities can be found in Section 2.4: Environmental Protection.

Culture, sports and energy industry heritage

By participating in nationwide cultural and sports events, Latvenergo Group promotes the development of Latvia's cultural traditions and the strengthening of its national identity and encourages an active lifestyle. In 2016, the Group's activities in this area included:

- Employee participation in the Lattelecom Riga Marathon, one of the largest marathons in Northern Europe, and in another large-scale national sporting event, the Latvian Cycling Union Race in Sigulda;
- Involvement in various initiatives of public importance related to the topic of light and energy. For the third year in a row, Latvenergo Group has taken part in the "Riga Carnival" event of the Riga Light Festival. During the festival, the Group headquarters at Pulkveža Brieža Street 12 are illuminated in different shades of colours.

The Group's Museum of Energy researches the energy history of Latvia and Latvenergo Group and ensures collection and preservation of energy industry heritage and its availability. The museum offers exploratory tours for various audiences. It also offers thematic educational activities where everyone can explore the history and industrial heritage of Latvia's electric power industry and Latvenergo Group and watch the film "How the Kegums Power Plant Was Built. The Memoirs of Kārlis Dumbrājs".

The travelling exhibition of E. Kraucs's collection of glass plate photonegatives entitled "Construction of the Kegums Hydropower Plant (1936–1940)", which was created at the museum, has been included in the register of the UNESCO Memory of the World Programme.

In 2016, the museum continued its participation in local and international campaigns and events such as Museum Night, European Researchers' Night, and Balttour 2016. In cooperation with Pasažieru vilciens AS, the project "By Train to the Museum of Energy in Kegums!" was continued in 2016. For additional information, visit the Latvenergo Group website: www.latvenergo.lv.

On 28 October 2016, the Museum of Energy was awarded the status of state-accredited museum. This accreditation confirms the museum's compliance with the legal acts of the Latvian museum sector and its ability to ensure sustainable preservation of energy industry heritage.

Social support and responsibility towards employees

Latvenergo Group engages in charity events and provides social support to its employees.

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

At the end of 2016, the Group's employees donated a variety of useful everyday items to those in need.

Information about the social protection of employees is available in Section 2.5: Employees and the Work Environment.

1.5 Group Governance

G4-34
G4-56

A Supervisory Board has been elected to enhance corporate governance of the Group

Latvenergo Group's corporate governance principles define the elements of its operation concerning the executive and supervisory institutions of its companies. These elements are reflected in the Latvenergo Group Corporate Governance Model and are an essential precondition for successful achievement of the goals specified by the strategy and for increasing the value of the company. A significant role in the maintenance of the Group's corporate governance system is assigned to the values of the Group and active communication, both internally and in cooperation with stakeholders. The governance model of Latvenergo Group is based on good governance practices, the regulatory framework and corporate governance guidelines. The model was enhanced in 2016 by electing a Supervisory Board.

- **Ethics and Compliance**

Latvenergo Group follows high standards of professional ethics in its operations and ensures the compliance of its activity with applicable legislation, creating an ethical business environment. The principles of ethical conduct are defined in the Code of Ethics of Latvenergo Group, which applies to the Group's employees and cooperation partners. The principles include prevention of conflict of interest, fraud and corruption, and the obligation to report breaches of the Code of Ethics. In 2016, the Code was reviewed and updated. It was adapted to the current organisational structure and improved with new informative elements. Informative activities are carried out on a regular basis to ensure employee awareness and understanding of the ethics and compliance standards. The Group continuously improves its internal regulations and takes other measures to prevent the possibility of corruptive or fraudulent activities.

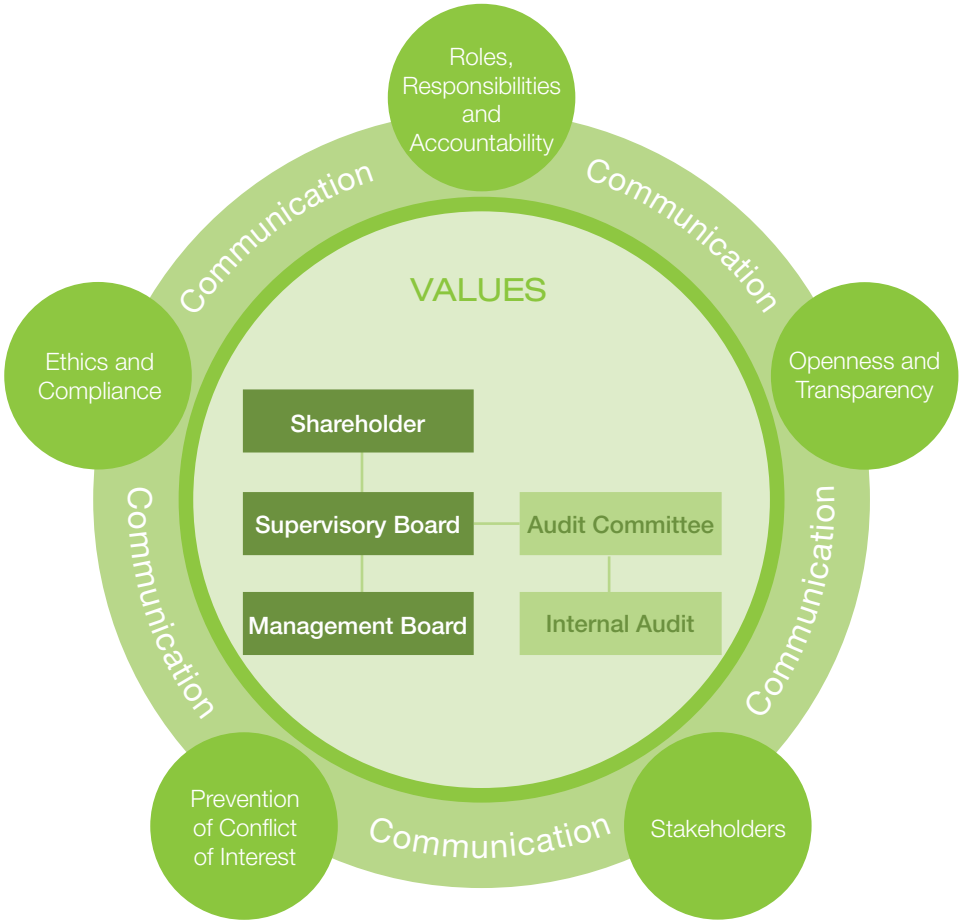
Latvenergo Group supports fair business practices, applies fair competition rules and does not engage in transactions that restrict competition or are corruptive or discriminatory. Latvenergo Group urges its contractual partners to adhere to similar ethical principles and, in signing agreements, asks them to adhere to the principles of fair business cooperation. It also encourages them to take action to avoid conflict of interest situations in cooperation with Latvenergo Group companies; this includes honouring restrictions on acceptance of gifts defined by the Group and not offering employees any material valuables as an incentive or reward.

Latvenergo Group's fundamental ethical principles for cooperation with contractors are published on the Latvenergo website (www.latvenergo.lv/eng) under the section *Tenders and offers/Procurement procedures*.

- **Roles, Responsibilities and Accountability**

The roles, responsibilities and accountability of governance and supervisory bodies are clearly defined in external laws and regulations and in the internal documents of the Group. The most important of these are the companies' Articles of Association and regulations of the governance and supervisory bodies. The Articles of Association of Latvenergo AS are published on the Latvenergo website (www.latvenergo.lv/eng) under the section *Investors/Corporate governance*.

Corporate Governance Model



• Openness and Transparency

The transparency of Latvenergo Group's financial and operational performance results is ensured through the publication of various reports and materials on its website and on external information sites, such as the Nasdaq Baltic website. These reports and materials are also prepared and distributed in printed format.

One of the main reports is the Annual Report of Latvenergo Group. Since 2002, it has been prepared according to the International Financial Reporting Standards (IFRS) approved by the EU. Since the launch of the bond issue programme and inclusion of the issued bonds on the Nasdaq Riga exchange in early 2013, Latvenergo Group has been publishing quarterly interim financial reports. These reports are prepared in accordance with the information disclosure requirements for bond issuers under the Law on the Financial Instruments Market. Moreover, virtual conferences on the financial results and business developments of the Group have been organised since 2015. As of 2015, the interim financial reports of Latvenergo AS and its subsidiaries are also published in compliance with the Law on Governance of Capital Shares of a Public Person and Capital Companies.

Since 2012, Latvenergo AS Corporate Governance Reports have been prepared and published in compliance with the corporate governance principles of Nasdaq Riga AS. Additional information on corporate governance and other subjects important for both the Group and its stakeholders is disclosed in the Sustainability Report. The Latvenergo Group Sustainability Report is the only audited sustainability report in Latvia, and since 2009 it has been prepared in compliance with the GRI guidelines.

The Group has been awarded for the openness and transparency of its financial and operational performance results. On 26 January 2017, Latvenergo AS received a Nasdaq exchange award in the category "Best Investor Relations in the Baltics among Bond Issuers 2016" (see the Awards subsection under Section 1.6: Group Management).

• Prevention of Conflict of Interest

In accordance with the Law on the Prevention of Conflict of Interest in the Activities of Public Officials, members of supervisory boards and management boards of state capital companies have the status of public officials. To prevent the influence of a personal or financial interest, the law restricts the activities of members of supervisory boards and management boards that fall outside the framework of their official powers. Members of supervisory boards and management boards are obliged to submit annual declarations of the financial status of public officials, specifying income received, positions held, transactions performed, participation in commercial activities, and other information. The Group's governance and supervisory bodies ensure that principles for prevention of conflict of interest are adhered to in the performance of official duties. The goal of the management is to raise awareness of conflict of interest situations through informative activities, training and monitoring. The Latvenergo Group Code of Ethics defines the types of conflict of interest and the measures to prevent such situations. Latvenergo Group organises training and informative activities to raise employee awareness of potential conflict of interest situations and prevent them in everyday work. Upon entering employment and signing the declaration, new employees must confirm in writing their understanding of conflict of interest situations and their commitment to preventing their occurrence. For timely prevention of such situations, Latvenergo Group has also introduced annual Conflict of Interest Declarations, which are evaluated and monitored.

In compliance with the Code of Ethics, managers of all levels and senior employees who participate in the decision-making as part of their official duties and could find themselves in conflict of interest situations must submit annual Conflict of Interest Declarations. The said employees should evaluate not only their commercial activities outside the Group, but also those of their relatives and family members, if such activities are closely related to the Group's operations, and report all potential situations of conflict of interest to the employer.

• Stakeholders

Cooperation and communication with stakeholders is an important element of the Latvenergo Group corporate governance system. The Group is aware of its impact on stakeholders and vice versa, and handles issues of material importance to its stakeholders with a sense of responsibility. More information on Latvenergo Group's cooperation with stakeholders is provided in Section 1.8: Stakeholder Engagement.

Shareholder

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

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

The principal objectives of the Latvenergo AS Shareholder's Meetings include:

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

Until the election of the Latvenergo AS Supervisory Board on 16 December 2016 (see the subsection Supervisory Board), the functions of the Supervisory Board were performed by the Shareholder's Meetings. 13 Shareholder's Meetings were convened in 2016. The most important decisions passed in 2016 were the approval of the Annual Report 2015, distribution of dividends in the amount of EUR 77.4 million, appointment of the auditor, and the election of the Supervisory Board. All members of the Management Board, the Audit Committee and the auditor participated in the approval of the Annual Report 2015 at the General Shareholder's Meeting.

Supervisory Board

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

The nomination process of Latvenergo AS Supervisory Board Members complied with the principles of good corporate governance. Selection of Supervisory Board Members occurred as an international competition in which the recruitment company Fontes Executive Search SIA was also engaged. The selection process and candidate evaluation were ensured by a diverse nomination committee that included representatives from the Ministry of Economics and the Cross-Sectoral Coordination Centre and independent experts and professionals from the Baltic Institute of Corporate Governance, Fontes Executive Search SIA and the Latvian trade union *Enerģija*.

Between 2009 and 2016, in accordance with the Law on State and Municipality Capital Shares and Capital Companies, no supervisory boards existed in any state capital companies in Latvia, including Latvenergo AS. Supervisory functions of capital companies were performed by shareholder's meetings. In 2016, in compliance with the Law on Governance of Capital Shares of a Public Person and Capital Companies, and following OECD recommendations, supervisory boards at large and medium-sized state-owned capital companies were restored, and Latvenergo AS was no exception.

The principal duties of the Latvenergo AS Supervisory Board include:

- continuous supervision of the Management Board's activities;

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

The Regulations of the Supervisory Board of Latvenergo AS are available on the Latvenergo website (www.latvenergo.lv/eng) under the section *Investors/Corporate governance/Supervisory Board.*

In compliance with the approved Regulations of the Latvenergo AS Supervisory Board, in order to examine certain issues in detail, it may establish committees from amongst its members. On 8 February 2017, the Supervisory Board established a committee on human resource management, appointing as its members M. Bičevskis, B. A. Rubesa and A. Liepiņš.

Audit Committee

An independent Audit Committee operates at Latvenergo AS, which, at the end of the reporting period, reports on its operations and performance at the Shareholder's Meeting. Having evaluated necessary competencies and professional experience, the Shareholder's Meeting elected three members to the Audit Committee before the election of the Supervisory Board. All members of the Audit Committee are independent specialists who are not engaged in the operational activities of the Group.

Five Audit Committee meetings were held in 2016. In addition to its regular duties, i.e., supervision of the financial reporting process, efficiency of the internal monitoring and risk management system, and monitoring the work of the internal audit and the external auditor, the Audit Committee reviewed and discussed the Group's risk management processes, integration of risk assessment into the planning and performance of internal audits, resources allocated to the internal audit, the operational efficiency project of Sadales tīkls AS, and the Group's medium-term strategy for 2017–2022.

Due to amendments to the Law on the Financial Instruments Market effective as of 1 January 2017 and the election of the Supervisory Board, the regulatory framework governing the operations of the Audit Committee has recently changed. As of this report's publication, the Audit Committee will be composed of five members, the majority of whom will be independent and at least one of whom will be a Member of the Supervisory Board of Latvenergo AS. In 3 March 2017, Supervisory Board Members A. Ozoliņš and A. Liepiņš were added to the Audit Committee. The Audit Committee is accountable to the Supervisory Board of Latvenergo AS for its operations and performance. Its term of office is three years.

The Regulations of the Audit Committee are available on the Latvenergo website (www.latvenergo.lv/eng) under the section *Investors/Corporate governance/Audit Committee.*

Management Board

The Management Board of Latvenergo AS is in charge of the Group's operations. After evaluating required competencies, experience and intended areas of responsibilities, the Supervisory Board (before the 16 December 2016 Shareholder's Meeting) appointed five members to the Management Board.

The Management Board operates in compliance with the Articles of Association and the Regulations of the Management Board. The principal duties of the Management Board of Latvenergo AS include:

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

The Regulations of the Management Board of Latvenergo AS are available on the Latvenergo website (www.latvenergo.lv/eng) under the section *Investors/Corporate governance.*

Management Board meetings are organised in order to manage the Group's activities and pass decisions in a timely manner. In 2016, 64 Management Board meetings were convened. The Management Board is entitled to pass decisions if at least three of its members are present, including the Chairman of the Management Board or his substitute.

Number of Management Board meetings attended: Ā. Žīgurs, Chairman of the Management Board – 64; G. Baļčūns, Member of the Management Board – 61; U. Bariss, Member of the Management Board – 59; M. Kuņickis, Member of the Management Board – 58; G. Stafeckis, Member of the Management Board – 50.

The Management Board reports to the Supervisory Board (before the Supervisory Board's election it reported at Shareholder's Meetings), and Members of the Management Board are jointly liable for compliance with all binding laws and regulations, execution of the decisions of the Shareholder's Meetings and the Supervisory Board, and the financial performance of the Group. All Members of the Management Board are independent in their activities and have no shareholdings in the capital of the contractual partners or associated companies. Furthermore, the Management Board of Latvenergo AS performs the functions of shareholder in subsidiaries fully owned by Latvenergo AS.

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

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

The monthly salary of the Chairman of the Supervisory Board and the Chairman of the Management Board is linked to the average monthly salary of employees in Latvia during the preceding year, as published in the Official Statistical Bulletin of the Central Statistical Bureau of the Republic of Latvia, multiplied by a ratio specified according to the capital company's reference criteria (turnover, assets, number of employees). The maximum ratio applicable to the monthly salary of the chairman of a supervisory board is 3, and in 2016 this was applied to the monthly salary of the Chairman of the Supervisory Board of Latvenergo AS. The maximum ratio applicable to the monthly salary of the chairman of a management board is 10; however, taking into account the restrictions on increases in uniform monthly salaries compared to the preceding year imposed by the Cabinet of Ministers Regulations, a 9.35 ratio was applied to the monthly salary of the Chairman of the Management Board of Latvenergo AS.

The remuneration of Supervisory Board and Management Board Members may not exceed 90% of the monthly salary of the Chairman of the Supervisory or Management Board respectively. Management Board Members are entitled to compensation for the performance of additional duties at the company. 20% of the uniform monthly salary of the Chairman and Members of the Management Board comprises remuneration for performing the duties of Chief Executive Officer (CEO) and Chief Officers.

Once a year, following the approval of the Annual Report and the evaluation of the performance results, the Shareholder's Meeting may decide on payment of bonuses to the Members of the Supervisory Board. The amount of the bonus may not exceed the amount of one month's salary.

The Supervisory Board (the Shareholder's Meetings until its election), in turn, may decide on payment of bonuses to the Members of the Management Board once a year following the approval of the Annual Report. The bonuses are based on the performance of the company, the execution of the strategy and the achievement of the set targets.

The amount of the bonus may not exceed two months' salary of the Member of the Management Board. The terms and conditions of the authorisation agreements signed with the Members of the Management Board provide for the possibility to receive a severance payment in the amount of three months' salary if they are recalled from their duties before the expiration of the term of office, including in the event of reorganisation or liquidation of the company. The remuneration policy does not provide for an option to pay remuneration in the form of shares or share options.

The remuneration of the Audit Committee established on the basis of the Law on the Financial Instruments Market of the Republic of Latvia is stipulated in the Regulations of the Audit Committee. The remuneration of the members of the Audit Committee is determined by the Shareholder's Meetings, and its amount corresponds to the average monthly salary of employees in Latvia during the preceding year, as published in the Official Statistical Bulletin of the Central Statistical Bureau of the Republic of Latvia. The monthly salaries of the Audit Committee members are determined for the entire term of their office, with the right to review them once per year. Members of the Audit Committee that are simultaneously Members of the Latvenergo AS Supervisory Board are not compensated for duties performed in the Audit Committee. Authorisation agreements are signed with the members of the Audit Committee, and the provisions of the Collective Bargaining Agreement do not apply.

The remuneration paid for the year 2016 to A. Ozoliņš, Chairman of the Supervisory Board of Latvenergo AS, was EUR 1,153, while it was EUR 1,038 for the other Members of the Supervisory Board. The remuneration paid to each member of the Audit Committee for the year 2016 was EUR 9,445.

For the year 2016, Ā. Žīgurs, Chairman of the Management Board and CEO of Latvenergo AS, received remuneration in the amount of EUR 131,241; G. Baļčūns, Member of the Management Board and Chief Financial Officer (CFO) received EUR 115,312; U. Bariss, Member of the Management Board and Chief Commercial Officer (CCO) received EUR 118,890; M. Kuņickis, Member of the Management Board and Chief Operating Officer (COO) received EUR 119,920; and G. Stafeckis, Member of the Management Board and Chief Technology and Support Officer (CTSO) received EUR 100,815.

Internal Audit

The Internal Audit is an independent unit of Latvenergo AS designed to provide impartial and objective assurance and consultations, and to help achieve the Group's objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, monitoring, and governance processes. The Internal Audit complies in its work with the International Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors (hereinafter the Standards), and its activities are monitored by the Audit Committee.

In accordance with the Standards and based on the results of the audits performed, the Internal Audit prepares and submits its overall conclusion on the operational efficiency of the internal monitoring environment at Latvenergo Group and makes recommendations for its improvement on an annual basis. This annual statement confirms that the monitoring introduced by the Group is sufficient for the management of major risks and the achievement of its objectives. In accordance with the Standards, the Internal Audit prepares and submits an activity report comprising information about compliance, self-assessment, and measures to ensure and improve service quality.

Dividend Policy

The distribution of Latvenergo AS dividends over the coming years is regulated by the Republic of Latvia Law on the State Budget for 2017 and the Law on the Medium-Term Budgetary Framework for 2017, 2018 and 2019. In accordance with these laws, the anticipated amount payable by Latvenergo AS in dividends is EUR 90.1 million in 2017 (for the reporting year 2016), EUR 121.7 million in 2018 and EUR 129.5 million in 2019. The actual amount payable by Latvenergo AS in dividends is determined by the Shareholder's Meeting after the approval of the annual report, upon evaluation of the results for the previous year.

Governance of Subsidiaries

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

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

On 5 May 2016, the Shareholder's Meeting of Sadales tīkls AS elected Baiba Priedīte to act as a Member of the Management Board as of

6 June 2016. Until 6 June 2016, the Management Board of Sadales tīkls AS consisted of four members.

At the beginning of 2016, changes were introduced in the corporate governance of Elektrum Lietuva UAB. On 22 February 2016, Uldis Mucinieks left his position as the Chairman of the Board and his duties were taken over by Martynas Giga. The number of members of the Supervisory Board was increased to five. Guntars Baļčūns and Uldis Mucinieks were appointed Members of the Supervisory Board on 9 February 2016 and 23 February 2016 respectively, and Gatis Junghāns left his position on the Board.

In 2016, changes took place in the composition of the Supervisory Board of Elektrum Eesti OÜ. On 24 May 2016, Guntars Baļčūns was appointed as a Member of the Supervisory Board, and Gatis Junghāns left his position on the Board.

Latvenergo AS Supervisory Board

Andris Ozoliņš (55)
Chairman of the Supervisory Board

Date appointed: 16.12.2016
Term expires: 15.12.2021

Experience

- 2017–present: Latvenergo AS, Member of the Audit Committee
- 2016–present: Latvenergo AS, Chairman of the Supervisory Board
- 2016–present: Baltic International Bank AS, Member of the Supervisory Board
- 2013–2014: Reverta AS, Member of the Supervisory Council
- 2013–2014: Kredītinformācijas birojs AS, Member of the Supervisory Council
- 2010–2011: DNB Bank ASA, Member of the Management Board
- 1999–2012: DNB banka AS (NORD/LB Latvija AS), President and Chairman of the Management Board, Member of the Management Board
- 1997–1999: Irvin & Co Baltics SIA, Chief Executive Officer, Senior Consultant

Education

- International Institute for Management Development in Switzerland, Business Development and Corporate Management Programme (2011)
- European School of Management and Technology Berlin, Executive Transition Programme (2006)
- RTU Riga Business School, Master of Business Administration (2002)
- The Chartered Institute of Bankers (Great Britain), Banking Certificate (1997)
- University of Latvia, Diploma in Philosophy (1991)

Andris Liepiņš (47)
Deputy Chairman of the Supervisory Board

Date appointed: 16.12.2016
Term expires: 15.12.2021

- 2017–present: Latvenergo AS, Member of the Audit Committee
- 2016–present: Latvenergo AS, Deputy Chairman of the Supervisory Board
- 2014–2016: Riga International Airport SJSC, Chairman of the Management Board
- 2011–2014: Air Baltic Corporation AS, Chairman of the Supervisory Board
- 2001–2014: Ministry of Economics, Deputy State Secretary
- 2002–2006: Latvenergo AS, Member of the Supervisory Board (Secretary of the Supervisory Board)
- 1995–2001: Development Agency of Latvia, Member of the Management Board, Director of the Investment Department
- 1994–1995: Saeima, Member of Parliament, Ministry of Economics, Parliamentary Secretary
- 1994: Development Agency of Latvia, Member of the Management Board, Director of the Investment Department
- 1991–1994: Ministry of Economics, Department of External Economic Relations, Senior Specialist

- RTU Riga Business School, Master of Business Administration (2010)
- Columbia University in the City of New York, Master of International Relations (1997)
- University of Latvia, Master of Public Administration (1996)
- University of Latvia, Diploma in Economics (1993)

Baiba Anda Rubesa (62)
Member of the Supervisory Board

Date appointed: 16.12.2016
Term expires: 15.12.2021

- 2016–present: Latvenergo AS, Member of the Supervisory Board
- 2015–present: RB RAIL AS, Chairperson of the Management Board, Chief Executive Officer
- 2014–present: RFactor SIA, Owner and Chairperson of the Management Board
- 2012–2015: Citadele Banka AS, Member of the Supervisory Board
- 2010–2013: Statoil ASA, Vice President, Corporate Social Responsibility
- 2008–2010: Statoil Azerbaijan, Director, Government & Public Affairs
- 2002–2009: DnB NORD Banka AS, Member of the Supervisory Board
- 2001–2008: Latvija Statoil SIA, Managing Director
- 1996–2000: Statoil Baltic States, Director, Marketing & Public Affairs
- 1994–1996: Es un partneri SIA, Owner
- 1993–1993: Bell Sygma Inc., Assistant Vice-President
- 1985–1992: Volkswagen Group, Manager of Corporate Image and Coordinator of International Public Relations

- Baltic Institute of Corporate Governance, Executive Education, Board Member Certificate (2014)
- Shaw College, Degree in Business Administration (1975)
- York University, Bachelor of Arts (1974)

Mārtiņš Bičevskis (42)
Member of the Supervisory Board

Date appointed: 16.12.2016
Term expires: 15.12.2021

- 2016–present: Latvenergo AS, Member of the Supervisory Board
- 2016–present: State Real Estate SJSC, Chairman of the Supervisory Board
- 2012–2017: Employers' Confederation of Latvia, Vice President, Member of the Supervisory Council
- 2011–2016: Association of Latvian Commercial Banks, President, Member of the Board
- 2008–2011: Ministry of Finance, State Secretary
- 2004–2008: Ministry of Justice, State Secretary
- 2003–2004: Ministry of the Interior, Deputy State Secretary
- 2000–2003: Office of Citizenship and Migration Affairs, Head
- 1999–2000: Ministry of the Interior, Parliamentary Secretary
- 1999: Saeima, Member of Parliament
- 1999: Privatisation Agency, Member of the Supervisory Board

- Harvard Kennedy School, John F. Kennedy School of Government, summer programme on crisis leadership (2008)
- University of Latvia, Faculty of Law, Lawyer (1998)

Martin Sedlacky (34)
Member of the Supervisory Board

Date appointed: 16.12.2016
Term expires: 15.12.2021

- 2016–present: Latvenergo AS, Member of the Supervisory Board
- 2012–present: Air Baltic Corporation AS, Member of the Management Board, Chief Operating Officer
- 2006–2013: The Boston Consulting Group (Czech Republic), Project Manager

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

Latvenergo AS Management Board

Āris Žīgurs (51)
Chairman of the Management Board

Date appointed: 16.11.2015
Term expires: 15.11.2020

Experience

- 2016–present: Member of the Council of Higher Education
- 2015–present: Employers' Confederation of Latvia, Member of the Council
- 2013–present: Latvenergo AS, Chief Executive Officer
- 2011–present: LUA, Member of the Counsellor Convent
- 2011–present: RTU, Chairman of the Counsellor Convent
- 2011–present: Latvian National Committee of the World Energy Council, Vice-president
- 2010–present: Latvenergo AS, Chairman of the Management Board
- 2010–present: EURELECTRIC, Member of the Board of Directors
- 1996–2010: Rīgas Siltums AS, President and Chairman of the Management Board

Education

- Baltic Institute of Corporate Governance, Executive Education, Chairman Certificate (2013)
- Baltic Institute of Corporate Governance, Executive Education, Board Member Certificate (2010)
- RTU, Doctor of Sciences in Engineering, energy sector (2009)
- RTU Riga Business School, Master of Business Administration (2004)
- LUA, Faculty of Engineering, engineer-mechanic (1988)

Guntars Baļčūns (36)
Member of the Management Board

Date appointed: 16.11.2015
Term expires: 15.11.2020

- 2016–present: Elektrum Eesti OÜ, Member of the Supervisory Board
- 2016–present: Baltic Institute of Corporate Governance, Member of the Supervisory Board
- 2016–present: Elektrum Lietuva UAB, Member of the Supervisory Board
- 2015–present: Latvenergo AS, Chief Financial Officer
- 2015–present: Latvenergo AS, Member of the Management Board
- 2014–2015: Enerģijas publiskais tirgotājs AS, Member of the Management Board
- 2005–2015: Latvenergo AS, Business Planning and Control Director, Corporate Strategy Project Manager
- 2003–2005: Aizkraukles Banka AS, Credit Analyst

- Baltic Institute of Corporate Governance, Executive Education, Board Member Certificate (2016)
- RTU Riga Business School, Master of Business Administration (2016)
- Komercizglitibas centrs SIA, business class (2008)
- University of Latvia, Master of Economics (2005)
- Stockholm School of Economics in Riga, Bachelor of Economics and Business Administration (2003)

Uldis Bariss (51)
Member of the Management Board

Date appointed: 16.11.2015
Term expires: 15.11.2020

- 2013–present: Latvenergo AS, Chief Commercial Officer
- 2010–present: Elektrum Eesti OÜ, Chairman of the Supervisory Board
- 2010–present: Elektrum Lietuva UAB, Chairman of the Supervisory Board
- 2005–present: Latvenergo AS, Member of the Management Board
- 2005: Latvenergo AS, Project Director of Distribution Network Restructuring
- 2002–2004: Latvenergo AS, Economics Department Director
- 1996–2002: Lattelekom SIA, Head of the Financial Planning and Control Division, Head of the Management Accounting Sector

- Baltic Institute of Corporate Governance, Executive Education, Board Member Certificate (2010)
- Stockholm School of Economics in Riga, Executive Master of Business Administration (2008)
- University of Latvia, Master of Economics (2004)
- International Chartered Accountant qualification (Association of Chartered Certified Accountants (ACCA)) (2000)

Māris Kuņickis (37)
Member of the Management Board

Date appointed: 16.11.2015
Term expires: 15.11.2020

- 2013–present: Latvenergo AS, Chief Operating Officer
- 2012–present: EURELECTRIC, Deputy Member of the Board of Directors
- 2011–present: Latvian Association of Power Engineers and Energy Constructors (LAPEEC), Member of the Board
- 2010–present: Latvenergo AS, Member of the Management Board
- 2006–2010: Rīgas gaisma LGA, Director, Executive Officer

- Studies in the RTU doctoral degree programme in the Faculty of Power and Electrical Engineering
- Baltic Institute of Corporate Governance, Executive Education, Board Member Certificate (2013)
- University of Latvia, Master's Degree, Faculty of Physics and Mathematics (2005)
- RTU, Bachelor's Degree, engineer, Faculty of Power and Electrical Engineering (2002)

Guntis Stafeckis (53)
Member of the Management Board

Date appointed: 16.11.2015
Term expires: 15.11.2020

- 2016–present: Latvenergo AS, Chief Technology and Support Officer
- 2015–present: Latvenergo AS, Member of the Management Board
- 2015–2016: Latvenergo AS, Chief Development Officer
- 2011–2015: Latvijas elektriskie tīkli AS, Chief Executive Officer, Chairman of the Management Board
- 2010–2011: Siltumelektroprojekts AS, Chief Executive Officer
- 1995–2009: Siemens SIA, Chief Executive Officer, Manager of the Energy Department, Manager of the Energy and Transport Systems Department
- 1995: Latvenergo AS, Deputy Head of the Technical and Production Department of Daugava HPPs

- Siemens, S4 – strategic and leadership training (2006)
- Training course by Larry W. Stout, development of management skills (2005)
- EBRD, procurement and project management seminar (1995)
- Vattenfall, Energy Management in the Baltic States (1993)
- RTU, Professional Master's Degree in Electrical Engineering (1986)

Latvenergo AS Audit Committee

Torben Pedersen (67)
Chairman of the Audit Committee

Date appointed: 03.03.2017
Term expires: 02.03.2020

Experience
- 2015–present: Electronic House UAB, Member of the Supervisory Board
- 2013–present: Vilnius International School, Shareholder Representative
- 2013–2014: Rus-Agro Team A/S, Member of the Management Board
- 2012–present: Latvenergo AS, Chairman of the Audit Committee
- 2012–present: Baltic Engineers UAB, Chairman of the Management Board
- 2011–present: Danish Chamber of Commerce in Lithuania, Member of the Supervisory Board
- 2001–2010: Deloitte, Partner
- 1994–2001: Arthur Andersen, Partner

Education
- Aarhus School of Business, Master of Economics and Auditing (1974)
- Chartered Accountant qualification (Denmark)

Marita Salgrāve (51)
Member of the Audit Committee

Date appointed: 03.03.2017
Term expires: 02.03.2020

- 2017–present: International Organization of Supreme Audit Institutions, FIPP member
- 2015–present: Latvenergo AS, Member of the Audit Committee
- 2015–present: State Audit Office of the Republic of Latvia, Advisor to the Auditor General of the Republic of Latvia in strategic issues
- 2007–2015: State Audit Office of the Republic of Latvia, Member of the Council, Director of the Fourth Audit Department
- 1998–2007: Central Finance and Contracting Agency, Deputy Director, Director of the Programme Management Department, Senior Procurement Specialist
- 1993–1998: RAMBOLL A/S, Denmark, Project Manager

- Sint-Aloysius School of Economics (EHSAL) in Brussels, Master of Business Administration (1998)
- University of Latvia, Faculty of Economics and Management, post-graduate qualification of an economist (accountant) (1997)
- Oxford College of Petroleum and Energy Studies, post-graduate qualification in energy and the environment (1995)
- University of Latvia, Faculty of Chemistry, Master of Analytical Chemistry (1988)

Svens Dinsdorfs (41)
Member of the Audit Committee

Date appointed: 03.03.2017
Term expires: 02.03.2020

- 2015–present: Elko Grupa AS, Director, Member of the Management Board
- 2012–present: Latvenergo AS, Member of the Audit Committee
- 2006–2014: Elko Grupa AS, Finance Director, Member of the Management Board
- 2004–2006: Sirowa Riga AS, Finance Director
- 1998–2004: Air Baltic Corporation AS, Vice President of Strategic Development, Business Control Director

- Stockholm School of Economics, Master of Finance and Economics (2003)
- Stockholm School of Economics in Riga, Bachelor of Economics and Business Administration (1998)

Andris Ozoliņš (55)
Member of the Audit Committee
Date appointed: 03.03.2017
Term expires: 02.03.2020

Information about experience and education is available in the subsection Latvenergo AS Supervisory Board

Andris Liepiņš (47)
Member of the Audit Committee
Date appointed: 03.03.2017
Term expires: 02.03.2020

Information about experience and education is available in the subsection Latvenergo AS Supervisory Board.

1.6 Group Management

G4-14
G4-33

Effective operation is ensured by separating strategic and operational management

G4-34

Latvenergo Group's management model is based on best corporate governance practice, separating strategic and operational management. The

G4-56

Group's strategic management is ensured by the Management Board, whose accountability is joint according to the Commercial Law. Operational management is ensured by Chief Officers, whose accountability is individual. The main duty of the Management Board is to lead the Group in order to reach the objectives stated in the medium-term strategy. The Management Board reports to the Supervisory Board at least quarterly and to a shareholder's representative at the Shareholder's Meeting annually. Chief Officers ensure the operational management of Latvenergo AS, including the achievement of set goals, implementation of strategy and policies, and other everyday duties according to delegation.

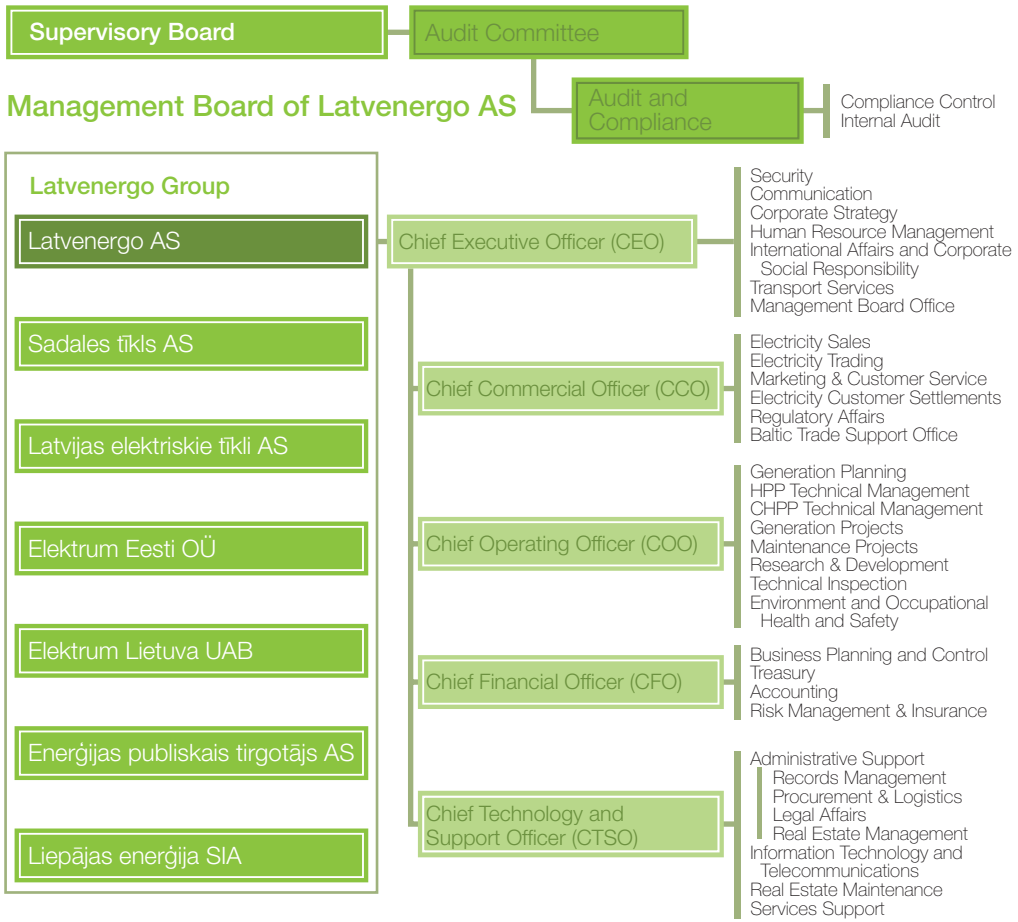
The Chief Officers' areas of accountability are clearly defined, and subordinated functions and supervision of administrative decisions within the framework of these functions are separated. Accordingly, Chief Officers are individually accountable to the Chief Executive Officer for the operational activity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

In September 2016, in order to improve the organisational structure for business operations and the decision-making process at Latvenergo AS, a new area of responsibility, Technology and Support, was established for research and development of new products and services. This was implemented by restructuring the units accountable to Chief Officers. A new unit, Services Support, was also established under the supervision of the Chief Technology and Support Officer. Considering their previous experience and knowledge of the Group's operations, Members of the Management Board of Latvenergo AS perform the duties of Chief Officers.

At the end of the reporting period, the duties of Chief Officers were assigned as follows:

- Āris Žīgurs – Chief Executive Officer (CEO)
- Guntars Baļčūns – Chief Financial Officer (CFO)
- Uldis Bariss – Chief Commercial Officer (CCO)
- Māris Kuņickis – Chief Operating Officer (COO)
- Guntis Stafeckis – Chief Technology and Support Officer (CTSO)

Latvenergo Group Organisational Structure



COSO cube

Internal Control System

To ensure the achievement of Latvenergo Group's strategic goals, successful supervision of operations, and efficiency, an internal control system has been introduced that takes into account COSO (Committee of Sponsoring Organizations of the Treadway Commission) guidelines. The COSO model ensures that the control environment, risk assessment, control measures, information exchange and communication, and monitoring activities are at the core of an effective internal control system. Through implementing these key elements, the aims of the internal control system are achieved: efficiency of the Group's operations, credibility of the information disclosed in the reports, and compliance with applicable legislation and other laws and regulations.

Control Environment

The management of the Group promotes business activities that are in line with the principles of good faith and comply with ethical standards. It takes actions necessary to prevent the risk of corruption and fraudulent conduct and to promote the improvement of the control environment. The Group promotes employee awareness of internal control processes and continuously improves their competences to further effective achievement of set targets. Specific responsibilities have been defined for creating and conducting controls at all organizational levels. On an annual basis, the Internal Audit prepares a general evaluation of the operational efficiency of the internal control environment and recommendations for its improvement.

Risk Assessment

Latvenergo Group continuously improves the risk management process in order to better adapt to the changing business environment and market development trends. Risk assessment is increasingly integrated into the company's governance processes, and various risk assessment methods and tools are combined. More information on the Group's risk management process and major risks is provided in the subsection Risk Management.

Control Measures

Latvenergo Group has introduced and continuously improves general controls (policies, instructions, process descriptions, etc.) aimed at promoting the implementation of its strategy and the achievement of its goals. To achieve the goals of its strategy, the Group develops annual targets and ensures that their performance is monitored. Annual targets are cascaded down to individual targets, so that employees are engaged in the achievement of strategic goals. To minimise material business risks, Latvenergo Group regularly updates its control activities.

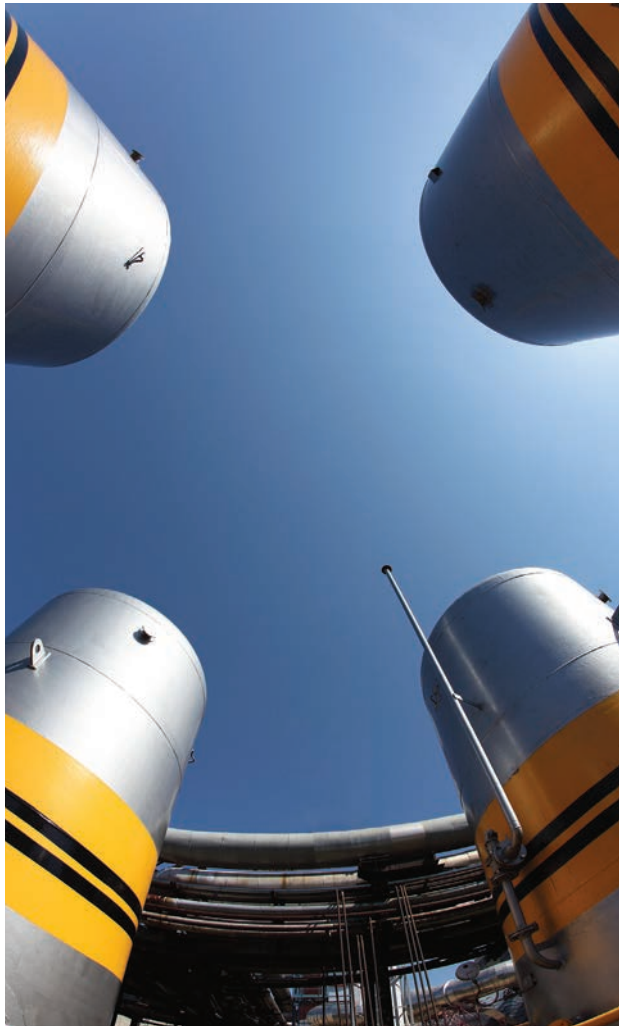
Information and Communication

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

Latvenergo Group's management pays considerable attention to ensuring employee awareness, regularly communicating both long-term and short-term plans. The key information exchange and communication channels are the Intranet, the employee newsletter Latvenergo Vēstis (Latvenergo News), internal record-keeping systems, electronic communication, internal databases, employee forums, workshops, etc. To ensure feedback, the Group relies on internal opinion surveys, employee development interviews, and evaluation of competencies. Working groups are also established where representatives with various skills, know-how and competencies are delegated to ensure the exchange of employees' opinions and knowledge, raise their motivation and engage them in the decision-making. Additionally, the Group provides employee training to improve understanding of control activities – their relevance and practical application in the Group's operations – and accountability in the implementation and improvement of controls.

Monitoring

The Group's management is responsible for regular assessment and improvement of controls. The management's performance is monitored by the Supervisory Board, the Audit Committee and the Internal Audit. The external auditor provides an evaluation of the compliance of financial reports. All the aforementioned institutions are independent in their operations.



Supervisory bodies

Institution	Objective	Monitoring scope and tasks	Reporting
Auditor	To evaluate compliance of the Group's financial reports with the IFRS	• auditing financial reports and reviewing non-financial reports • evaluating accounting principles and major management accounting estimates	Once a year, following the finalization of the consolidated financial statements, the Auditor reports at the Shareholder's Meeting
Supervisory Board	To represent the interests of the Shareholder in between the Shareholder's Meetings and supervise the operation of the Management Board	• supervising the Management Board's operation • supervising the preparation of annual reports • supervising the compliance of the company's operations with legislation, the Articles of Association and decisions adopted at the Shareholder's Meetings	At least once a year the Supervisory Board reports at the Shareholder's Meeting
Audit Committee	To oversee the preparation of the Group's financial reports and the operation of internal control systems, thus stimulating transparency at the company	• supervising the preparation of financial reports • supervising the operation of internal control and risk management systems • monitoring activities of the Internal Audit and external auditor and implementing the Fraud Risk Management Plan	At least once a year, the Audit Committee reports on its activities and performance of tasks to the Supervisory Board (at the Shareholder's Meeting until the establishment of the Supervisory Board)
Internal Audit	To evaluate and assist governance bodies and organisational units in improvement of the efficiency of risk management, internal controls and corporate governance processes	• evaluating the efficiency of internal controls, risk management and corporate governance processes, preparing recommendations for the improvement and supervision of their implementation	Every quarter the Audit and Compliance Director reports to the Audit Committee on the audits performed and the status of implementation of audit recommendations

Risk Management

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

The Group's risk management objectives and guiding principles are defined in the Risk Management Policy. The risk management process at Latvenergo Group provides for continuous risk identification, assessment and management.

Significant risks identified by the Group are analysed in detail in internal cross-department working groups and at the Risk Management Committee, a designated risk management and monitoring body established at the Management Board level of Latvenergo AS. Within the framework of risk analysis, the probability and impact of risks are assessed, risk mitigating measures are developed and their implementation is monitored. Risk management is integrated not only into the strategy development and implementation process, but also into everyday operations. The principles of internal risk management ensure that it is continuously within the scope of operations and responsibility of the Latvenergo AS Management Board, Audit Committee and Supervisory Board.

Significant risks for the Group are divided into four categories:

- *Strategic risks* involve matters of strategic importance for the Group, such as the development of the sector, new competitors entering the market, and implementation of projects of strategic importance. The main risk management instruments for this category are monitoring change and development trends in the energy sector and the political environment, participating in developments that affect the Group's operational aspects, and evaluating and implementing necessary changes;
- *Operational risks* include risks arising from the Group's operational specifics: energy generation, maintaining power plants and ensuring their functionality, and energy supply and distribution. There are also operational risks associated with loss of assets, threats to human health and safety, information technologies, environmental impact, and other issues. Operational risks arise from imperfect or insufficiently effective processes and systems, employee error or lack of competence, damage to equipment, or external events. Operational risk management is aimed at mitigating the negative impact of adverse effects. For this purpose, the Group works continuously on its internal control systems, maintenance and development plans, uses insurance services and takes other steps to minimise operational risks;
- *Financial risks* stem from the need of a capital-intensive industry to regularly attract funding (financial market, liquidity and financing risks). To minimise financial risks, the Group uses financial instruments, diversifies the sources of its loans as much as possible, and ensures a liquidity reserve for a period of at least 12 calendar months. Similarly, tax, financial statement and reporting risks are also evaluated and monitored;
- *Legal and compliance risks* are risks arising from rules and regulations issued by the EU and Latvian institutions. The main risk management instruments for this risk category are: monitoring changes and development trends in the legal environment that affect the Group's operational aspects, participation in the development process of new regulatory documents, and implementation of required changes. The Group has developed and maintains a strict internal operations compliance and control system to prevent any kind of abuse, including improper or illegal activities for personal gain. Continuous employee training and monitoring is an important instrument for managing this type of risk.

The Group monitors any risks identified and keeps them as low as possible. Significant risks for the Group are added to the scope of the Internal Audit system, which allows for the use of risk assessments in the planning of Internal Audit activities.

Awards

The awards and recognitions Latvenergo Group received during the reporting period affirm its responsible and sustainable business practices and good corporate governance.

The most valuable company in Latvia for the ninth time

For the ninth time, Latvenergo AS has been acknowledged as the most valuable enterprise in the Top 101 Most Valuable Companies of Latvia list compiled by Prudentia AS and Nasdaq Riga in cooperation with Lursoft IT SIA and the magazine Kapitāls. According to the study, the value of Latvenergo AS increased in 2016 by 22% compared to 2015. The study commended the corporate governance of Latvenergo AS, its transparency and quality of information disclosed to the public (91 out of 100 points).

Latvenergo AS ranks fifth on the list of Top 10 Most Valuable Companies in the Baltics.

Best Investor Relations in the Baltics among Bond Issuers

Latvenergo AS is the first company in the Baltic states to receive the award for Best Investor Relations in the Baltics among Bond Issuers.

Nasdaq Baltic has presented the Baltic Market Awards since 2006. 2017 was the first year they were awarded to bond-issuing companies listed on Baltic stock exchanges. After evaluation of 160 criteria, Latvenergo AS was awarded for reliable, transparent and best practice investor relations in 2016. In addition to the award, Latvenergo AS received an invitation from the stock exchange to ring the closing bell of the trading session at Nasdaq MarketSite in New York City's Times Square.

The highest category in the Sustainability Index of Latvia for the fourth year in a row

2016 was the fourth year in a row in which Latvenergo AS received the Platinum category (the highest) from the Sustainability Index of Latvia, which assesses the sustainability of companies in all aspects of corporate social responsibility, based on international requirements. Latvenergo AS has participated in the Sustainability Index since 2010.

At the CSR Idea Market conference held on 8 June 2016 as part of Sustainability Week, Latvenergo AS received a Family-Friendly Company Certificate from the Ministry of Welfare of the Republic of Latvia for the fifth year in a row. This reflects the company's concern for the families of its employees and customers, which promotes loyalty and improves its reputation.

At the Sustainability Index's closing ceremony on 9 June 2016, Latvenergo AS also received a special "Fair Trade Award" from the Ministry of Foreign Affairs for building relationships with employees, customers, cooperation partners and the local community based on respect, honesty and openness. Latvenergo AS was also recognised for its fair business practices and compliance with the rules of fair competition, which it also encourages among its contractors.

In 2016, Sadales tīkls AS participated in the Sustainability Index for the first time and received one of the highest assessments, the Gold category. The company also received the status of Family-Friendly Company for its responsibility towards employees, customers and their families. Liepājas enerģija SIA also participated in the Sustainability Index for the first time and was awarded the Silver category. This assessment is evidence of the company's openness, transparency and responsibility with regard to customers, cooperation partners, society, and the environment.

Corporate reputation leader in the electricity, gas and water supply sector for the fifth year in a row

The Latvian corporate reputation ranking organised by Nords Porter Novelli SIA, the newspaper Dienas Bizness, the Investment and Development Agency of Latvia (LIAA) and SKDS Marketing and Public Opinion Research Centre listed Latvenergo AS as the leader in the electricity, gas and water supply sector for the fifth year in a row.

Latvenergo AS: awarded in three categories of the TOP 500 ranking: state-owned company, local capital company, EBITDA maker

At TOP 500, an event honouring the largest, most profitable, most stable and most viable Latvian companies, organised by the newspaper Dienas Bizness, Lursoft IT SIA and the LIAA in November 2016, Latvenergo AS was awarded in three categories: state-owned company, local capital company, and EBITDA maker. Latvenergo AS ranked first among the largest energy industry companies in terms of net turnover in 2015 and was among the companies with the largest long-term investments in 2015, which is a confirmation of its ability to make extensive investments and attract external funding.

Annually the Most Attractive Employer

In the Top Employer 2016 survey conducted by the online recruitment company CV-Online Latvia at the end of the year, Latvenergo AS was ranked as the most attractive employer in Latvia and the top employer in the production sector for the fifth year in a row. Latvenergo AS came highly recommended for its motivating salaries and additional benefits, name recognition and good reputation, career opportunities, inspiring and professional management, and attractive corporate culture.

The *Greenest* Workplace in Latvia

In 2016, the association Eizenšteins un dēli, in cooperation with the Latvian Environmental Protection Fund and Riga TV 24, invited companies to join a new movement to improve the quality of life and promote an environmentally friendly lifestyle. Latvenergo AS was recognised as the *greenest* workplace in Latvia in 2016. The award was presented for respect for the environment in energy generation, energy efficiency activities, stakeholder engagement in the replenishment of fish stocks, white stork monitoring, the ISO 14001-certified Environmental Management System, and other activities (see Section 2.4: Environmental Protection).

The Best Internship Provider

At its Annual Award 2016 ceremony, the Employers' Confederation of Latvia (ECL) awarded the best employers and, for the first time, the best internship provider in the country. Latvenergo AS was recognised as the best internship provider. The purpose of the ECL Annual Awards is to single out the contribution of employers to regional growth and to stimulate the development of public-sector practices that encourage entrepreneurship throughout Latvia and the exchange of best practices at industry and regional levels.

Namejs Prize 2016

The Latvian Chamber of Commerce in Lithuania and the Embassy of the Republic of Latvia in Lithuania awarded Elektrum Lietuva UAB the Namejs Prize 2016 in the category "Largest Tax Contributor to the Lithuanian Budget" for its contribution of more than EUR 16 million in taxes in 2015.

Largest taxpayer among state and municipal companies in Latvia

Latvenergo AS was awarded in the category "Largest Taxpayer in the Country for 2016 among State and Municipal Companies" at the Largest Taxpayers award ceremony organized by the State Revenue Service.

1.7 Corporate Governance Report and Audit Committee Report

Corporate Governance Report

We implement Nasdaq Riga Principles of Corporate Governance

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

Upon evaluating the company's governance system and compliance with these principles in 2016, the Management Board of Latvenergo AS confirms that the company has complied with all applicable principles of corporate governance in all key material aspects.

The Latvenergo AS Corporate Governance Report 2016 is publicly available on the Latvenergo website (www.latvenergo.lv) and the Nasdaq Baltic website (www.nasdaqbaltic.com). Detailed information on compliance with the corporate governance principles is presented in Section 1.5: Group Governance and Section 1.6: Group Management. Of the 83 Nasdaq Riga corporate governance principles, Latvenergo AS complies with 77 fully, while 6 are not applicable to company operations.

Audit Committee Report

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

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

In 2016, the activities of the Audit Committee focused on reviewing the following issues, which impact the Group's operations:

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

Having assessed the information and processes reviewed during the 2016 financial year, nothing has come to our attention that would lead us to believe that the internal controls of Latvenergo AS do not provide a reliable basis for the preparation of the 2016 Annual Report.

We submit the summary of our assessment to the Shareholder's Meeting of Latvenergo AS on the date of approval of the Consolidated Annual Report 2016.

Torben Pedersen,
Chairman of the Audit Committee

Marita Salgrāve,
Member of the Audit Committee

Svens Dinsdorfs,
Member of the Audit Committee

Andris Ozoliņš,
Member of the Audit Committee
(as of 03.03.2017)

Andris Liepiņš,
Member of the Audit Committee
(as of 03.03.2017)

1.8 Stakeholder Engagement

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G4-24

G4-25

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G4-27

Stakeholder engagement in the Group's operations

Latvenergo Group identifies the needs of its stakeholders within the scope of its operations and addresses them responsibly, aware of the Group's social, environmental and economic impact.

The stakeholders identified by Latvenergo Group through internal and external discussions are grouped in the Stakeholder map. Stakeholders are evaluated based on their impact on Latvenergo Group operations and vice versa. The evaluation is carried out in all aspects of the GRI: Economic Performance, Environmental Protection, Employment and Work Environment, Society, and Product Responsibility. Identification and grouping is carried out taking into account the GRI G4 Guidelines and the voluntary AA 1000 Stakeholder Engagement Standard, which sets an example for best practice in quality stakeholder engagement at both a strategic and an operational level.

Latvenergo Group engages with stakeholders on several levels:

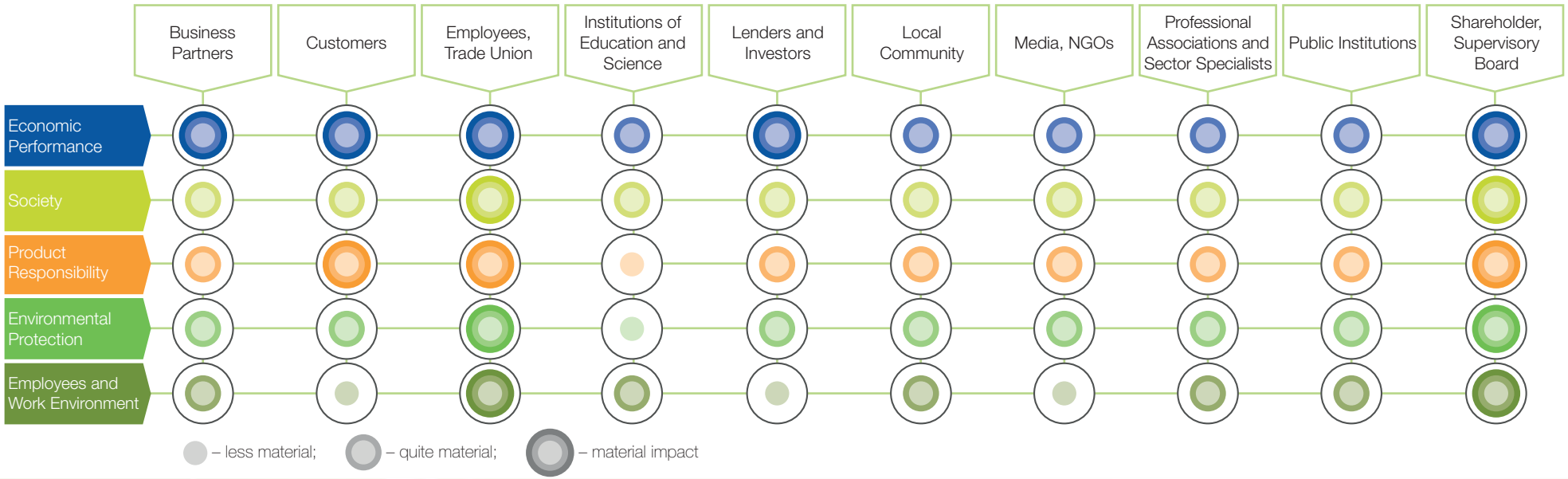
- consultation – identification of current issues;
- negotiation – participatory discussions;
- involvement – exchange of opinion while acting independently;
- collaboration – joint decision-making and operation.

In 2016, Latvenergo Group continued to promote best practice in sustainability, social responsibility and corporate governance. The Group shared its experience at the conference "Corporate Governance Reform in Latvia: Progress and Future Outlook", organised by the Cross-Sectoral Coordination Centre in February 2016, and at the Responsible Idea Market conference organised by the Institute for Corporate Sustainability and Responsibility, the Free Trade Union Confederation of Latvia and the ECL in June 2016.

In 2016, Latvenergo Group implemented the recommendations for improvement of operations received at the stakeholders' workshop in autumn 2015. The Group continues cooperation with scientific and educational institutions in line with stakeholder recommendations, in order to promote young people's interest in science-related subjects and technical engineering professions. Likewise, based on the recommendations, first call resolution has been determined as a key performance indicator in customer service and is regularly measured and analysed.

For more information on the stakeholder workshop and aspects relevant to the sustainability of the Group, see Section 1.9: Materiality Assessment.

Stakeholders of Latvenergo Group



Stakeholder	Representatives	Material issues / Sustainability aspects	Engagement methods	Level of engagement
Business Partners	Construction companies and equipment suppliers, service providers, energy resource suppliers, energy generators and suppliers, transmission system operators (TSO), etc.	• Clear and transparent procurement tenders; • Electricity transmission and distribution; • Mandatory procurement (MP) of electricity and Subsidised Electricity Tax (SET); • Development of electricity interconnections; • Efficiency of energy generation facilities.	The Group regularly informs its business partners about ethical principles for contractual parties, maintains and regularly updates its Register of Qualified Bidders, and encourages partners to apply for inclusion in its qualification system. The Group regularly surveys its current and potential business partners, defining areas for improvement. Business representatives were one of the respondent groups of the Corporate Reputation Study 2016. In 2016, Sadales tīkls AS organised Corporate Customer Days, offering information on electricity cost reduction opportunities. In 2016, Latvenergo AS discussed harmonisation of balancing market elements in the Baltic states with Baltic electricity TSOs.	Involvement
Customers	Current and potential customers (households and legal entities)	• Electricity products, tariffs, pricing of related services; • Quality of the services provided; • Customer satisfaction with the company, its services, service level, availability of information and its content; • Payment options and services; • Availability and efficiency of distribution services; • Reducing the frequency and duration of unscheduled power outages; • Transparent, fair and ethical marketing and communication practice; • Compliance with the requirements of regulatory acts and fair competition; • Contingency management plans.	Latvenergo Group's selection of electricity products is adjusted to customer needs. Information required by customers is regularly provided on the customer portal at www.elektrum.lv/en, in social networks, at Customer Service Centres and through other information channels. Latvenergo Group conducts annual customer satisfaction surveys and undertakes activities to increase customer satisfaction (more information in Section 2.3: Product Responsibility). The Group prepares Electricity Market Overviews and regularly sends them to business customers.	Involvement
Employees, Trade Union	Existing and potential employees, trade union *Enerģija*	• Collective Bargaining Agreement, occupational health and safety, rights and responsibilities of the employer and employees; • Productivity and motivation, competencies, remuneration and welfare of employees; • Data safety; • Availability and efficiency of distribution services; • The Group's contribution to the national economy.	Latvenergo Group conducts annual employee opinion polls to investigate employees' attitudes towards various factors that impact the work environment. Employee performance is assessed on a quarterly basis. During the annual career development interviews, employees and their managers discuss achievement of annual targets and further activities for improving their competencies. The employee opinion poll of 2016 included questions about the use and content of the Sustainability Report. In 2016, representatives of the Group had 16 meetings with the trade union on issues of mutual importance. A new Collective Bargaining Agreement was signed at the employee conference in late 2016 for the period of 1 January 2017 to 31 December 2021.	Negotiation and involvement
Institutions of Education and Science	Academic institutions, institutions of higher, secondary and vocational education	• Educational programmes meeting the requirements of the labour market; • Content of educational materials for children and youth; • Contribution to the public welfare and CSR activities; • Involvement in the development of energy sector policy; • Transparent, fair and ethical marketing and communication practice; • Availability of information.	In 2016, theoretical and practical training of specialists was continued in cooperation with LUA and RTU, with experts from the Group participating as guest lecturers in study programmes and on bachelor's and master's thesis defence committees and hosting student field trips to energy generation facilities and other sites. In cooperation with the Latvian Academy of Sciences, the Group awards scientists annually for their achievements in the energy sector, organises graduation paper and scholarship competitions, and provides students with internship opportunities. In 2016, the Group continued to support the RTU School of Engineering. Within social responsibility projects, the Group promotes young people's interest in science-related subjects and technical engineering professions, supports their excellence in the exact sciences, supplements training materials for teachers, and supports researchers' and teachers' scientific activities in the field of energy.	Collaboration

Lenders and Investors	Banks, European Commission (EC), bondholders	• Latvenergo Group's financial results, significant events, compliance with the terms of agreements; • Involvement in the development of energy sector policy; • Compliance with the requirements of regulatory acts and fair competition; • Transparent, fair and ethical marketing and communication practice; • Customer satisfaction with the company, its services, service level, availability of information and its content; • The Group's contribution to the national economy.	On the Latvenergo Group website, investors are provided with up-to-date information about its financial results and performance indicators, including quarterly publication of interim financial reports. All relevant information is also published on the Nasdaq Riga exchange website and submitted to the Official System for Central Storage of the Regulated Information of the Financial and Capital Market Commission. In 2016, Latvenergo Group continued to organise webinars on financial results and business developments where anyone interested could post questions online. In 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million, completing the second bond programme with a total amount of EUR 100 million. For more information on *green* bonds, see the annex *Green* Bond Report.	Consultation and collaboration
Local Community	Residents of Latvia, municipalities, residents in the vicinity of the Group's facilities	• Latvenergo Group CSR activities; • Environmental protection, modernisation of generation facilities, and electricity network infrastructure projects; • Provision of Latvenergo Group services and problem solving; • MP PSO fee.	The local community is regularly involved in the discussion of the modernisation projects of the Group's facilities. In 2016, the Group organised public consultations on the environmental impact assessment of the third Estonia–Latvia power transmission network interconnection project regarding a new local electricity transmission network solution in Salaspils District. The opinion of Latvian society is regularly surveyed through various opinion polls, including the Group's Corporate Reputation Study 2016. The Group also organises a wide range of social responsibility activities, which are described in Section 1.4: Corporate Social Responsibility. In 2016, Latvenergo Group continued its cooperation with local governments on such issues as power supply, environmental impact assessment for modernisation projects of the Group's facilities, and the development of the regulatory environment for the energy sector by municipalities and public institutions. More information is available in Section 2.2: Society.	Consultation, involvement and negotiation
Media, Non-Governmental Organisations (NGOs)	Journalists, NGOs	• Group operations and corporate governance; • Current issues in energy sector policy in Latvia and the EU; • MP process and MP public service obligation (PSO) fee; • The Group's CSR activities; • Efficiency of energy generation facilities; • Contingency management plans; • Electricity and thermal energy generation from renewable energy resources; • Occupational health and safety; • Availability and efficiency of distribution services.	Latvenergo Group cooperates with national and regional media. Almost 200 press releases were issued in 2016, and numerous media events and press conferences were organised. The main topics were the Group's Medium-Term Strategy for 2017–2022, replenishment of fish stocks, fish migration and natural replenishment possibilities in the Daugava River upstream from Riga HPP. The Group regularly provides up-to-date information on its activities and answers questions from journalists on its own website and in social media. Journalists were also one of the respondent groups of the Corporate Reputation Study 2016. Latvenergo Group also provides information related to its core business to NGOs whose activities are focused on the development of society and protection of individual rights.	Consultation and involvement

Professional Associations and Sector Specialists	See below: Associations, Organisations and Unions	• The energy sector and related policies and the regulatory environment in the EU and Latvia; • Development trends and innovations in the energy sector; • Optimisation of electricity consumption for one's own use; • Electricity and thermal energy generation from renewable energy resources; • The amount of air pollution from generation of electricity and thermal energy; • Expenditure on environmental protection; • Compliance with environmental requirements; • Compliance with the requirements of regulatory acts and fair competition; • Contingency management plans; • Transparent, fair and ethical marketing and communication practice; • Contribution to the national economy.	In 2016, the Group discussed the development issues and regulatory environment of the energy sector and related sectors with sector specialists at the energy forum "Towards sustainable energy supply in Latvia", organised by the newspaper Dienas Bizness, at the forum "Energy 2016" organized by Big Event, and at other conferences, workshops and working groups. For more information, see the subsection Associations, Organisations and Unions.	Consultation and involvement
Public Institutions	Ministry of Economics of the Republic of Latvia, Public Utilities Commission (PUC), Competition Council, Ministry of Environmental Protection and Regional Development, Procurement Monitoring Bureau, etc.	• Development of Latvian and EU energy policies and regulatory provisions; • Improvement of the regulatory environment; • Energy tariffs and their components; • Electricity and thermal energy generation from renewable energy resources; • Contingency management plans; • Compliance with the requirements of regulatory acts and fair competition; • Efficiency of energy generation facilities.	In 2016, Latvenergo Group experts continued to assist in the development of energy sector policy documents and legislative acts and regularly offered opinions for the preparation of national position statements regarding energy and environmental matters on the current agenda of the EU Council. Information on position statements prepared in 2016 is available in Section 2.2: Society. In compliance with the procedures stipulated by legal acts, Latvenergo Group cooperates with the Competition Council, which focusses its activities on free and fair competition in all sectors of the national economy, including energy. Latvenergo Group regularly informs the PUC about its operations, financial results and calculations of MP components. In 2016, Latvenergo Group integrated the key principles of *green* procurement into procurement procedures.	Consultation and involvement
Shareholder and Supervisory Board	Ministry of Economics of the Republic of Latvia, Members of the Supervisory Board	• Group strategy, governance, investments and performance; • Compliance with the requirements of regulatory acts and fair competition; • Involvement in the development of energy sector policy; • The Group's contribution to the national economy; • Efficiency of energy generation facilities; • Electricity and thermal energy generation from renewable energy resources, increasing its share; • Contribution to the promotion of public welfare and CSR activities; • Contingency management plans.	On 16 December 2016, the Supervisory Board of Latvenergo AS was elected at the Latvenergo AS Shareholder's Meeting. Information on the Supervisory Board, the number of Shareholder's Meetings and major decisions passed in 2016 is available in Section 1.5: Group Governance.	Collaboration

Associations, Organisations and Unions

Latvenergo Group's cooperation with national and international associations and professional organisations ensures representation of its interests in the development of national and international policy documents, legal acts and standards. It also ensures up-to-date information on the latest developments in the energy industry and related industries.

National Associations and Professional Organisations

Association, Professional Organisation	Engagement Methods
Latvian Association of Power Engineers and Energy Constructors (LAPEEC)	Through membership in the LAPEEC, the Group is able to participate in the following: evaluation and development of legal acts, policy documents and standards for electrical power engineering and energy construction; the organisation of staff certification and training programmes; scientific research; and the organisation of scientific and technical events related to electrical power engineering. The Group is also able to cooperate with educational institutions specialising in electrical power engineering, including in the accreditation of study programmes. In 2016, Latvenergo Group representatives regularly participated in LAPEEC meetings to ensure exchange of ideas on topical issues for the energy sector, including the performance of the distribution network and the management and building supervision of electricity network construction. At the 95th anniversary conference organised by the LAPEEC in November 2016, Latvenergo Group representatives discussed the Group's Strategy for 2017–2022 and cooperation on standardisation issues.
Latvian Association of Large Dams	Membership in the Association ensures exchange of information on technical, economic, environmental and social aspects of dams and related innovations and safety issues. The Association is represented at the International Commission on Large Dams (ICOLD). In 2016, representatives of the Association participated in the 84th ICOLD Annual Meeting in Johannesburg, South Africa, and continued work on the ICOLD Dam Safety Committee.
Latvian Association of Heat Supply Companies (LAHC)	The LAHC provides Latvenergo Group with current information on district heating and cogeneration, generation of thermal energy from renewable sources, and other topical issues in sector development, and represents the interests of the Group at state and local government institutions. In 2016, specialists from the Group continued their participation in the preparation of LAHC position statements on draft policy documents and legal acts regarding topical issues of the sector, including on the introduction of energy efficiency obligation scheme requirements under Energy Efficiency Directive 2012/27/EU into Latvian law. In September 2016, the Group's subsidiary Liepājas enerģija SIA organised an LAHC Council meeting to discuss the possibility of using renewable sources of energy in district heating and topical issues for the industry and the regulatory framework.
Latvian Chamber of Commerce and Industry (LCCI)	The LCCI is a member of the Association of European Chambers of Commerce and Industry and of the International Chamber of Commerce. The LCCI represents the interests of its members, including those of Latvenergo Group, in drafting policy documents and legislation specific to business activity in general and the energy sector by state and local government institutions.
Employers' Confederation of Latvia (ECL)	Participation in the ECL ensures representation of the Group's interests in the drafting of policy documents and legislation on labour law and labour protection and fosters the development of economic, educational and social policies favourable to business development. In 2016, Latvenergo Group representatives continued their involvement in the ECL Platform for Energy and Environment and in the drafting of position statements, and they participated in ECL working groups, competitions, conferences and workshops.
Institute for Corporate Sustainability and Responsibility	In 2016, Latvenergo Group representatives continued their participation in the Sustainability Index of Latvia, conducted by the Institute for Corporate Sustainability and Responsibility. The Index is an internationally recognised methodology for evaluating corporate sustainability and responsibility. For information on awards received, see Section 1.6: Group Management. In 2016, the Group participated in Sustainability Week, organised by the Institute, including at the CSR Idea Market conference, and provided information for the Responsible Ideas Catalogue on sustainable development of Latvenergo Group via stakeholder engagement.
World Energy Council, Latvian National Committee (WEC LNC)	Latvenergo Group representatives actively participate in the work of the WEC LNC, particularly on issues related to national electricity policy and strategy. Participation in the WEC LNC provides the opportunity to receive up-to-date information about the research, extraction, transport, transformation and efficient use of energy resources on both a national and international scale. In October 2016, WEC LNC representatives participated in the 23rd World Energy Congress in Istanbul, Turkey, discussing international developments in the energy sector, including the future of global energy, business opportunities and sustainable energy.

International Organisations and Unions

International Organisation, Union	Engagement Methods
The Baltic Institute of Corporate Governance (BICG)	Latvenergo Group has been an active BICG member since the very outset of its operations, engaging in activities and training and assisting with the development of corporate governance guidelines for Baltic companies. With the launch of the BICG Latvia Office in August 2015, the Group has become a Corporate Development Member of the BICG, thus promoting the development of best corporate governance practice in Latvia. At the BICG, Latvenergo Group's management gains deeper insight into best governance practices and communicates the readiness of the Group to implement these practices. In May 2016, a meeting of BICG Latvia members and an experience-sharing event on sustainable company development took place at Riga HPP. At the corporate governance conference organised by the BICG in December 2016, Latvenergo AS informed the audience about the issuance of securities and the transparency of the Group's operations.
Union of the Electricity Industry (EURELECTRIC)	EURELECTRIC represents the interests of the electricity industry on an international level. Participation of Latvenergo Group representatives in the Union is ensured by the LAPEEC, a member of EURELECTRIC, on the basis of a representation agreement. Participation in EURELECTRIC's Board of Directors, committees and working groups gives Latvenergo Group access to information on the latest developments in the energy sector and ensures participation in the drafting of EU policy documents, legislation, EURELECTRIC research papers and position statements. More information on the participation of Latvenergo Group specialists in the drafting of various EURELECTRIC position statements in 2016 is available in Section 2.2: Society.
Organization for Economic Cooperation and Development (OECD), Business and Industry Advisory Committee (BIAC)	The BIAC is involved in the shaping of OECD policies and provides members with up-to-date information on the OECD's business development initiatives. Representation on the BIAC enables Latvenergo Group to receive information and participate in discussions and decision-making on business development matters of international importance. In 2016, Latvenergo Group participated in the fourth Global OECD Forum on Responsible Business Conduct, where participants discussed the Guidelines for Multinational Enterprises, non-financial reporting and stakeholder engagement.
Technical Association for Power and Heat Generation VGB PowerTech e.V	Representation in the Association ensures that Latvenergo Group receives information on the best practice of power plants in the areas of exploitation, development and environmental protection, including the availability and safety of similar power plant equipment and solutions for increasing operational flexibility and efficiency. In 2016, the Group organised the autumn VGB Committee of Hydro Power Plants meeting in Latvia. During the visit, representatives of the Association obtained information on hydropower unit reconstruction work at the Daugava HPPs and greatly appreciated the quality of their operation.
European Distribution System Operators' Association for Smart Grids	Representation in the Association ensures that Sadales tīkls AS receives up-to-date information on European distribution system operators' plans and on smart grid technologies. It also enables participation in drafting position statements in the area of smart grids.

Commitments to External Initiatives

In its operations, Latvenergo Group complies not only with the provisions of applicable legislation, but also with the requirements of international standards.

Integrated management systems have been introduced and certified in the Latvenergo AS Generation Segment and at Sadales tīkls AS, covering the areas of environmental management, quality management and labour protection. In the Generation Segment, project management has also been introduced and certified within the quality management system. An accredited certification company audits and certifies the compliance of the abovementioned systems with the requirements of the international ISO 14001, ISO 9001, and OHSAS 18001 standards. Latvijas elektriskie tīkli AS and Liepājas enerģija SIA, in turn, have certified and maintain quality management systems in compliance with ISO 9001 requirements.

In 2016, Latvenergo AS introduced and certified an energy management system in compliance with ISO 50001.

In cooperation with stakeholders, Latvenergo Group voluntarily integrates activities into its operations to improve public welfare and the environmental situation, following the principles of social responsibility under the voluntary ISO 26000 standard and stakeholder engagement principles under the AA 1000 standard.

1.9 Materiality Assessment

G4-18 G4-19 G4-20 G4-21 G4-23

We disclose material aspects for the Group and its stakeholders

The content of the Latvenergo Group Sustainability Report is based on material aspects in the areas of economic performance, environmental protection, employment and work environment, human rights, society, and product responsibility, in compliance with the GRI G4 Guidelines and the materiality assessment methodology developed by the Group. In defining the 2015 report's content, the engagement of the Group's management and stakeholders was enhanced. In 2016, the sustainability aspects and indicators were re-examined. The process of defining the content can be divided into four steps.

Step 1	Step 2	Step 3	Step 4
Identifying relevant sustainability aspects. Identifying priority stakeholders.	Determining the most material sustainability aspects.	Incorporating the most material aspects into a matrix and evaluating them. Selection of disclosable indicators.	Reassessment of sustainability aspects and indicators.

Step 1

The process of determining the Sustainability Report's content started with compiling a list of sustainability aspects potentially relevant to Latvenergo Group operations and important for both the Group and its stakeholders. The list was based on the following sources of information:

- GRI G4 Guidelines;
- GRI Electric Utilities Sector Disclosures;
- Information disclosed by similar companies operating in the energy sector;
- Latvenergo Group strategy and policies;
- Information disclosed in previous Sustainability Reports;
- A study of the Group's communications;
- Stakeholder opinion, etc.

A list of aspects potentially material to the sustainability of Latvenergo Group was drawn up for the areas of environmental protection, employment and work environment, human rights, society, and product responsibility. An assessment was made regarding aspects that are consistent with the Group's operations, those that meet stakeholders' expectations, and those that could be combined in order to facilitate the evaluation of their significance. A total of 27 aspects were identified as relevant to Latvenergo Group operations (see the Materiality Matrix on page 39).

Latvenergo Group's priority stakeholders in each sustainability area were identified through Group management surveys and assessed by the responsible managers of the respective areas.

Step 2

Group manager surveys were carried out and working groups were organised to identify the most material sustainability aspects for Latvenergo Group.

A workshop was organised for priority stakeholders in order to find out their views not only on material aspects for the Group's sustainability but also on prior cooperation and necessary improvements for the Group. About 70 stakeholder representatives were invited to the workshop, representing all the priority stakeholder groups of Latvenergo Group.

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

Furthermore, the opinions of all Group employees were determined through the annual survey, which comprised questions about material aspects of the Group's sustainability.

Step 3

In compiling the results of the stakeholder workshop and employee opinion survey with those of the Group management survey and the working groups, a materiality matrix of sustainability aspects was drawn up which has been assessed and approved by the top management of Latvenergo Group.

The vertical axis of the materiality matrix reflects subjects that are most important to stakeholders, while the horizontal axis reflects their importance to Latvenergo Group's management. The matrix comprises 27 sustainability aspects identified as relevant to Latvenergo Group. The materiality matrix is divided into three parts: most, moderately and least material. Nine aspects were evaluated as being the most material, rated as such by both stakeholders and Latvenergo Group. The majority of those are "Society" aspects; however, "Efficiency of energy generation facilities" from the "Economic Performance" category is the most material. Twelve aspects were recognised as being of moderate materiality and six as being least material.

This report does not include aspects rated as least material. During the assessment of the most material aspects, "Biodiversity", one of the fundamental principles of Latvenergo Group's Environmental Policy, was included as an additional disclosable aspect. Latvenergo Group has obtained assurances that certain stakeholders would appreciate information on the Group's contribution to the protection of biological

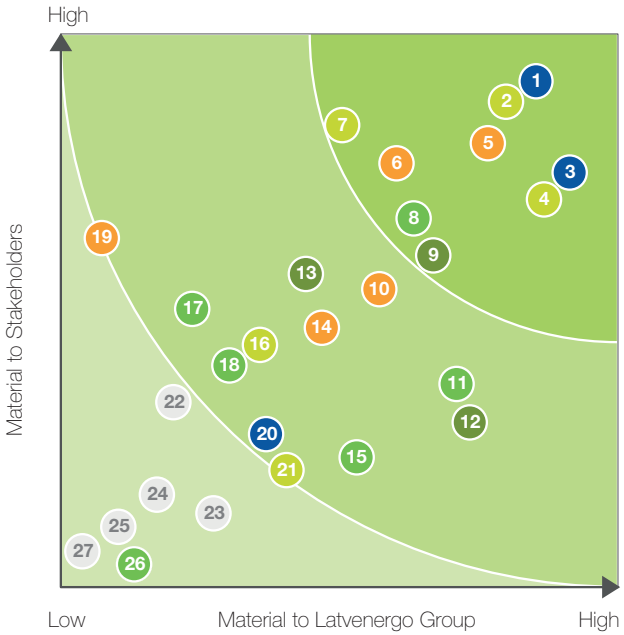
diversity, especially regarding such issues as the protection of white storks and the replenishment of fish stocks in the Daugava River basin. This leads to a total of 22 sustainability aspects disclosed in the Report.

After an assessment of the disclosable aspects according to the GRI G4 Guidelines, in cooperation with the responsible managers of the respective areas, disclosable indicators corresponding to those aspects were identified. Overall, the Report discloses information on 22 sustainability aspects and 34 Specific Standard Disclosure indicators significant for Latvenergo Group operations (see the GRI Index on page 79). In preparing information to be disclosed in the Report, the materiality of each aspect to Latvenergo Group companies and stakeholders was evaluated and taken into account (see Section 1.8: Stakeholder Engagement and the annex Materiality of Sustainability Aspects and Conformity to GRI Aspects).

Step 4

The preparation process for the review of information provided in the previous report included an evaluation of stakeholder opinion that took into consideration changes in the business environment. Information disclosed in the previous annual report was assessed taking account of changes in Latvenergo Group operations as well as feedback received from stakeholders, including on the previous report. The evaluation showed that there is no need to change the sustainability aspects identified. We also re-examined the indicators of material aspects. After the re-examination, we replaced the G4-LA5 indicator with G4-LA6, which discloses information more broadly reflected in the industry and characterises the efficiency of the occupational safety system. Similarly, since the sustainability area "Economic Performance" is generally the highest ranked area, we included an additional G4-EC3 indicator in the 2016 report.

Materiality matrix



Economic Performanc

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

Society

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

Product Responsibility

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

Environmental Protection

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

Employment and the Work Environment

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

1.10 Operating Segments

G4-13 Latvenergo Group's activity is organised along three operating segments: generation and trade, distribution, and lease of transmission system assets.

EU1 The generation and trade segment comprises generation of electricity and thermal energy, ensured by Latvenergo AS and Liepājas enerģija SIA, as well as electricity trade (retail and wholesale) operations in the Baltic States carried out by Latvenergo AS, and subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB. The functions of public trader are performed by the subsidiary Enerģijas publiskais tirgotājs AS.

EU2 The distribution segment provides electricity distribution services in Latvia through Sadales tīkls AS – the largest distribution system operator in Latvia.

EU3 The segment handling lease of transmission system assets is ensured by Latvijas elektriskie tīkli AS, the owner of the transmission system assets, which leases them to the transmission system operator Augstsprieguma tīkls AS.

1.10.1 Generation and Trade

Skilful operations in new market conditions

Generation and trade is the Group's largest operating segment in terms of both revenue and EBITDA value. Activities within this segment include trade of generated and procured electricity both to retail customers in the Baltics and wholesale (mostly on the Nord Pool power market). The Group also generates and trades thermal energy in Riga and Liepaja. The majority of generation and trade segment revenue is unregulated, while tariff-regulated operational revenue comprises revenue from:

- capacity payment for the installed electrical capacity and generation of thermal energy at Riga combined heat and power plants (CHPPs);
- generation of electricity and thermal energy at Liepaja generation facilities and small plants (Aiviekste hydropower plant (HPP) and Kegums boiler house).

Latvenergo Group is the largest electricity supplier in the Baltics with approximately 30% of the Baltic market in 2016. In 2016, the total amount of electricity supplied in retail and wholesale (including auxiliary consumption) constituted 10,245 GWh, of which 74% was supplied to retail customers.

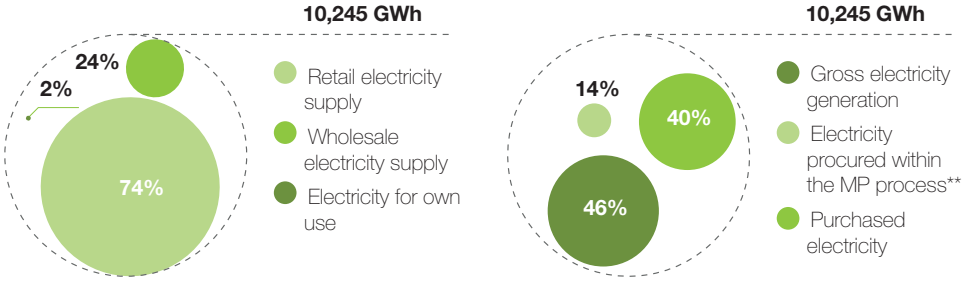
In 2016, 59% or 4,461 GWh of the energy supplied by Latvenergo Group in retail was *green* energy[1] – electricity generated from renewable resources. This included both energy generated at Latvenergo Group power plants and energy procured on the Nord Pool electricity power market or from other generators through bilateral transactions.

In 2016, Latvenergo Group power plants generated 4,707 GWh or 46% of the total electricity trade. Compared to 2015, the electricity generated increased by 21%. More than half of it was generated from renewable energy sources.

The generation capacities of Latvenergo Group also ensure electricity trade support services, such as provision of emergency back-up capacity and supply of regulating electricity to TSOs.

[1] Electricity generated from non-fossil renewable resources, such as hydropower, wind power, biomass, biogas, etc.

Latvenergo Group electricity balance sheet 2016*



Latvenergo Group electricity balance sheet (2012–2016)*

	Unit	2012	2013	2014	2015	2016
Retail electricity supply	GWh	8,287	7,954	8,688	7,869	7,580
Wholesale electricity supply	GWh	1,886	1,588	1,561	1,907	2,474
Electricity for own use	GWh	177	215	201	188	191
TOTAL	**GWh**	**10,350**	**9,757**	**10,450**	**9,963**	**10,245**
Gross electricity generation	GWh	5,077	4,854	3,625	3,882	4,707
Electricity procured within the MP process**	GWh	1,019	1,247	1,235	1,380	1,457
Purchased electricity	GWh	4,254	3,656	5,590	4,701	4,081
TOTAL	**GWh**	**10 350**	**9,757**	**10,450**	**9,963**	**10,245**

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

Generation

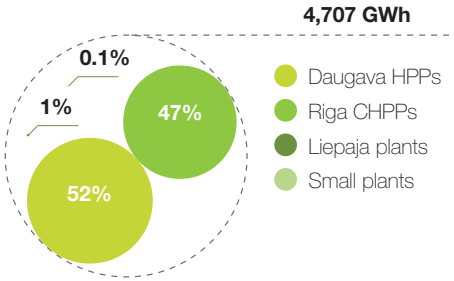
Flexible operation in the market

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

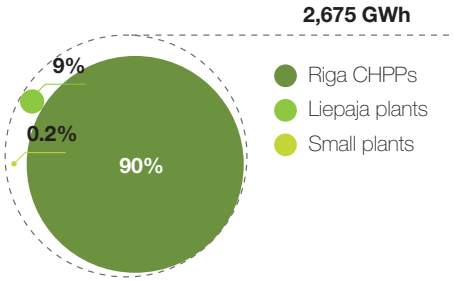
The total installed electrical capacity at Latvenergo Group generation facilities is 2,569 MW_{el}, exceeding 85% of the total installed capacity at power plants in Latvia. The installed thermal capacity of Latvenergo Group thermal energy generation facilities is 1,842 MW_{th}.

In 2016, the facilities of Latvenergo Group generated 4,707 GWh of electricity and 2,675 GWh of thermal energy.

Electricity generation in 2016



Thermal energy generation in 2016



Installed electrical capacity of generation facilities (2012–2016)

	Unit	2012	2013	2014	2015	2016
Daugava HPPs	MW_{el}	1,536	1,536	1,536	1,536	1,536
Riga CHPPs*	MW_{el}	806	1,025	1,025	1,025	1,025
Liepaja plants	MW_{el}	6	6	6	6	6
Small plants	MW_{el}	1	2	2	2	2
TOTAL	**MW_{el}**	**2,349**	**2,569**	**2,569**	**2,569**	**2,569**

* installed capacity, when Riga CHPPs is in condensation mode.

Installed thermal energy capacity of generation facilities (2012–2016)

	Unit	2012	2013	2014	2015	2016
Riga CHPPs	MW_{th}	1,840	1,617	1,617	1,617	1,617
Liepaja plants	MW_{th}	208	236	223	223	221
Small plants	MW_{th}	4	4	4	4	4
TOTAL	**MW_{th}**	**2,052**	**1,857**	**1,844**	**1,844**	**1,842**

Electricity generation (2012–2016)

	Unit	2012	2013	2014	2015	2016
Daugava HPPs	GWh	3,627	2,852	1,925	1,805	2,449
Riga CHPPs	GWh	1,409	1,957	1,648	2,025	2,206
Liepaja plants	GWh	37	43	48	48	47
Small plants	GWh	4	3	4	3	5
TOTAL	**GWh**	**5,077**	**4,854**	**3,625**	**3,882**	**4,707**

Thermal energy generation (2012–2016)

	Unit	2012	2013	2014	2015	2016
Riga CHPPs	GWh	2,446	2,305	2,308	2,175	2,417
Liepaja plants	GWh	261	257	248	229	253
Small plants	GWh	5	5	5	4	5
TOTAL	**GWh**	**2,712**	**2,566**	**2,560**	**2,408**	**2,675**

Daugava HPPs

The Group generates most of its electricity at the three largest HPPs in the country, ensuring an environmentally friendly means of electricity generation. They operate on water – a renewable energy source.

Although the installed capacity of generation facilities at the hydropower plants is high, their ability to generate electricity depends on the water inflow in the Daugava River. The Daugava HPPs operate at full capacity during the spring flooding season, which lasts for about one to two months annually. Water inflow in the Daugava River during this time may exceed water inflow during low water periods (mainly in summer) more than 10 times. During the spring flooding, Latvenergo Group is able to cover the entire customer demand for electricity and trade the excess on the electricity exchange.

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

In 2016, the Daugava HPPs generated 2,449 GWh of electricity, which constituted 52% of the Group's total electricity output. Due to higher water inflow in the Daugava River, the amount of electricity generated was 36% higher compared to the previous year.

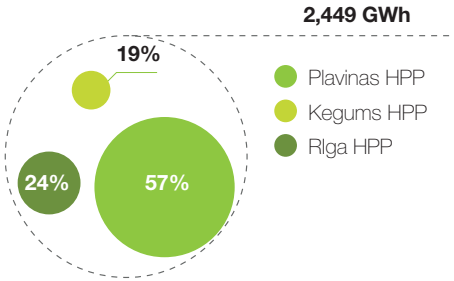
Installed electrical capacity of generation facilities at Daugava HPPs (2012–2016)

	Unit	2012	2013	2014	2015	2016
Kegums HPP	MW_{el}	240	240	240	240	240
Plavinas HPP	MW_{el}	894	894	894	894	894
Riga HPP	MW_{el}	402	402	402	402	402
TOTAL	**MW_{el}**	**1,536**	**1,536**	**1,536**	**1,536**	**1,536**

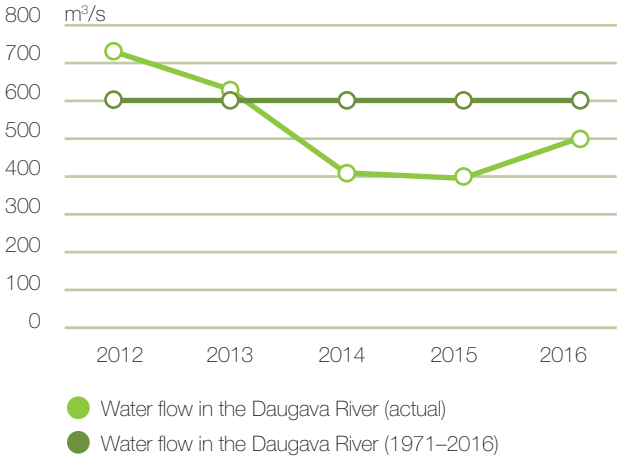
Electricity generation at Daugava HPPs (2012–2016)

	Unit	2012	2013	2014	2015	2016
Kegums HPP	GWh	702	532	376	350	475
Plavinas HPP	GWh	2,067	1,640	1,089	1,022	1,386
Riga HPP	GWh	858	679	460	433	588
TOTAL	**GWh**	**3,627**	**2,852**	**1,925**	**1,805**	**2,449**

Electricity generation at Daugava HPPs in 2016



Water flow in the Daugava River (2012–2016)



Daugava HPPs: construction chronology

Kegums HPP, built in 1936–1939 and reconstructed in 1945–1947, is the oldest of the Daugava HPPs with an initial installed capacity of 72 MW. Three additional hydropower units with a total capacity of 168 MW were built by 1979. From 1998 to 2001 reconstruction of the plant took place; four hydropower units were replaced, and as a result, the plant's total capacity reached 240 MW. At the end of 2016, due to the hydropower unit reconstruction programme, the total capacity of Kegums HPP was 184 MW (one hydropower unit has been removed for reconstruction).

Plavinas HPP is the largest hydropower plant in the Baltics and one of the largest in the EU in terms of installed capacity. The power plant started operating in 1968 with ten hydropower units; capacity amounted to 825 MW at the time. From 1991 to 2001 five hydropower units were reconstructed, and as a result, the installed capacity reached 869 MW. Reconstruction of the hydropower units continued from 2007 to 2010, and three hydropower units were upgraded, increasing the installed capacity of the plant to 894 MW. With the reconstruction of the hydropower units, the efficiency of Plavinas HPP has also improved. As a result of the hydropower unit reconstruction programme, the installed capacity at the end of 2016 was 811 MW (one hydropower unit has been removed for reconstruction).

Riga HPP, with 6 hydropower units and a total capacity of 402 MW, was commissioned in 1974. As a result of the hydropower unit reconstruction programme, the installed capacity at the end of 2016 was 335 MW (one hydropower unit has been removed for reconstruction).

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

Investments

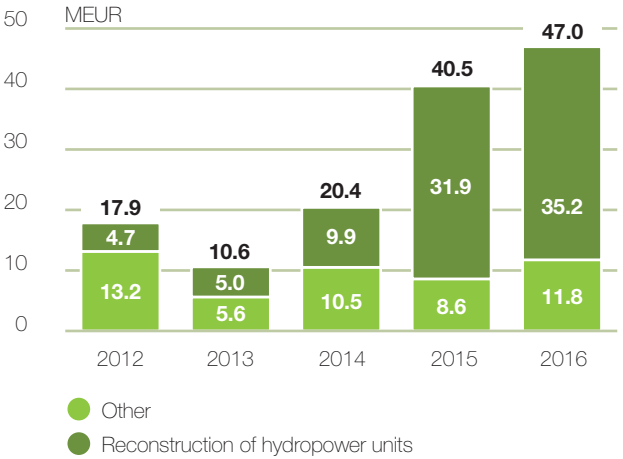
In 2016, total investments in Daugava HPP assets amounted to EUR 47.0 million, including EUR 35.2 million for the Daugava HPP hydropower unit reconstruction programme.

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

Twelve of the 23 Daugava HPPs hydropower units have already been modernised. The hydropower unit reconstruction process is scheduled for completion in 2022, and the total cost for reconstructing the 11 other hydropower units is expected to exceed EUR 200 million. The Group plans to complete the reconstruction of one Plavinas HPP and one Kegums HPP hydropower unit in summer 2017 and one Plavinas HPP, one Kegums HPP and two Riga HPP hydropower units in spring 2018.

Increasing the installed capacity and efficiency ratios of the hydropower units ensures more efficient use of water – a renewable energy source. Each additional megawatt hour (MWh) of electricity generated by the Daugava HPPs reduces CO_2 emissions by 0.39 t/MWh, assuming that this energy would otherwise be generated in condensation mode at combined heat and power plants. In this way, the Group mitigates the negative impact on climate change.

Investments in Daugava HPPs (2012–2016)



Riga CHPPs

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

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

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

The amount of electricity generated by the Riga CHPPs in 2016 was 2,206 GWh, a 9% increase compared to the previous year. The Riga CHPPs operate efficiently and flexibly, adapting their operational modes to market conditions. The amount of electricity generated by the Riga CHPPs in 2016 was 47% of Latvenergo Group's total electricity output.

In 2016, the amount of thermal energy generated by the Riga CHPPs was 2,417 GWh or 11% more compared to the previous year. Generation of thermal energy at the Riga CHPPs depends on thermal energy demand, determined by the ambient air temperature and duration of the heating season. Thermal energy generated by the Riga CHPPs is supplied to a Riga heating company at regulated tariffs.

Riga CHPPs: construction chronology

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

The second combined heat and power plant in Riga (Riga CHPP-2) is the largest in Latvia. It was launched in 1973. Reconstruction of Riga CHPP-2 was started in 2006, with construction of the first power unit completed in late 2008 and a second power unit commissioned in late 2013, thus finalising the reconstruction of the Group's combined heat and power plants. With the commissioning of Riga CHPP-2's second power unit, exploitation of inefficient and environmentally unfriendly power units was suspended.

Currently Riga CHPP-2 is the most efficient and up-to-date combined cycle power plant in the Baltics. Two combined-cycle gas turbine (CCGT) units and five water boilers are currently operated at Riga CHPP-2. With the commissioning of the second power unit, the electrical capacity of Riga CHPP-2 in cogeneration mode reaches 832 MW_{el}, while the thermal energy capacity of the two power units is 544 MW_{th} in cogeneration mode. The total thermal energy capacity of Riga CHPP-2, including water boilers, is 1,124 MW_{th}.

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

In 2016, total investment in Riga CHPP assets was EUR 11.3 million.

Electricity generation at Riga CHPPs (2012–2016)

	Unit	2012	2013	2014	2015	2016
Riga CHPP-1	GWh	328	406	487	464	613
Riga CHPP-2	GWh	1,081	1,550	1,161	1,561	1,593
TOTAL	**GWh**	**1,409**	**1,957**	**1,648**	**2,025**	**2,206**

Thermal energy generation at Riga CHPPs (2012–2016)

	Unit	2012	2013	2014	2015	2016
Riga CHPP-1	GWh	976	772	966	978	1,110
Riga CHPP-2	GWh	1,470	1,533	1,342	1,197	1,307
TOTAL	**GWh**	**2,446**	**2,305**	**2,308**	**2,175**	**2,417**

Investments in Riga CHPPs (2012–2016)

	Unit	2012	2013	2014	2015	2016
Investments	MEUR	106.1	34.0	11.0	15.0	11.3

Liepaja plants

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

The total installed thermal energy capacity of the Liepaja plants is 221 MW_{th}, including 40 MW_{th} from a renewable source: woodchips. Installed electrical capacity totals 6 MW_{el}. In 2016, the Liepaja plants generated 253 GWh of thermal energy and 47 GWh of electricity.

Over the past few years, new generation capacities have been built with co-financing from the EU Cohesion Fund, increasing the share of biomass consumption in the fuel balance at the Liepaja plants from 0% before 2010 to 62% in 2016.

Due to the reconstruction of thermal energy transmission and distribution networks in Liepaja, thermal energy losses have also been reduced considerably over the past few years. The loss ratio decreased from 15.5% in 2012 to 13.0% in 2016.

Similarly, encouraging responsible use of thermal energy and urging users to take care of environmental sustainability, Liepājas enerģija SIA now provides a possibility for customers to obtain and analyse thermal energy consumption data for their homes online.

Small plants

The generation facilities within Latvenergo Group's energy system also include two small power plants: Ainazi WPP, with a capacity of 1.0 MW_{el}, and Aiviekste HPP, with a capacity of 0.8 MW_{el}.

Kegums boiler house, with an installed thermal capacity of 4 MW_{th}, generates only thermal energy. It is fuelled by woodchips.

In 2016, total electricity output at the small plants was 5 GWh, which is approximately 0.1% of Latvenergo Group's total electricity output. Total thermal energy output at Kegums boiler house in 2016 was 5 GWh.

Liepaja plants (2012–2016)

	Unit	2012	2013	2014	2015	2016
Installed electrical capacity of generation facilities	MW_{el}	6	6	6	6	6
Installed thermal energy capacity of generation facilities	MW_{th}	208	236	223	223	221
Electricity generation	GWh	37	43	48	48	47
Thermal energy generation	GWh	261	257	248	229	253
Thermal energy losses	GWh	40	38	36	32	32
Proportion of losses	%	15.5	15.4	15.2	14.3	13.0

Trade

Leadership in the Baltic electricity market

Latvenergo Group supplies electricity in the Baltic States under the *Elektrum* brand. Its product range includes various electricity market products designed for different consumption and usage patterns so that each customer can choose the one that is most suitable (more on recognition of *Elektrum* and client satisfaction in Section 2.3: Product Responsibility).

In 2016, Latvenergo Group successfully retained its leadership in the Baltic electricity market. Latvenergo Group has approximately a 30% share in the Baltic electricity market, which consumes a total of nearly 26 TWh.

The amount of electricity supplied outside Latvia constitutes almost one third of the total amount of retail electricity supply or 2,376 GWh, which is about 20% more than the amount of electricity supplied in Latvia by competitors.

Latvenergo Group's retail electricity supply in the Baltics in 2016 was 7,580 GWh, or 4% less compared to the previous year. The decrease is related primarily to increasing price competition in the large business customer segment.

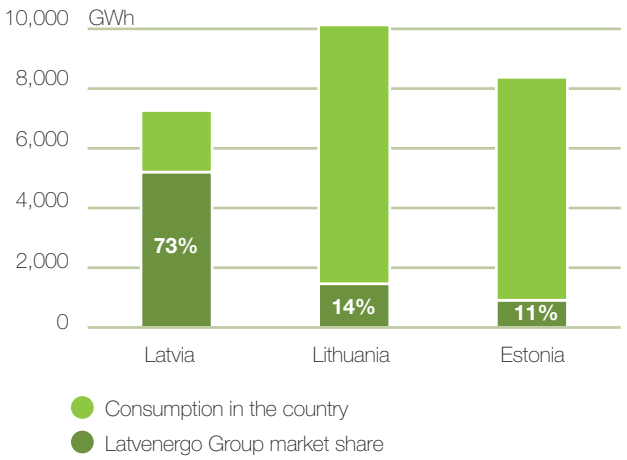
Latvenergo Group's customer portfolio in the Baltics remained stable. The main focus outside Latvia was on the micro and small and medium-sized business segments, where the total number of customers increased by 3%.

Overall, at the end of 2016 Latvenergo Group supplied electricity to approximately 821.2 thousand households and 33.7 thousand corporate customers. The breakdown according to country was as follows:

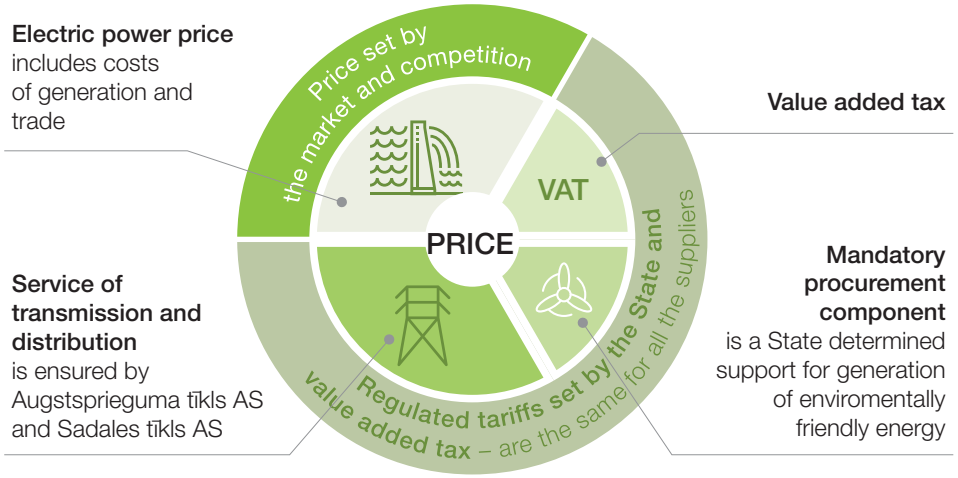
- 795.5 thousand households and 24.9 thousand corporate customers in Latvia;
- 7.1 thousand corporate customers in Lithuania;
- 25.7 thousand households and 1.9 thousand corporate customers in Estonia.

In the customer breakdown according to segments, households constituted 96% of the total number of customers and corporate customers constituted 4%.

Market share in the Baltics in 2016



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



Mandatory Procurement

The total mandatory procurement component remains unchanged

Mandatory procurement (MP) is a state-regulated support mechanism for electricity generators in Latvia in the form of electricity procurement or guaranteed payments for the installed capacity. Mandatory procurement costs are financed through payments by electricity end-users and a state budget grant.

In accordance with the Electricity Market Law, the right to sell electricity generated within MP or receive guaranteed payment for the installed capacity at power plants is granted to generators who generate electricity in efficient cogeneration or from renewable energy sources. The institution granting these rights to generators is the Ministry of Economics of the Republic of Latvia. The provisions for electricity generation, electricity MP pricing and the amount of guaranteed capacity payments are governed by regulations of the Cabinet of Ministers of the Republic of Latvia. The amount of MP support depends on the type of energy resource used (wind, water, biomass, biogas, natural gas), the installed capacity, and, for some plants, the cost of natural gas. In 2016, small hydropower plants and biogas plants received the most support within MP (after the subsidized energy tax (SET)) for one kilowatt-hour – 12.8 cents/kWh and 11.4 cents/kWh respectively – while the Riga CHPPs received the least support: 3.9 cents/kWh.

As of 1 April 2014, the functions of public trader have been transferred to the Latvenergo AS subsidiary Enerģijas publiskais tirgotājs AS. Expenditures associated with MP and guaranteed capacity payments are compensated to the public trader by the end-users in Latvia through the MP PSO fee in proportion to their electricity consumption. The amount of the MP PSO fee is based on the actual expenditures in the preceding year and provision of expected administrative costs as approved by the PUC, and the changes take effect on 1 April of the following year.

Enerģijas publiskais tirgotājs AS receives a state grant to keep the total MP PSO fee static; it has been 2.679 cents/kWh since 1 April 2014. The grant is funded through SET revenues and dividends paid by Latvenergo AS. The SET was introduced on 1 January 2014 and applies to state aid for generators within MP, i.e., to income from electricity supplied within MP, as well as to guaranteed capacity payments for cogeneration power plants. The tax differs depending on the type of energy source used.

Mandatory procurement: key indicators

In 2016, 1,503 GWh of electricity were procured within the MP process, including 630 GWh or 42% generated in cogeneration and 873 GWh or 58% generated from renewable energy sources. Compared to 2015, the amount of electricity procured from renewable sources increased by 5%. The increase in the amount of electricity procured under MP was mainly due to the commissioning of new power plants and the increasing capacity of existing ones.

In 2016, the total MP PSO fee remained static, and since 1 April 2017 the PUC has set it at 2.679 cents/kWh. To maintain this fee level in 2016, a state budget grant of EUR 78.9 million was allocated[2]. To maintain it in 2017, a state budget grant of EUR 62.9 million is expected.

According to changes in the MP PSO fee calculation methodology approved by the PUC, at the beginning of 2017 the state grant is fully applied to the MP PSO fee from generators that generate electricity in cogeneration. Consequently, from 1 April 2017 the share of renewable energy and cogeneration components will change substantially.

[2] EUR 59.2 million in 2016 and EUR 17.9 million in February 2017.

Mandatory procurement key indicators (2012–2016)

	Unit	2012	2013	2014	2015	2016
Power plants	number	335	368	386	400	402
MP paid-up capacity	MW	1,033	1,310	1,354	1,364	1,379
Electricity purchased within the MP	GWh	2,263	2,610	1,284	1,427	1,503
MP costs above the market price (after SET)	MEUR	189.0	209.9	215.4	224.3	207.9

Mandatory procurement PSO fee (2013–2017)

	Unit	04/01/13	04/01/14	04/01/15	04/01/16	04/01/17
Mandatory procurement PSO fee	cents/kWh	2.689	2.679	2.679	2.679	2.679
Cogeneration	cents/kWh	1.892	1.737	1.671	1.625	1.185
Renewable energy sources	cents/kWh	0.797	0.942	1.008	1.054	1.494

1.10.2 Distribution

Economically justified electricity network development for customers' needs

Latvenergo Group's distribution segment is its second largest in terms of turnover. Its operations involve the provision of distribution system services to approximately 828 thousand customers in Latvia at regulated tariffs. The distribution system service is provided by Sadales tīkls AS, the largest distribution system operator in Latvia. The distribution system operator ensures equal access to electricity distribution networks, which is one of the prerequisites for ensuring competition in the Latvian electricity market.

The electricity distribution network ensures the flow of electricity from the transmission network and electricity generators connected to the distribution networks to electricity consumers. At the end of 2016, the total length of electricity lines was 93,813 km. The number of distribution network transformers was 29,899, while the number of transformer substations was 26,916, with a total installed capacity of 5,892 MVA.

Due to significant investment in distribution networks, the length of low-voltage lines to distribution system users has been decreasing every year. This has improved service quality, since the long low-voltage lines built historically do not ensure an electricity distribution quality that corresponds to required standards. Similarly, along with investment in the implementation of the Cable Programme, the share of cable lines in the total length of electricity lines has been increasing steadily. At the end of 2016, cable lines constituted one third of total line length.

In 2016, the amount of electricity distributed increased by 3% to 6,465 GWh. Electricity distribution losses constitute a significant performance indicator of the distribution segment (see also the EU12 indicator). Compared to 2015, electricity losses did not change significantly and constituted 4.6% of the total electricity received by the network. Total losses during the 2012–2016 period decreased by 23% or 98 GWh.

In 2016, the amount of electricity received by distribution networks from small electricity generators continued to increase, reaching 1,495 GWh, which is 1.6 times more compared to 2012. The increased electricity input from small plants is mainly due to the commissioning of new electricity generation capacities.

On 1 August 2016, the new balanced electricity distribution system service tariff came into force. The price of electricity distribution consists of two components: a fixed fee for the provision of the connection and a variable component according to the consumed amount. The new balanced tariffs contribute to effective use of power grid connection capacity. Distribution service tariffs that were effective from April 2011 until 1 August 2016 did not cover all the distribution service costs.

Investment and maintenance

Each year, maintenance and development of distribution networks include large-scale repairs and investment. This is aimed at promoting quality and reliable energy supply, reducing the frequency and duration of scheduled and unscheduled power supply outages due to damage and ensuring adequate voltage quality. Increased cleaning of electricity transmission lines as well as the implementation of the investment programme in 2016 reduced the amount of damage in power networks by 19% and decreased unscheduled power outage duration per user by 17% compared to 2015 (for additional information, see indicators EU28 and EU29).

Over the last three years, the amount invested in distribution assets has stabilised at the level strategically required for distribution assets. In 2016, the amount of investment was more than EUR 100 million.

Investment in reconstruction and modernisation of distribution networks is made in line with the

Distributed electricity and losses (2012–2016)

	Unit	2012	2013	2014	2015	2016
Distributed electricity	GWh	6,468	6,447	6,421	6,263*	6,465
Electricity distribution losses, technological and internal consumption	GWh	432	361	346	328**	334
TOTAL	**GWh**	**6,900**	**6,808**	**6,767**	**6,591**	**6,799**
Electricity losses	%	5.9	5.0	4.8	4.6	4.6

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

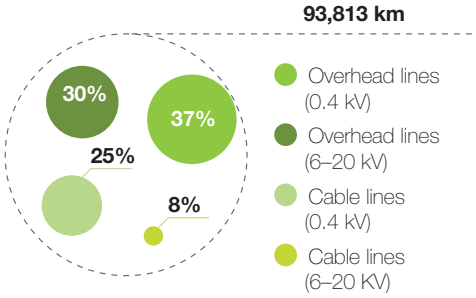
Electricity received in distribution network (2012–2016)

	Unit	2012	2013	2014	2015	2016
From transmission network	GWh	5,993	5,670	5,470	5,236	5,304
From small generators	GWh	907	1,139	1,297	1,448	1,495
TOTAL	**GWh**	**6,900**	**6,808**	**6,767**	**6,684**	**6,799**

Reconstruction and construction (2012–2016)

	Unit	2012	2013	2014	2015	2016
Overhead lines constructed (0.4 kV)	km	64	17	19	37	22
Cable lines constructed (0.4 kV)	km	852	995	1 089	934	651
TOTAL LOW-VOLTAGE POWER LINES	**km**	**916**	**1,012**	**1,107**	**972**	**673**
Overhead lines constructed (6–20 kV)	km	149	305	300	556	628
Cable lines constructed (6–20 KV)	km	212	126	104	189	140
Cable lines constructed (6–20 KV) – Cable programme	km	144	162	207	210	208
TOTAL MEDIUM-VOLTAGE POWER LINES	**km**	**505**	**593**	**611**	**955**	**976**
Transformer substations reconstructed	number	388	577	649	877	773
Connections constructed	number	6,944	7,335	8,510	7,588	9,353

Length of electricity distribution lines in 2016



Sadales tīkls AS Development Plan 2014–2023. The Development Plan was updated in 2016. The objective of the plan is to ensure a sustainable and economically sound electricity distribution service through effective management of the electricity network and improvement of the reliability and quality of electricity supply. This is important for the competitiveness and growth of the national economy. The plan details the actions to be taken for the achievement of goals set by the Medium-Term Operational Strategy of Sadales tīkls AS.

In 2016, Sadales tīkls AS completed an analysis of electricity network development and usage perspectives and set criteria to be considered when planning reconstruction and renovation work.

In 2016, the distribution segment continued the following investment projects and programmes:

- *Automation Programme.* Connecting remote-controlled circuit breakers and installing fault location detectors to ensure more efficient recovery from electricity supply disruptions. This enables fast receipt of information on electricity supply failures in the electricity networks.
- *Cable Programme.* Replacing medium-voltage non-isolated overhead lines with cable lines (mostly in forested areas). This helps to reduce the number of electricity supply disruptions due to unfavourable weather conditions. A total of 208 km of medium-voltage cable lines were built in 2016.
- *Restoration of lines and reconstruction of transformer substations.* 9,353 new connections were built and voltage quality was improved for 1,992 customer sites.
- *Introduction of smart electricity meters.* The purpose of the project is to improve customer awareness of electricity consumption, promoting the efficiency of electricity consumption and cost reduction for the distribution system operator, customers and electricity traders. The project was launched in 2014 in compliance with Directive 2009/72/EC of the European Parliament and the Council. A total of 270 thousand smart meters have been installed over three years, which corresponds to 25% of all meters and accounts for 75% of customers' overall electricity consumption.

Investments in distribution networks (2012–2016)

	Unit	2012	2013	2014	2015	2016
Investments	MEUR	87.2	92.0	103.2	102.0	106.4

1.10.3 Lease of Transmission System Assets

Projects to strengthen and integrate the power system

The operations of this segment include leasing transmission system assets in Latvia owned by Latvijas elektriskie tīkli AS (330 kV and 110 kV electricity transmission lines, substations and distribution points) to the transmission system operator Augstsprieguma tīkls AS.

At the end of 2016, the total length of electricity transmission lines was 5,237 km, 74% of which comprised 110 kV lines and 26% of which comprised 330 kV lines. Sixteen 330 kV substations with a total autotransformer capacity of 3,825 MVA and one hundred twenty-one 110 kV substations with a total installed transformer capacity of 5,125 MVA are used for ensuring the operation of the transmission network.

Investment

Total investment in transmission system assets in 2016 amounted to EUR 25.5 million. The most important transmission network investment projects include the *Kurzeme Ring* project and the third Latvia–Estonia transmission network interconnection.

The *Kurzeme Ring* project

The *Kurzeme Ring* project, the most ambitious transmission system investment project in recent years, was launched in 2009. It is being implemented in three stages. The first stage was completed in 2012 through construction of the *Riga Ring*. The commissioning of the new *Grobiņa–Ventspils* 330 kV electricity transmission line in August 2014 completed the second stage.

The environmental impact assessment for the final stage of the project – *Ventspils–Tume–Riga* – has been completed, and the design and construction of a 330 kV line was begun in 2016. Total investment in transmission system assets in 2016 amounted to EUR 4.5 million. An agreement on 45% co-financing for the third stage has been concluded with the EC Innovation and Networks Executive Agency.

The *Kurzeme Ring* project is scheduled for completion in 2019. Total construction costs are estimated to be EUR 220 million, including EUR 95 million for implementation of the first and second stages. The total projected length of the 330 kV transmission ring is 330 km.

The third Estonia–Latvia power transmission network interconnection

An important future electricity transmission infrastructure project for the entire Baltic region is a new, third electricity transmission network interconnection between Estonia and Latvia. Implementation of this project is part of the 10-year electricity transmission network development plan of Augstsprieguma tīkls AS. The new 330 kV interconnection will increase the available throughput between the Latvian and Estonian energy systems, reducing the price differences in the Latvian and Estonian bidding areas.

The planned length of the new 330 kV interconnection line is about 190 km in Latvia; it is scheduled for completion by the end of 2020. The overall construction costs of the project in Latvia are estimated to be EUR 100 million. In 2015, an agreement with the EC Innovation and Networks Executive Agency was concluded that provides 65% co-financing for the total eligible project costs. In 2016, an environmental impact assessment was completed for the project and the Cabinet of Ministers of the Republic of Latvia approved the activities and location for reconstruction and new construction of the interconnection, granting the project the status of object of national interest.

To increase the stability of electricity supply and meet capacity demand at transmission network points, other transmission network investment projects were carried out in 2016. The most important of these included reconstruction of 110 kV switchgear at the 330/110 kV *Imanta* substation, the start of 110 kV switchgear reconstruction at the *Aloja, Ventspils* and *Viskaļi* substations, and replacement of 110 kV transformers at the *Iecava, Valka, Priekule, Jēkabpils, Lauma, Sigulda, Ezerkrasts* and *Inčukalns* substations. Reconstruction of 330 kV and 110 kV electricity lines continues through the overhaul of line elements, and reconstruction of the *Andrejsala–Hanza* 110 kV cable line was completed.

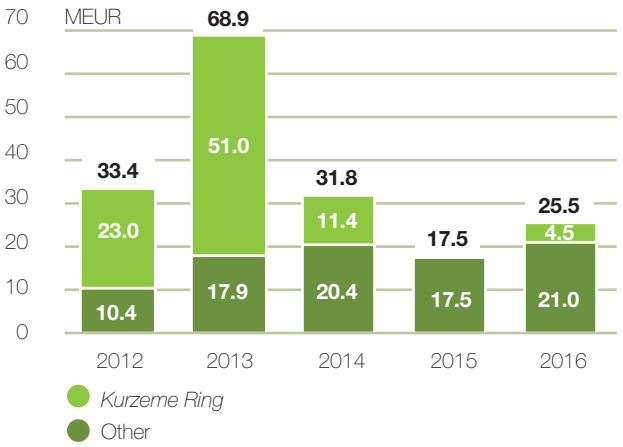
Length of power transmission lines (2012–2016)

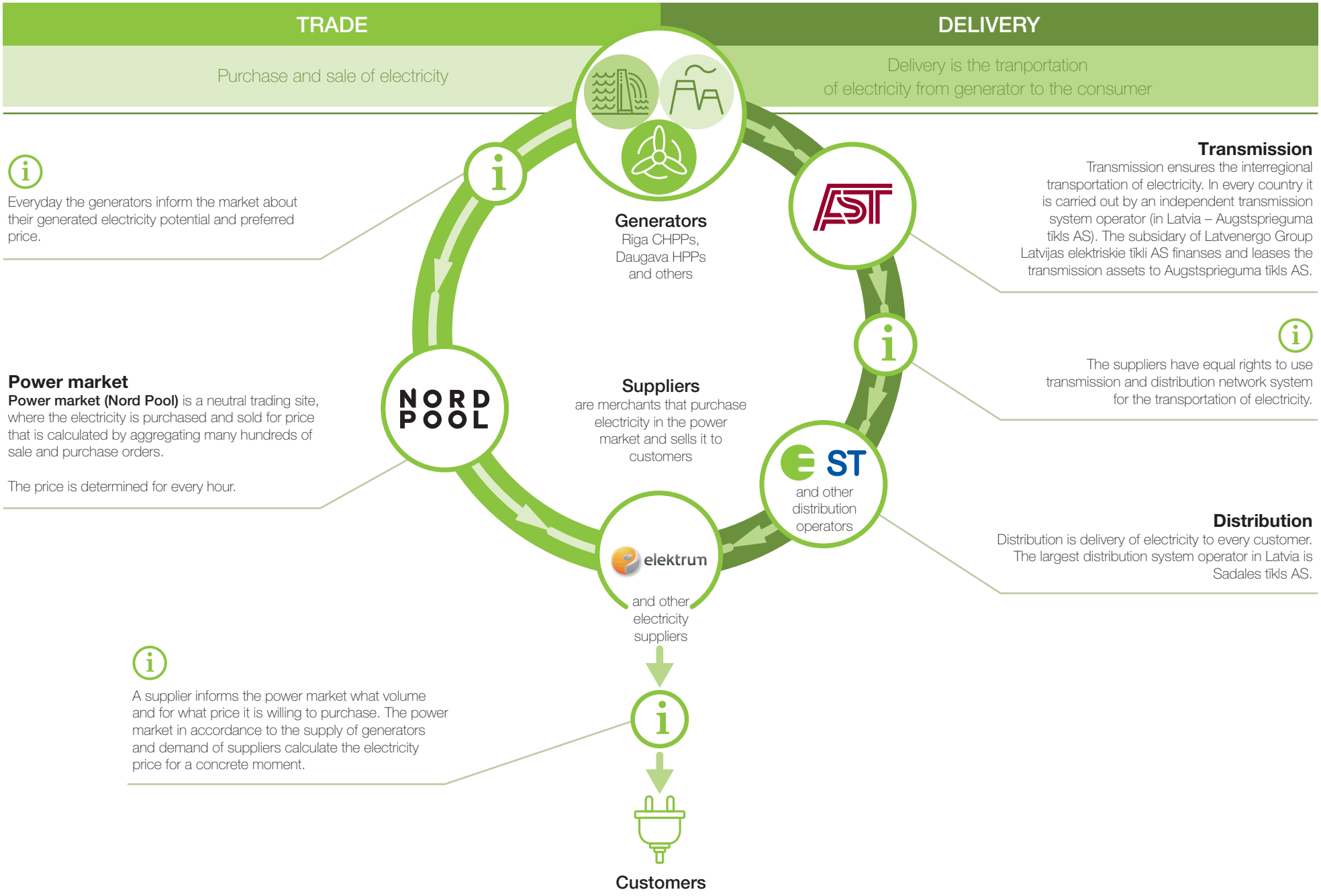
	Unit	2012	2013	2014	2015	2016
330 kV	km	1,250	1,265	1,381	1,360	1,346
110 kV	km	4,010	4,010	3,891	3,891	3,891
TOTAL	**km**	**5,260**	**5,275**	**5,273**	**5,251**	**5,237**

Number of transformer substations, transformers and installed capacities (2012–2016)

	Unit	2012	2013	2014	2015	2016
Substations (330 kV)	number	15	15	16	16	16
Autotransformers (330 kV)	number	22	23	25	25	25
Installed capacity of autotransformers (330 kV)	MVA	3,325	3,575	3,825	3,825	3,825
Transformer substations (110 kV)	number	121	122	121	121	121
Transformers (110 kV)	number	244	246	246	246	245
Installed capacity of transformers (110 kV and 10 kV booster transformers)	MVA	4,902	4,968	5,075	5,102	5,125

Investments in transmission system assets (2012–2016)




TRADE
Purchase and sale of electricity
DELIVERY
Delivery is the tranportation of electricity from generator to the consumer
Generators
Riga CHPPs, Daugava HPPs and others
Everyday the generators inform the market about their generated electricity potential and preferred price.
Power market
Power market (Nord Pool) is a neutral trading site, where the electricity is purchased and sold for price that is calculated by aggregating many hundreds of sale and purchase orders.
The price is determined for every hour.
Suppliers
are merchants that purchase electricity in the power market and sells it to customers
and other electricity suppliers
A supplier informs the power market what volume and for what price it is willing to purchase. The power market in accordance to the supply of generators and demand of suppliers calculate the electricity price for a concrete moment.
Customers
Transmission
Transmission ensures the interregional transportation of electricity. In every country it is carried out by an independent transmission system operator (in Latvia – Augstsprieguma tīkls AS). The subsidary of Latvenergo Group Latvijas elektriskie tīkli AS finanses and leases the transmission assets to Augstsprieguma tīkls AS.
The suppliers have equal rights to use transmission and distribution network system for the transportation of electricity.
and other distribution operators
Distribution
Distribution is delivery of electricity to every customer. The largest distribution system operator in Latvia is Sadales tīkls AS.

1.11 Group Procurement

Transparency in the procurement process

To ensure its operations, Latvenergo Group procures electricity and fuel as well as various types of construction work, goods and services. In 2016, the total cost of Latvenergo Group's procurement was around EUR 640 million, a large part of which or approximately 45% constituted construction work, goods and services, while electricity and electricity services constituted approximately 34% and fuel constituted approximately 21%.

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

The Group's procurement complies with EU legislation and the legal acts of the Republic of Latvia and those countries in whose territory the Group carries out its commercial activity. The key principles of the Group's procurement are based on the requirements of Directives 2014/24/EU and 2014/25/EU of the European Parliament and the Council and those of the Law on Procurement of Public Service Providers of the Republic of Latvia. When procuring a product or service, Latvenergo Group is committed to ensuring the most efficient use of funds and follows the principles of transparency, equality and non-discrimination. Supplier selection is based on competition, equal and fair treatment and respect for the principle of procurement transparency.

Latvenergo Group requests that its contractors comply with the Group's ethical principles and the principles of fair business cooperation. Upon signing cooperation agreements, Latvenergo Group asks partners to provide declarations of adherence to high ethical standards in cooperation. Latvenergo Group's ethical principles for cooperation with contractual partners are published on the Latvenergo website (www.latvenergo.lv/eng) under the section *Tenders and offers/Procurement procedures*.

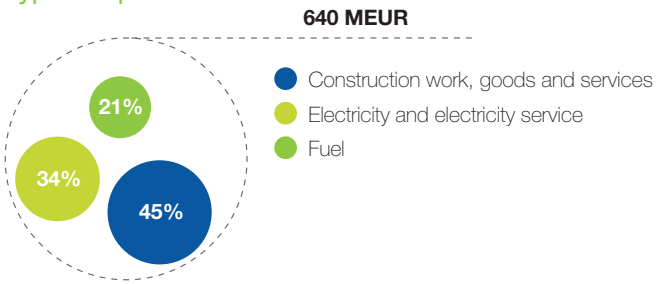
To ensure efficient procurement, Latvenergo Group has established a qualification system for suppliers of construction work and services, aimed at selecting and maintaining a list of qualified suppliers. The qualification system contains 24 types of construction work and services (engineering) with 103 qualified contractors and service providers (planning engineers).

Electricity Procurement

In 2016, Latvenergo Group's procurement of electricity and electricity service amounted to approximately EUR 215 million, constituting about 34% of its overall procurement expense. Electricity and electricity service procurement includes ancillary electricity services and electricity wholesale operations to reduce price risks. The total amount of electricity purchased wholesale was 4,081 GWh. The Group sells electricity it generates and at the same time procures electricity for its customers on the Nord Pool, the leading international power exchange in Europe, thus ensuring full transparency of procurement.

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

Types of procurement



Purchased electricity (2012–2016)

	Unit	2012	2013	2014	2015	2016
Purchased electricity	GWh	4,254	3,656	5,590	4,701	4,081

Fuel Procurement

Latvenergo Group fuel procurement comprises natural gas, diesel fuel and woodchips. In 2016, Latvenergo Group's fuel procurement amounted to approximately EUR 140 million, constituting approximately 21% of its overall procurement expense. The Riga CHPPs accounted for more than 90% of Latvenergo Group's fuel expense, the rest coming from the Liepaja plants and Kegums boiler house.

Natural gas accounts for approximately 98% of Latvenergo Group's overall fuel expense. As their primary fuel, the Riga CHPPs use natural gas, which is the environmentally friendliest type of fossil fuel available for power generation. Natural gas is also used in part at the Liepaja plants. Annual natural gas consumption ranges from 500 to 650 million nm^3.

Natural gas procurement differs from other procurement, since unlike other energy market segments, natural gas supply is a fully regulated service. In compliance with the legal framework, Latvijas Gāze AS is the only merchant of natural gas supply services in the territory of Latvia until 3 April 2017. Natural gas prices are determined according to the differentiated end-user tariffs approved by the PUC and pegged to oil product prices. As a result of the global fall in oil prices, in 2016 natural gas prices (including excise duty) in Latvia were on average 24% lower than the year before, leading to reduced fuel prices for Latvenergo Group.

Latvijas Gāze AS supplies natural gas to Latvenergo Group facilities based on bilateral agreements. Deliveries are made according to the necessary natural gas volumes, subject to a prior agreement.

The total amount of natural gas procured in 2016 was 604 million nm^3. Natural gas consumption at Latvenergo Group facilities depends on thermal energy demand and the situation on the electricity market. The Riga CHPPs operate in a market conjuncture, planning operating modes and fuel consumption efficiently, i.e., in unfavourable market conditions, generation at power plants is reduced, and the opportunity to purchase cheaper electricity on the exchange is used.

The latest changes in Latvian legislation provide for the opening of the natural gas market on 3 April 2017. These changes and the fact that in October 2014 a liquefied natural gas terminal was brought into operation in Klaipeda provide for a possibility for Latvenergo Group to diversify natural gas supply solutions over the coming years.

To ensure the reliability of thermal energy supply for emergency situations in which the supply of natural gas is interrupted, the Riga CHPPs store back-up fuel reserves of diesel. In 2016, a new boiler house, powered by diesel fuel, was built at Liepājas enerģija SIA. Overall, the Group's diesel fuel procurement in 2016 constituted an insignificant share of its total fuel procurement expense.

At the Liepaja plants and Ķegums boiler house, Latvenergo Group uses a renewable energy source: woodchips. In 2016, woodchips accounted for approximately 2% of Latvenergo Group's total fuel procurement expense.

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

Amounts of fuel procurement (2012–2016)

	Unit	2012	2013	2014	2015	2016
Natural gas	thsd. nm^3	514,673	597,846	517,119	569,003	603,720
Wood chips	loose m^3	45,501	162,491	226,826	211,283	219,315
Diesel fuel	t			6,843		3

LATVENERGO GROUP PERFORMANCE INDICATORS

2.1 Economic Performance

Management Approach

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

In 2016, amount paid to the state budget

209 MEUR including **77 MEUR** in dividends

Contribution to the national economy

Latvenergo Group is the largest power supply utility and one of the most valuable companies in the Baltic countries. Latvenergo Group operations make a significant contribution to society and economic growth. With its large investment volumes and direct and indirect job creation, the energy industry is an important driving force in the economy. In 2016, Latvenergo Group made investments in the amount of EUR 201 million, with total investment over the past five years exceeding EUR 1 billion. Significant amounts have been invested in environmentally friendly and environment-enhancing energy generation and network development investment projects: the Daugava HPP hydropower unit reconstruction programme, the *Kurzeme Ring* project and others (see the annex *Green* Bond Report).

At the same time, Latvenergo Group provides a direct economic benefit to society as a whole. Latvenergo Group is one of the largest taxpayers in Latvia. Over the past five years, Latvenergo Group has paid more than EUR 810 million to the state budget, including EUR 230 million paid in dividends for use of state capital. The Group is also one of the biggest employers in Latvia, with a total of 4,131 employees as of the end of 2016. Through contributions to the Pension Fund and termination benefits upon retirement, Latvenergo Group takes good care of its employees.

Latvenergo Group's financial results indicate its stable financial position and development. Detailed information about the performance of the Group is available in the Latvenergo Consolidated Annual Report 2016.

Efficiency of energy generation facilities

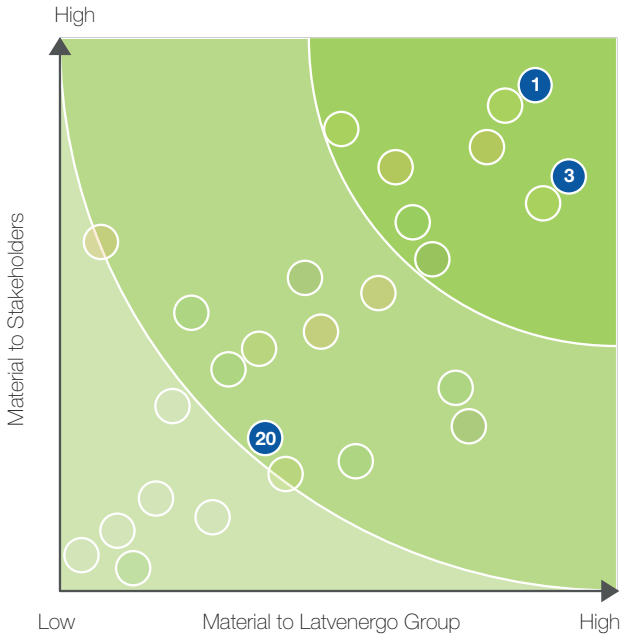
The Daugava HPPs and Riga CHPPs, the Group's largest energy generation facilities, operate in conditions of free competition, trading all the electricity they generate on the Nord Pool power exchange. The efficiency of the energy generation facilities is very important for maintaining the competitiveness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

With the commissioning of its power unit in late 2013, which completed the reconstruction of its power generation plant, Riga CHPP-2 has become the most advanced and efficient combined cycle heat and power plant in the Baltics. Riga CHPP-1, in turn, was overhauled in 2005. The Riga CHPPs guarantee substantial base-load electricity capacity for Latvia. Renovation of the Daugava HPPs is ongoing. Until 2022, Latvenergo Group plans to gradually overhaul the remaining 11 hydropower units at the Daugava HPPs. Thus, hydropower turbine efficiency ratios and installed capacity will be improved, increasing annual electricity output.

The Riga CHPPs plan their operating modes and fuel consumption efficiently, according to the market situation. In unfavourable market conditions, generation at the power plants is reduced, and cheaper electricity is purchased from the Nordic countries. The output of the Daugava HPPs is planned considering the water inflow in the Daugava River and the possibility to accumulate water and generate electricity during periods of high demand and prices. Through optimal combination of Riga CHPP and Daugava HPP output with import opportunities in the region, customers in the Baltics benefit from both price approximation to the Nordic level and long-term price stability.

Operation of Latvenergo Group generation facilities is organised in compliance with the fundamental principles of sustainable development. A certified integrated management system for electricity and thermal energy generation has been implemented at generation facilities, certifying operational efficiency. The aim of the Group's quality policy is to continuously improve and develop its thermal energy and electricity generation processes, ensuring their quality and stable performance in line with the requirements of legal acts and customer demand.

Economic Performance aspects in the Materiality Matrix*



* see Section 1.9: Materiality Assessment

Distribution efficiency

Along with the improvement of electricity supply quality, Latvenergo Group implements programmes and activities to reduce electricity losses in distribution networks. These include regular monitoring of electricity consumption and measures for its improvement, optimisation and automation of electricity networks, and gradual introduction of smart grid technologies. Various measures to reduce distribution network losses will be continued in the coming years as well.

For more information, see Subsection 1.10.2: Distribution.

G4-EC1 Direct economic value generated and distributed

In 2016, the economic value generated by Latvenergo Group was EUR 940.6 million, while distributed economic value was EUR 656.8 million. The decline in distributed economic value compared to the previous year was mainly due to the decline in procurement costs for electricity and fuel on account of lower electricity and natural gas prices. At the same time, the positive impact on distributed economic value was due to a larger amount of dividends and corporate income tax.

Distributed economic value reached 70% of the economic value generated. The majority or 65% of distributed value is comprised of operating costs, including electricity procurement, electricity services, fuel and other operational costs.

In 2016, dividends paid for 2015 comprised EUR 77.4 million. Latvenergo Group is a significant payer of dividends for the use of state capital in Latvia. Over the last five years EUR 230 million have been paid into the state budget. Latvenergo AS dividends, in addition to SET revenue, are used as a source of funding for the state budget program "Electricity user support", thereby maintaining the MP PSO fee in the coming years at its current level.

In 2016, the undistributed economic value of Latvenergo Group represented 30% of the economic value generated, reaching EUR 281.1 million, of which EUR 200.7 million has been earmarked for investment.

Economic value generated and distributed (2015–2016)

	Unit	2015	2016
Economic value generated	**MEUR**	**936.9**	**940.6**
Revenue and other income	MEUR	934.0	938.3
Income from financial activities	MEUR	2.9	2.3
Economic value distributed	**MEUR**	**679.4**	**656.8**
Raw materials, consumables and other operational expenses	MEUR	507.4	424.2
Remuneration of employees	MEUR	94.6	96.0
Payments for the use of state capital	MEUR	31.5	77.4
Payments to providers of debt capital	MEUR	18.6	14.2
State imposed payments	MEUR	26.7	44.6
Charity and sponsorships	MEUR	0.7	0.5
Retained economic value	**MEUR**	**256.7**	**281.1**
Depreciation and amortisation	MEUR	182.5	186.8
Savings and reserves	MEUR	74.2	94.3

G4-EC3 Coverage of the organization's defined benefit plan obligations

Taking care of its employees and respecting the terms stated in the Collective Bargaining Agreement, Latvenergo Group makes contributions to the Pension Plan and pays termination benefits to employees upon their retirement (for more information on the Collective Bargaining Agreement, see Section 2.5: Employees and the Work Environment). These benefits apply to 97% of the Group's employees.

In compliance with the Collective Bargaining Agreement, Latvenergo Group makes monthly contributions to the current account of Pirmais Slēgtais Pensiju fonds AS (the Pension Plan) on behalf of employees until they reach the pensionable age for statutory pensions. The contributions amount to 5% of each pension plan member's monthly remuneration. In 2016, Latvenergo Group contributed EUR 2.3 million to the Pension Plan on behalf of its employees (EUR 2.6 million in 2015). The lower amount of contributions compared to 2015 is attributable to the introduction of an optional benefit system in 2015. This system enables employees to channel the employer's envisaged contributions to the Pension Plan towards other benefits.

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

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

G4-EC4 Financial assistance received from government

For the implementation of major investment projects, Latvenergo Group has attracted co-financing (foreign financial assistance) from the EU. One of the key projects for which co-financing was attracted is the *Kurzeme Ring* transmission network project. The construction of the initial stages, the *Riga Ring* and *Grobina–Ventspils,* received 50% co-financing within the framework of the European Energy Programme for Recovery. An agreement on 45% co-financing for the final project stage, *Ventspils–Tume–Riga*, has been signed with the EC Innovation and Networks Executive Agency. EU funds have also been attracted in the amount of 65% co-financing for the third Estonia–Latvia power transmission 330 kV network interconnection. As of 1 January 2015, transmission projects are implemented by Augstsprieguma tīkls AS (for more information

Funding received from the state and the EU (2012–2016)

	Unit	2012	2013	2014	2015	2016
Project *Kurzeme Ring*	MEUR	0.2	7.6		18.0	0.2
Liepaja plants	MEUR	3.4	2.4	2.2		
Smart technology	MEUR		0.2			
Grant for limiting MP PSO fee	MEUR			29.3	20.3	59.2
TOTAL	**MEUR**	**3.6**	**10.1**	**31.4**	**38.3**	**59.4**

on the projects, see Section 1.10: Operating Segments).

Enerģijas publiskais tirgotājs AS, which performs the statutory duties of a public trader, also received a targeted grant from the state budget. The purpose of the grant is to prevent an increase in the MP PSO fee, keeping it at the previous year's level of 2.69 cents/kWh. The source of funding of the state targeted grant is Latvenergo AS dividends and the SET introduced in Latvia in 2014. The tax applies to companies that receive aid for electricity generation within the framework of MP or guaranteed payments for installed electrical capacity at power plants. In 2016, Enerģijas publiskais tirgotājs AS received a EUR 59.2 million targeted grant from the state budget.

EU11 Average generation efficiency of thermal plants by energy source and by regulatory regime

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

In 2016, generation efficiency at the Daugava HPPs did not change significantly. To maintain high generation efficiency, the Daugava HPPs make use of the possibility to accumulate water and generate electricity when demand is high (during daily peak hours). Along with lower electricity output in condensation mode compared to 2015, the generation efficiency indicators of the Riga CHPPs improved. The Riga CHPPs operate according to the market situation, planning their operating modes and fuel consumption efficiently.

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

Generation facility efficiency indicators (2012–2016)

	Unit	2012	2013	2014	2015	2016
Daugava HPPs	m^3/kWh	19.4	19.5	18.7	18.8	18.9
Riga CHPPs	%	85	79	80	79	83
Liepaja plants	%	93	91	91	90	90
Kegums boiler house	%	83	86	86	86	86

EU12 Distribution losses as a percentage of total energy

One of the most important indicators describing the efficiency of the distribution segment is distribution losses as a percentage of total electricity received in the network.

Compared to the previous year, in 2016, this indicator remained unchanged at 4.6%. This is the lowest ever electricity loss rate for Latvenergo Group's distribution segment.

Distribution losses (2012–2016)

	Unit	2012	2013	2014	2015	2016
Distribution losses	%	5.9	5.0	4.8	4.6	4.6

EU30 Average plant availability factor by energy source and by regulatory regime

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

In 2016, the plant availability factors for the Daugava HPPs were lower than in the previous year. The decrease was due to the Daugava HPP hydropower unit reconstruction programme, within which reconstruction of three hydropower units took place in 2016. Compared to the previous year, in 2016, the plant availability factors for the Riga CHPPs remained unchanged.

In 2016, the Daugava HPPs were operational for an average of 1,907 hours and on back-up for an average of 6,246 hours. The average annual duration of scheduled repair work per hydropower unit was 743 hours, with unscheduled work, performed for hydropower units at Plavinas HPP and Riga HPP, totalling 111 hours.

The CHPPs were operational for an average of 2,675 hours and on back-up for an average of 4,927 hours. The average annual duration of scheduled repair work per unit was 1,164 hours, with unscheduled work, performed only on one steam turbine at CHPP-1 and on the gas turbine of the second power unit at Riga CHPP-2, totalling 212 hours.

Average plant availability (2012–2016)

	Unit	2012	2013	2014	2015	2016
Daugava HPPs	%	90	91	93	87	81
Riga CHPPs	%	86	93	86	82	82

2.2 Society

Management Approach

Responsibility is one of Latvenergo Group's values and a fundamental principle of corporate governance. The Group and its employees undertake responsibility for tasks performed in compliance with the requirements of applicable laws and regulations. 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.

Responsibility towards society in all areas of operation

In the view of both Latvenergo Group and its stakeholders, aspects belonging to the category Society are especially important (see the Materiality Matrix in Section 1.9: Materiality Assessment).

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

- In compliance with the principles defined by its Code of Ethics, Latvenergo Group guarantees fair and equal treatment of employees, customers, suppliers and other stakeholders, preventing fraud and corruption. Latvenergo Group's contractors are urged to follow similar ethical principles and base their cooperation on the principles of fair business cooperation;
- The Group evaluates the impact of its activities on society and the environment in its day-to-day operations and in implementing new projects. Local communities are regularly involved in the discussion of modernisation projects at the Group's facilities. Emergency and crisis management and prevention plans have been developed for the Group's critical infrastructure;
- The Group is actively involved in shaping public opinion on subjects regarding energy and related industries which are of mutual importance for the Group and its stakeholders.

Compliance with the requirements of regulatory acts and fair competition

One of the cornerstones of Latvenergo Group corporate governance is ethics and compliance.

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

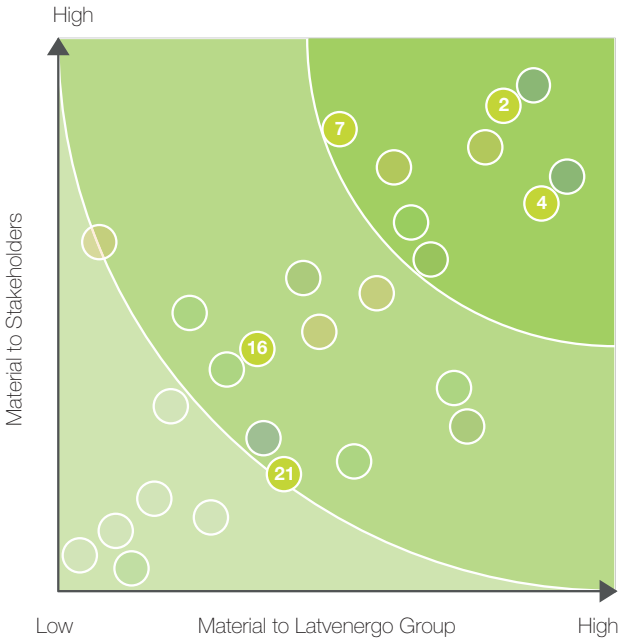
Latvenergo Group has also developed and introduced a Fraud and Corruption Risk Management Policy, which defines the basic principles of fraud and corruption risk management and the main tasks and responsibilities of the parties involved at various organisational levels of the Group. Along with the Policy, a range of measures have been introduced to mitigate the risk of fraud and corruption:

- Annual fraud and compliance risk assessment and corrective action planning and quarterly monitoring of the implementation of risk mitigation measures;
- To prevent potential conflicts of interest, the Group's employees fill out an annual declaration. Upon entering employment relations and signing the declaration, new employees must confirm in writing their understanding of conflict of interest situations and commitment to prevent their occurrence;
- The Group's employees receive regular training on best practice for the prevention and mitigation of fraud and corruption;
- The Group also encourages improvement of internal regulations and other measures to ensure fair commercial practice and prevent any risk of corruption and fraud.

Latvenergo Group takes responsibility for conducting its operations in compliance with applicable law. Financial and human resources are allocated to ensure the legal compliance of the Group's operations, preventing the occurrence of compliance risks. The Group regularly follows any changes to laws and regulations, participates in public hearings and keeps in touch with the responsible institutions. The Group also develops and maintains its internal procedures to ensure the compliance of its operations.

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

Society aspects in the Materiality Matrix*



* see Section 1.9: Materiality Assessment

Emergency management plans

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

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

Employees receive regular instruction on their duties in managing emergency and crisis situations. Moreover, in cooperation with Augstsprieguma tikls AS, emergency and crisis management training for employees of various Latvenergo Group organisational units is carried out annually; possible emergency scenarios are simulated and specialists from the Department of Management and Operations of the SFRS and from the National Armed Forces are involved. To improve recovery response and reduce material losses, the training process is subsequently analysed and preventive measures to be taken are defined.

Involvement in shaping energy sector policy

As one of the Baltic leaders in power supply, Latvenergo Group engages in shaping the sustainable energy sector. In line with the Group's medium-term strategy, representatives engage in drafting statements on Latvian and EU-level studies, guidelines, standards, policy documents and legislation pertaining to the energy sector and related sectors.

In 2016, Group experts made recommendations for the development and improvement of various Latvian regulatory documents. The most important of these included the establishment of a regulatory environment for the Latvian natural gas market, integration of the requirements of the EU Energy Efficiency Directive into the national regulatory framework, the Natural Resources Tax Law, improvement of the application principles of financing MP PSO fees, etc.

Lobbying of the Group's interests in the EU is ensured through its participation in the European electricity sector professional association EURELECTRIC. In 2016, Group experts participated in drafting EURELECTRIC position statements on energy efficiency and energy supply risk issues. In 2016, in collaboration with EURELECTRIC, Riga CHPP-2 was nominated by the EC as a success story in the implementation of the EU Industrial Emissions Directive.

By participating in various forums, Latvenergo Group's experts promote the exchange of opinions on topical issues for Latvian and EU energy policy. The most significant examples are the energy forum "Towards sustainable energy supply in Latvia", organised by the newspaper Dienas Bizness, and the conference "Energy 2016" organised by BIG Event. These forums discuss sector-related subjects, such as the impact of the primary resources market on the competitiveness of the energy producer, development of the electricity market, and balanced development of the distribution network.

Impact on society

Latvenergo Group is aware that its operations impact stakeholders. The Group follows all regulatory requirements regarding the assessment of the impact of its operations and takes necessary mitigation measures. To mitigate the potential harm or risk thereof to the environment and society and to ensure the public's involvement in decision-making, the Group identifies stakeholders' views through public consultations, organized in the most convenient manner for the stakeholders (see Section 2.3: Product Responsibility). The Group also conducts studies on environmental protection and carries out environmental impact assessments. Latvenergo Group cooperates with the responsible services, institutions and local governments to ensure the safety of local communities affected by the Daugava HPP reservoirs during the spring flood period. More information on public engagement activities in 2016 is available in the G4-SO1 indicator section.

G4-SO1 Percentage of operations with implemented local community engagement, impact assessments and development programs

Latvenergo Group engages society in all projects where public interests are at stake. When implementing electricity network infrastructure projects, for example, in line with the requirements of laws and regulations, the Group communicates with the public and finds out its views at the earliest project stage possible. The third Estonia–Latvia 330 kV power network interconnection is a significant future electricity transmission project in the Baltic region, and in 2016 Latvenergo Group organised discussions with local governments and landowners on the influence of its infrastructure facilities. In 2016, several meetings were held with residents of Salaspils District, leading to the completion of the environmental impact assessment report and project submission to and acceptance by the State Environmental Bureau. Based on this, the project was granted the status of object of national interest. Public consultations on the third Estonia–Latvia power network interconnection project took place in line with the requirements of the Law on Environmental Impact Assessment.

As in previous years, to ensure coordinated action and provide information on the operational situation in water reservoirs in Latvia during the spring flood, the SFRS, in cooperation with Latvenergo AS, organised a spring flood coordination meeting.

In public information activities regarding its operations, Latvenergo Group cooperates with national and regional media. Media events on the Latvenergo Group Operational Strategy 2017–2022, replenishment of fish stocks and the scientific project "Fish Migration and Natural Replenishment Possibilities in the Daugava River Upstream from Riga HPP" were organised in 2016.

For communication with the public and customers, Latvenergo Group makes active use of social media, promptly answering questions about the Group's operations and replying to specific practical questions from customers

G4-SO4 Communication and training on anti-corruption policies and procedures

In 2016, training on fraud and corruption risk management and recommended risk mitigation measures was continued for Latvenergo Group employees. Evaluating the potential risks and controls needed to raise employee awareness of anti-corruption issues, trainings were organised and consultations were given.

In 2016, 100% of Latvenergo AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS Management Board Members, Chief Officers and managers underwent training on fraud and corruption risk management and recommended preventive measures.

In addition to on-site workshops and discussions, in 2016, Latvenergo Group developed an e-learning programme on the prevention of conflict of interest situations. The first training took place in December 2016. The programme is developed to improve employee awareness of conflict of interest situations and reduce conflict of interest risk. The Group plans to conduct e-learning courses for all Latvenergo Group employees in 2017.

G4-SO5 Confirmed incidents of corruption and actions taken

No cases of corruption were identified within Latvenergo Group in 2016.

Latvenergo Group conducts annual assessments of fraud and corruption risks. The purpose of the risk assessments is to identify fraud and corruption risks within the Group, evaluate the efficiency of controls and prepare the necessary risk mitigation measures. Thus, potential losses and harm to the Group's reputation are minimised along with the possibility of statutory obligations or sanctions being imposed on the Group.

The risk of fraud and corruption at Latvenergo Group is properly managed in compliance with the risk assessment results. Mitigation of fraud and corruption risks is ensured through internal documents regulating employees' activities and limiting the scope of their authorities (policies, procedures and regulations, the Code of Ethics and other documents). Furthermore, to increase the efficiency of fraud and corruption risk management, Latvenergo Group carries out risk mitigation activities and continuously improves its preventive measures and detection.

In 2016, a uniform software for fraud and corruption risk assessment was introduced at Latvenergo AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS.

G4-SO6 Total value of political contributions by country and recipient/beneficiary

Latvenergo Group does not make any monetary and/or non-monetary contributions to political organisations.

G4-SO7 Total number of legal actions for anti-competitive behaviour, anti-trust, and monopoly practices and their outcomes

In 2016, no cases of anti-competitive behaviour or misuse of the dominant position by Latvenergo Group have been identified, and no court proceedings against Latvenergo Group have been initiated or are ongoing.

G4-SO8 Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations

Latvenergo Group ensures compliance of its operations with applicable laws and regulations, and no significant fines or non-monetary sanctions were applied in 2016 for any failure by the Group to comply with the legislation.

2.3 Product Responsibility

Management Approach

Latvenergo Group is continuing its strategic course towards strengthening its position on the Baltic market and becoming a recognisable and competitive electricity market player in all three Baltic states. The Group's operations are targeted at developing and offering electricity products and services that meet customers' needs and at increasing the value of the *Elektrum* product brand. At the same time, Latvenergo Group is striving to achieve a high level of customer satisfaction while building loyal and mutually rewarding relationships with various customer segments. Taking into account the open electricity market and increasing competition, the Group is focusing its organisational and product and service development strategy on the fundamental principles of cost-effectiveness and operational excellence.

Loyal and mutually rewarding customer relationships

In 2016, by strengthening its position of leading electricity supplier in the Baltic market, the Group continued to develop and increase the value of the *Elektrum* product brand. Initiatives were also taken to ensure a high level of customer satisfaction and loyalty and to develop new services and service provision approaches in line with customer needs.

Several activities were taken in 2016 to build awareness of the *Elektrum* product brand and its association with friendly energy:

- The Group signed a cooperation agreement with the Latvian Olympic Committee. According to the agreement, the *Elektrum* brand was widely popularised at three Olympic Centres, including allocation of the *Elektrum* name to the Olympic Sports Centre in Riga and the ice arena of Valmiera Olympic Centre;
- During the Olympic Games, *Elektrum* ran a nationwide campaign, "Give Energy to the Olympians!". Ten symbolic "energy collection" events were organised throughout Latvia during the campaign, along with an advertising campaign in the media: "Let's keep our fingers crossed for our people!";
- A new, creative communication platform has been developed and introduced to communicate the *Elektrum* brand. It features scientist Vjačeslavs Kaščejevs, and the emphasis is on one of the *Elektrum* brand's values – the ability to explain complicated issues in a simple way;
- *Elektrum* accounts have been created on *Twitter* and *Facebook*.

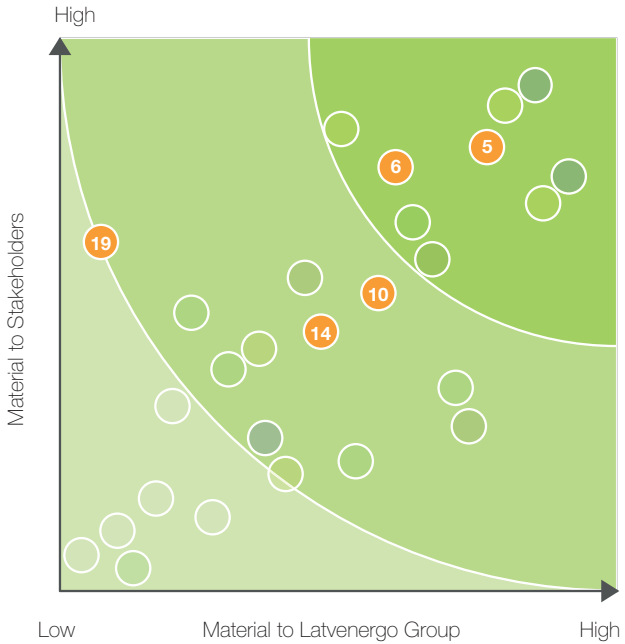
Due to these activities, in one year's time *Elektrum* brand awareness increased from 44% to 92%, while its spontaneous awareness increased from 2% to 45%

To increase the Group's competitiveness and customer satisfaction and loyalty, customer service options and services are continuously developed and improved in response to increasing customer demand for convenience, availability and speed. At the end of 2016, the *Elektrum* mobile application was downloaded by more than 44 thousand households, and its functionality was supplemented by services for corporate users. Along with a range of other services, the application offers membership in the "Friendly Benefits" programme. Regular advertising activities in the media and on social networks are carried out to popularise the mobile application. These are aimed at promoting cost-effective, modern and customer-oriented service options. New functionalities have also been introduced in the *elektrum.lv* customer portal, providing companies with the possibility to draw up reconciliation statements and to review smart electricity accounting and energy monitoring data.

Based on customer interests and needs, the Group takes active measures to raise the awareness of energy efficiency and safety issues among customers and society in general. Advice on these issues is regularly published in the customer newsletter "*Elektrum* tavām mājām" (*Elektrum* for your home) and in *Elektrum* social network accounts, and regular informative activities and campaigns are organised at *Elektrum* Energy Efficiency Centre. Sadales tīkls AS is also engaged in educating society on energy safety issues.

To promote customer loyalty, Latvenergo Group implements the "*Elektrum* Friendly Benefits" programme. During 2016, this section of the Group's portal was visited more than 237 thousand times, and more than 14.3 thousand customers have made use of the discount offers. To strengthen friendly and loyal relationships, customers are sent season's greetings and congratulated on birthdays.

Product Responsibility aspects in the Materiality Matrix *



* see Section 1.9: Materiality Assessment

Customer service and channels

A variety of convenient service channels are offered to maintain a high level of service quality and availability and hence customer satisfaction. In Latvia, customer service is ensured through the following channels:

- the *elektrum.lv* self-service portal;
- customer service by phone;
- service on site at Customer Service Centres;
- an option to submit questions electronically via e-mail;
- social networks.

In Lithuania and Estonia, customer service is ensured via the *elektrum.lt* and *elektrum.ee* portals as well as by phone. Residents who are not

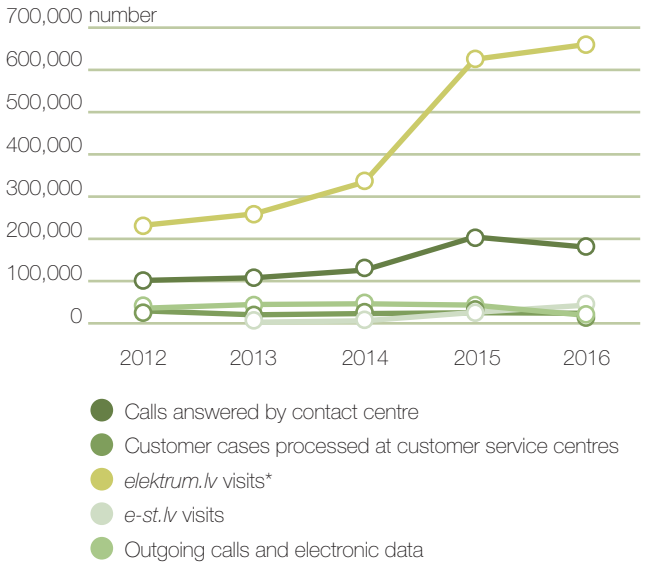
Latvenergo Group customers are also provided an opportunity to submit complaints or applications through the aforementioned customer service channels (except customer self-service portals).

The most popular customer service channel is the *elektrum.lv* self-service portal, and the number of visits in 2016 remained at the previous year's level. Customers make active use of the portal to report meter readings, make payments, extend agreements and select electricity products. The number of visits in 2016 fluctuated between 567 and 777 thousand per month. The average number of customer visits per month registered by the portal was over 660 thousand, of which 357 thousand were unique users.

The number of visits to the *e-st.lv* self-service portal of Sadales tīkls AS increased by 65%. In 2016, the average number of unique portal users per month was 42.9 thousand. Other customer service channels were used less frequently compared to 2015, when the opening of the electricity market caused significant customer activity.

Overall, in 2016, the average number of customer contacts through various service channels in Latvia was 935 thousand per month. Only 430 of these were complaints, representing less than one percent of the Group's customers. 9% of the complaints were substantiated and 8% were partially substantiated. Responses were given promptly: 71% of all complaints were handled within 15 days.

Average number of customer cases serviced per month (2012–2016)



* previously *e-latvenergo.lv*

Customer service quality

Latvenergo Group has defined key customer service performance indicators to regularly monitor quality. These include customer call response (percentage of calls answered, calls answered within 30 seconds) and complaints and submissions handled within 15 days. Compared to previous years, the level of the indicators has decreased. This is related to the growing complexity of the questions, which require more time and resources to answer.

A new key performance indicator, first call resolution, was added in 2016. It shows the number of questions received through various customer service channels that were resolved during the first contact, thus eliminating the need for further contact. Quality measurements are also important in terms of cost-effectiveness and operational excellence. In 2016, 91% of customer issues were resolved during the first contact.

Customer service key performance indicators in Latvia (2012–2016)

	Unit	2012	2013	2014	2015	2016
Calls answered	%	90	92	90	90	87
Calls answered within 30 seconds	%	82	86	78	78	73
Claims answered in 15 days	%	58	63	75	69	71
First call resolution for household segment	%	n/a	n/a	n/a	n/a	91

Customer satisfaction

According to Latvenergo Group's management approach, customer satisfaction is essential for building long-term and loyal relationships with customers. To ensure high quality customer service, Latvenergo Group, in cooperation with sociological research agencies, conducts regular customer satisfaction and loyalty surveys. These surveys make it possible to:

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

Customer satisfaction is measured according to overall satisfaction with the company and its services, customer service, payment options, and the availability and content of information. Customer satisfaction and loyalty are evaluated separately in the household and business customer segments (see the G4-PR5 indicator).

Customer data security

Latvenergo Group has extensive customer databases, and the processing and maintenance complies with all regulatory requirements in terms of data security and confidentiality. Customer service processes are adapted to ensure confidentiality of data. Data security and protection are also ensured through customer authorisation on the customer portal and in direct communication with customers. Information on customer data privacy is available under the G4-PR8 indicator.

Service availability

To ensure service clarity, availability and convenience for a wide range of customers, the Group provides:

- Customer service over the phone, electronically and in person, in Latvian, Lithuanian, Estonian, Russian and English;
- Information on the websites www.latvenergo.lv and www.sadalestikls.lv and self-service portals *elektrum.lv, elektrum.ee* and *elektrum.lt* – not only in the respective national languages, but also in Russian and English. The www.let.lv website is available in Latvian and English;
- Informative materials and advertising on the company's services at Latvenergo Group customer service centres, which are also available in Russian;
- Russian translations of direct mail messages and agreements in customer service channels.

Customer Service Centres ensure access for customers with reduced mobility and wheelchair users. To reduce the waiting time for customers with children and pregnant women, separate queues are arranged for them.

Honest communication with customers

In communicating with customers through marketing and sponsorship activities, Latvenergo Group ensures compliance of information not only with Latvian and EU law and the standards of fair competition, but also with internal policy. The most important internal documents include the Group's Code of Ethics, Brand Management Policy, and Corporate Social Responsibility Policy. The communication of Latvenergo Group and its brands is always based on compliance with Group and brand values.

Quality of electricity distribution services

Sadales tīkls AS is the largest distribution system operator in Latvia, covering approximately 99% of the territory of Latvia. The operations of Sadales tīkls AS centre on the provision of quality and reliable electricity supply services to residents of Latvia.

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

The key performance indicators for quality of electricity supply, analysed in detail by Sadales tīkls AS, are average number and duration of electricity supply interruptions. These indicators are calculated on a per-customer-per-year basis and expressed as the frequency (SAIFI) and duration in minutes (SAIDI) (see the EU28 and EU29 indicators).

Electricity supply interruption indicators are divided into scheduled and unscheduled interruptions. Scheduled supply interruptions are associated with planned network maintenance repair and construction work. The frequency of unscheduled supply interruptions is determined by the historical technical solutions of the electricity grid, damage due to adverse weather conditions (storms, snow, floods, etc.), and damage caused by third parties or theft. To reduce the duration of unscheduled power outages, the following activities were continued in 2016:

- replacement of medium-voltage overhead lines in forested areas with cables for a total length of 208 km;
- electricity line maintenance and clearance work on electricity transmission line routes totalling 6,677 km;
- 269 remote-controlled circuit breakers installed to isolate electricity lines in densely populated areas and forested rural areas, technically and visually out-of-date circuit breakers replaced with the latest technology.

Preventive measures to reduce the frequency and duration of power outages are also planned for the coming years. To this end, the Group plans to continue the construction of new cable lines, carry out clearance work on electricity line routes, introduce new technical solutions and improve existing processes. A gradual reduction of the duration of power outages for scheduled work to 5 hours maximum is planned during winter months. Performance of scheduled work on low-voltage installations will be encouraged without power supply interruptions for customers.

Safety of electricity distribution services

Provision of safe energy services is a priority for Sadales tīkls AS. Accidents at Sadales tīkls AS electrical installations are most frequently caused by third party negligence: disregarding the requirements of the Protection Zone Law in business operations and touching 20 kV electricity line wires with machinery. Information on the number and types of accidents is available under the EU25 indicator. Sadales tīkls AS carries out a variety of educational activities to reduce the number of electrical injuries and accidents, including lectures at schools and other educational institutions and educational work at electrical safety events organised by institutions supervising agricultural work, etc. Within the scope of these activities, Sadales tīkls AS employees explain the nature of electrical hazards and what to do in the event of accidents. To address electrical safety issues in the virtual environment, an electrical safety site *(Elektrodrošība)* has been created on the *draugiem.lv* portal, and an electrical safety section has been added to the Sadales tīkls AS website at www.sadalestikls.lv.

G4-PR5 Results of surveys measuring customer satisfaction

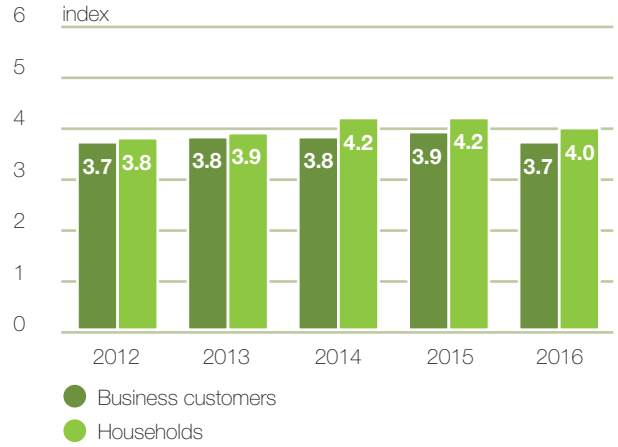
Electricity trade

Customer satisfaction is measured by the customer satisfaction index on a 6-point scale. In 2016, customer satisfaction decreased slightly among both households and the business segment. The decrease was influenced by the balanced distribution tariffs which came into effect on 1 August 2016. The aspects receiving the highest rating from households are the delivery convenience of meter readings, payment options in general, and the *elektrum.lv* customer portal. Business customers, in turn, have given the highest satisfaction rating to problem-solving, customer service employees, the *elektrum.lv* customer portal, and payment options. The net promoter score (NPS) decreased from +16 in the previous year to –10 in 2016 for households and from –1 to –28 for businesses. The fall in customer satisfaction correlates with the reduced loyalty index in 2016.

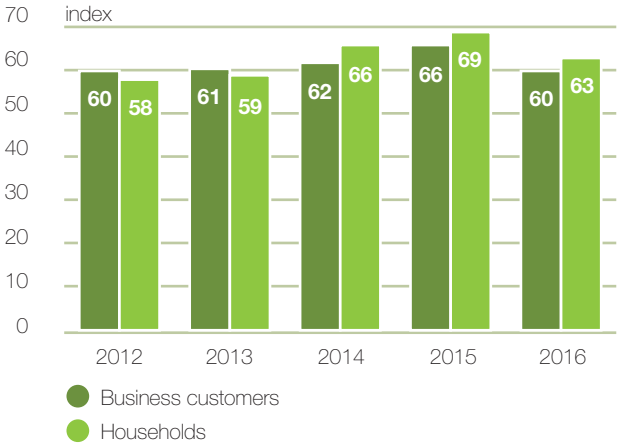
Distribution services

In 2016, the overall customer satisfaction index for distribution services was 61 index points, which is not a significant change compared to the 2015 study results and is considered medium high. Households and businesses gave an equal rating in 2016. It must be noted that since the introduction of the index in 2014, the indicator has followed a moderately increasing trend among businesses.

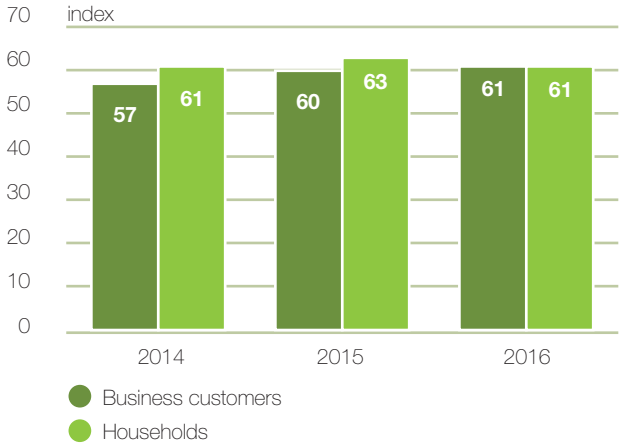
Latvenergo customer satisfaction index among business customers and households in Latvia (2012–2016)



Latvenergo customer loyalty index among business customers and households in Latvia (2012–2016)



Sadales tīkls AS customer satisfaction index among business customers and households (2014–2016)



G4-PR7 Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship, by type of outcomes

No cases of non-compliance of Latvenergo Group marketing activities with legal or voluntary provisions were identified in 2016.

G4-PR8 Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data

In 2016, two justified (2015: five) and two unjustified (2015: six) complaints were registered concerning possible customer data privacy violations. The errors in customer data processing were eliminated immediately upon receipt of the complaints. All the complaints submitted were from customers. There are more than 850 thousand customers.

G4-PR9 Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services

In 2016, compensation for damage to electrical equipment due to distribution network disruptions were paid in 48 cases for a total amount of EUR 24.1 thousand. A reduced electricity distribution tariff for inadequate voltage quality was applied to 131 customer sites.

Reparation for electrical lesions associated with disruptions in distribution system power grids (2012–2016)

	Unit	2012	2013	2014	2015	2016
Reparation cases	number	83	97	71	66	48
Amount paid	thsd. EUR	20.0	43.3	31.3	23.0	24.1

Customer sites of reduced electricity distribution tariff for inadequate voltage quality (2012–2016)

	Unit	2012	2013	2014	2015	2016
Sites	number	38	72	156	163	131

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

In 2016, 56 persons suffered from electrical injuries, including 15 children. Three accidents occurred in 2016 involving third party exposure to voltage. All the accidents were due to fishing rods touching electricity lines. No fatalities occurred in 2016. There were no court cases during the period under review.

The number of accidents to third parties (2012–2016)

	Unit	2012	2013	2014	2015	2016
Fatal	number	4	2	0	2	0
Serious	number	1	1	1	0	1
Not serious	number	3	6	2	5	2
TOTAL	**number**	**8**	**9**	**3**	**7**	**3**

EU26 Percentage of population unserved in licensed distribution or service areas

The service area specified in the electricity distribution licence covers 99% of the territory of the Republic of Latvia. Electricity distribution is ensured to approximately 828 thousand electricity distribution service customers. Electricity distribution services are provided to all households that have concluded agreements on electricity supply within the service area specified in the licence.

EU28 Power outage frequency (SAIFI) and average power outage duration (SAIDI)

EU29 Well-targeted investment in the distribution segment has contributed to reduced power interruption frequency (SAIFI) and duration (SAIDI) over the last five years. Other contributing factors were the renovation of electricity networks with a high impact on power outages and clearance work on electricity transmission line routes.

In 2016, the goal of reducing SAIDI to no more than 350 minutes was achieved. In 2016, the company continued to increase the share of work performed without cutting voltage for consumers.

System Average Interruption Frequency Index (SAIFI) (2012–2016)

	Unit	2012	2013	2014	2015	2015
Unscheduled: natural phenomena (massive damage)	number	0.5	0.6	0.4	0.2	0.2
Unscheduled: damage (incl. if caused by third parties)	number	3.4	2.9	2.4	2.1	2.2
Scheduled: network maintenance and overhaul	number	0.9	1.0	1.0	0.8	0.7
Total SAIFI	**number**	**4.8**	**4.5**	**3.8**	**3.2**	**3.1**

System Average Interruption Duration Index (SAIDI) (2012–2016)

	Unit	2012	2013	2014	2015	2016
Unscheduled: natural phenomena (massive damage)	minutes	116	149	57	18	26
Unscheduled: damage (incl. if caused by third parties)	minutes	255	192	153	126	104
Scheduled: network maintenance and overhaul	minutes	265	280	256	206	156
TOTAL SAIDI	**minutes**	**636**	**621**	**466**	**350**	**286**

2.4 Environmental Protection

Management Approach

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

> Energy management – one more step in the direction of more efficient use of resources

Environmental Policy

The key principles of Latvenergo Group in relation to environmental issues are determined by its Environmental Policy. One of the priority issues of the Environmental Policy is to mitigate the impact of climate change in accordance with the initiatives and decisions of the European Parliament, the Council, and the Commission. The following key principles of the Environmental Policy characterise the Group's environmental philosophy and attitude towards the environment:

- effective management of environmental risks in all business areas of Latvenergo Group;
- reducing pollutant emissions and the Group's impact on climate change;
- efficient use of natural resources;
- fostering preservation of biodiversity;
- assessment of the environmental impact of investment projects in development planning and minimising the harm caused to the environment;
- providing regular and open information to society and stakeholders about environmental activities;
- acting in an environmentally friendly manner and urging society and partners to do the same;
- integrating the key principles of *green* procurement into procurement procedures.

Efficient and environmentally friendly energy consumption

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

Latvenergo Group is proud of its achievements in generating electricity from renewable energy resources, its goal-oriented conduct and environmentally friendly technologies. In 2016, more than half of Latvenergo Group's total electricity output came from renewable energy resources, while the remaining part was mainly generated at combined heat and power plants fuelled by the most environmentally friendly fossil fuel: natural gas. Latvenergo Group plans to continue with investment projects that will lead not only to technological improvements, but also to the reduction of the environmental impact of generation processes and facilities.

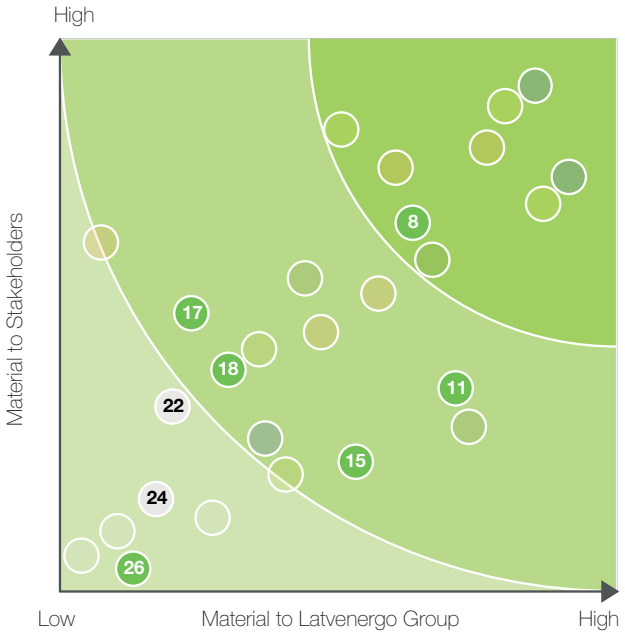
In summer 2016, in popularising *green* thinking and use of renewable energy resources, the Liepaja plants started to use solar radiation from solar collectors installed at one of the boiler houses for generation of thermal energy. Currently the capacity of the installed solar system is low: 15 kW. During the summer season, it can ensure supply of hot water to the neighbouring kindergarten and two apartment houses. In the future, the Liepaja plants will consider the possibility of creating a larger solar collector farm, considerably increasing the generation of *green* thermal energy.

Using efficient and modern technologies is one of the main ways to save resources and reduce emissions. The Riga CHPPs are highly effective plants where consumption of energy resources and emissions of CO_2 and other harmful substances are minimised.

One of the CHPP performance indicators is the fuel utilisation factor. For the reconstructed facilities of Latvenergo Group's CHPPs, this indicator (gross) is between 80% and 91% in cogeneration mode, and 51% on average in condensation mode. Cogeneration mode saves primary energy resources to a greater degree than condensation mode. In 2016, use of cogeneration potential resulted in 27% (Riga CHPP-1) and 19% (Riga CHPP-2) savings of primary energy resources.

Emphasizing the environmental benefits achieved by the CHPP-2 reconstruction project, Latvenergo Group has participated in an EC initiative compiling European "success stories" in reducing industrial emissions.

Environmental Protection aspects in the Materiality Matrix*



* see Section 1.9: Materiality Assessment

Compliance with environmental requirements

Latvenergo Group actively cooperates with national environmental institutions to ensure compliance with environmental protection legislation. The Group provides state institutions with information related to environmental protection, ensuring compliance with limitations on

polluting activities, and consults on issues related to environmental protection.

Air pollution

One of the most topical global environmental issues is greenhouse gas-induced climate change. Modernization of Latvenergo Group facilities, replacing older and less efficient facilities with ones that comply with the best and latest methodologies, is a significant contribution to the mitigation of climate change and the achievement of the Group's goals.

In 2016, EU institutions continued to develop and improve laws and regulations on climate and energy for the period after 2020. On the way towards CO_2 emissions reduction, changes are expected in the operation of the EU Emissions Trading Scheme (EU ETS). Latvenergo Group expects that the drafting and implementation of the new legislation will create fair and equal conditions for EU ETS participants and emissions allowance prices will reflect the advantages of efficient and environmentally friendly technologies on the electricity market.

Biodiversity

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

Environmental management and energy efficiency

Latvenergo Group's ability to develop and enhance its environmental performance is evidenced by its Environmental Management System, implemented and certified in compliance with the ISO 14001 standard. In 2016, the Group's Environmental Management System was certified in line with the latest (2015) version of the standard.

The new Energy Efficiency Law entered into force in 2016, integrating the EU energy efficiency policy guidelines and the requirements of laws and regulations. One of the energy efficiency elements is the obligation for large companies to conduct energy audits and plan energy efficiency measures. So far, Latvenergo Group has focused on efficient use of energy resources within its certified Environmental Management System. Latvenergo Group continued its improvements in 2016, introducing and certifying the Latvenergo AS Energy Management System in compliance with the ISO 50001 standard. This certificate confirms that the Group is following the right tactics for improving energy efficiency, and at the same time it is an obligation to set and achieve energy efficiency targets in the future. To fulfil energy efficiency requirements, the energy management principles of Sadales tīkls AS have been included in the certified Environmental Management System.

In 2016, Latvenergo Group approved the *Green* Procurement Guidelines, furthering broader integration of environmental protection criteria into procurement procedures.

G4-EN1

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

G4-EN3

Latvenergo Group uses renewable energy resources (water, wind and wood) as well as fossil fuel (primarily natural gas, diesel fuel in smaller amounts) to generate electricity and thermal energy. In 2016, renewables accounted for 32% of total consumption of energy resources. Other energy resources mostly consisted of fossil fuel.

Generating electricity and thermal energy requires a different proportion of renewable and fossil energy resources. In 2016, 45% of primary energy resources consumed for electricity generation were renewables, while the most environmentally friendly fossil fuel – natural gas – accounted for 54%. The high proportion of renewable energy resources was ensured primarily through electricity generation at the Daugava HPPs. For thermal energy generation, in turn, renewable energy resources represented 6% of the total consumption of primary energy resources. Woodchips are used to generate thermal energy at the Kegums boiler house and two Liepaja generation facilities: a biomass-fired combined heat and power plant and a biomass-fired boiler house.

The share of renewables in overall energy resource consumption over the years depends on the amount of energy generated, which in turn is determined by hydrological conditions and market factors (see Section 1.10.1: Generation and Trade).

In 2016, the amount of electricity generated from renewable resources (water, wind, wood) was 2,469 GWh, while 2,238 GWh were generated using natural gas as the fuel.

The amount of thermal energy generated from natural gas and, in small amounts, diesel fuel was 2,507 GWh or 93%, while woodchips accounted for 177 GWh or 7% of the total amount.

In 2016, energy consumption for generation processes (own use) was 162 GWh.

In 2016, fuel used for vehicles included 1,297 thousand litres of petrol and 2,451 thousand litres of diesel fuel.

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

Consumption of primary energy resources (2012–2016)

	Unit	2012	2013	2014	2015	2016
Water, wind*	TJ	13,072	10,278	6,946	6,511	8,834
Natural gas	TJ	17,364	20,168	17,459	19,194	20,185
Wood	TJ	147	522	718	693	759
Diesel fuel	TJ	1	1	6	2	1

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

Direct energy consumption by primary energy source for electricity generation (2012–2016)

	Unit	2012	2013	2014	2015	2016
Water, wind*	TJ	13,072	10,278	6,946	6,511	8,834
Natural gas	TJ	6,746	10,253	8,391	10,910	10,583
Wood	TJ	14	59	173	181	193

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

Direct energy consumption by primary energy source for thermal energy generation (2012–2016)

	Unit	2012	2013	2014	2015	2016
Natural gas	TJ	10,618	9,915	9,068	8,284	9,602
Wood	TJ	133	463	545	512	566
Diesel fuel	TJ	1	1	6	2	1

G4-EN8 Total water withdrawal by source

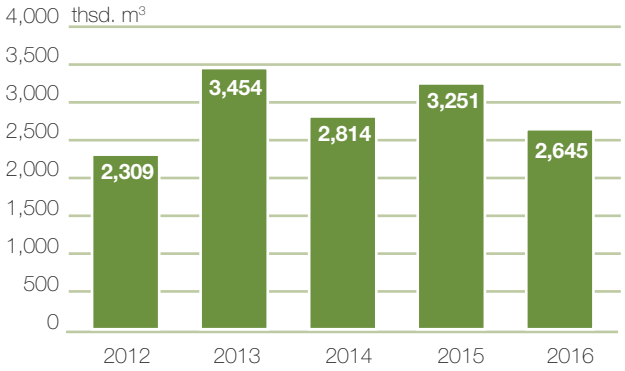
Latvenergo Group uses water resources mainly for the support of generation processes. A relatively small amount of water is used for various technological needs and also for water supply to external users.

Latvenergo Group's water consumption includes surface, underground and supply system water. In 2016, water used for operational needs amounted to 2,645 thousand m^3, including 2,410 thousand m^3 of surface water, 145 thousand m^3 of underground water and 90 thousand m^3 of supply system water.

The largest consumer of surface water resources is Riga CHPP-2, which consumed 2,404 thousand m^3 of water for generation needs in 2016 (3,047 thousand m^3 in 2015), representing 91% of total consumption. The majority of this amount – 2,082 thousand m^3 – was cooling water. The consumption of water resources at the Riga CHPPs is affected by the operational modes of the generation facilities and the amount of energy generated.

The largest consumer of underground water is Riga CHPP-1, which consumed 63 thousand m^3 of underground water to feed the heating networks.

Total water withdrawal (2012–2016)



G4-EN12 Description of significant impacts of activities, products and services on biodiversity

Bird protection

Latvenergo Group cooperates with the Latvian Ornithological Society (LOS) to address bird protection and research issues. Particular attention is paid to the issue of protecting white storks. The White Stork Monitoring Project, carried out by Latvenergo Group and the LOS in order to gather information on the white stork population in Latvia, is now in its sixth year. At least 12,000 white stork couples nest in Latvia, and power line poles are their most frequent nesting sites. 9,688 white stork nests were found on electricity line poles in Latvia in 2016. To ensure compliance with electricity supply safety requirements and reduce the number of white stork fatalities on electric lines, 1,065 potentially dangerous nests were removed from electricity line poles in 2016 following approval from the environmental authorities. During the nesting period, the birds are disturbed only in exceptional cases where the safety of the electricity supply or the public is endangered.

Replenishment of fish stock and reinforcement of the Daugava riverbanks

In compliance with applicable law, Latvenergo Group makes annual contributions to replenish fish stocks in the Daugava River basin and invests in the reinforcement of the Daugava riverbanks and the maintenance of protective structures. In 2016, the Group invested EUR 1,035.5 thousand and EUR 1,452.3 thousand in these programmes respectively. Changes in laws and regulations on covering the reinforcement costs of the Daugava riverbanks came into force at the beginning of 2017. In future, these costs will be covered by the natural resource tax on water used at HPPs for electricity generation.

Spending on fish stock replenishment is directed towards artificial replenishment of fish populations, minimising the impact of the Daugava HPPs on fish stock. 664.7 thousand salmon and sea trout smolt and fry, 884.3 thousand pike perch, whitefish and vimba fry, and 5.8 million pike and lamprey larvae were released into the Daugava River basin in 2016.

In 2016, Latvenergo Group continued its cooperation with *Mēs zivīm*, a fish conservation society. In May 2016, 400 artificial spawning nests were placed in the Ķegums HPP and Riga HPP reservoirs to stimulate the replenishment of common fish species in the Daugava River basin.

In addition to the abovementioned fish stock replenishment activities, Latvenergo Group prevents fish die-off when it lowers water levels to perform necessary repair work at HPPs during the summer season. When water levels at the Ķegums HPP reservoirs were lowered, HPP operation modes were adjusted accordingly, and exposed areas were surveyed in cooperation with *Mēs zivīm*.

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

In cooperation with local and foreign experts, Latvenergo Group continued a study initiated in 2013 of fish migration and natural replenishment possibilities in the Daugava River basin. In 2016, the Group cooperated with Swedish scientists and representatives of energy companies to learn from international experience, identify the next steps, and evaluate possibilities for restoring natural replenishment of migratory fish in the Daugava River. Informative events were organised within the project, and cooperation was started with Ogre Municipality. Latvenergo Group will continue the study in 2017. The results will be used in planning other scientifically justified fish stock protection activities in the Daugava River, supplementing current activities and contributing to natural replenishment of fish stock.

G4-EN15 Direct greenhouse gas (GHG) emissions (Scope 1)

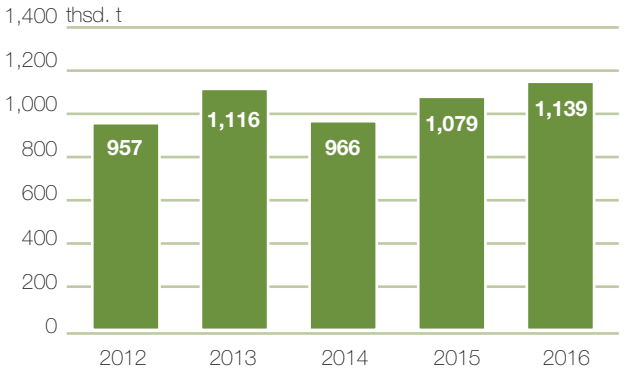
The amount of direct greenhouse gas emitted by Latvenergo Group is determined by fuel consumption, which, in turn, depends on the amount of energy generated and the operational modes selected by the plants. In 2016, Latvenergo Group's combustion plants emitted 1,139 thousand tonnes of CO_2, which is an increase of 61 thousand tonnes compared to the previous year (for CO_2 emissions per one MWh, see indicator G4-EN18). The increase in CO_2 emissions compared with the previous year was due to an increase in electricity output of 9% and an increase in thermal energy output of 11% at the Riga CHPPs.

The Group's CO_2 emissions include emissions from facilities that participate in the EU ETS (combustion plants with total rated thermal input exceeding 20 MW) and non-participating facilities (9.8 tonnes of CO_2). They also include indirect CO_2 emissions associated with supporting the energy generation process.

CO_2 emissions are calculated in compliance with the requirements of the laws and regulations of the Republic of Latvia, greenhouse gas emissions permits for CHPP-1 and CHPP-2, and EU regulations.

Use of fuel by Latvenergo Group vehicles also results in CO_2 emissions. In 2016, the volume of CO_2 emissions from vehicles was 9.5 thousand tonnes or approximately 1% of total emissions.

CO_2 emission from combustion plants (2012–2016)

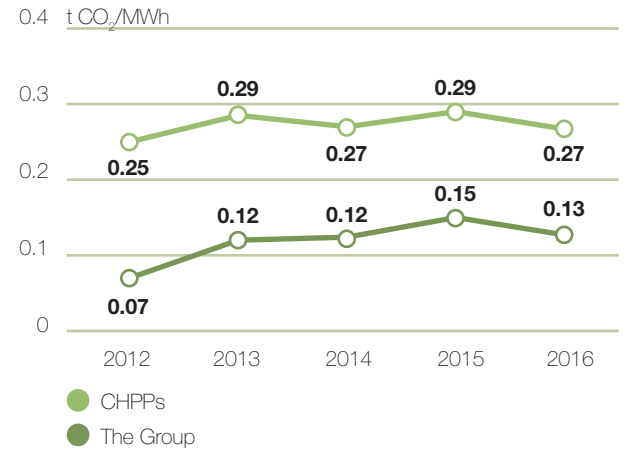


G4-EN18 Greenhouse gas (GHG) emissions intensity

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

In 2016, CO_2 emissions per unit of electricity generated were 0.13 t CO_2/MWh, with 0.27 t CO_2/MWh at the Riga CHPPs alone. In 2016, the decrease in overall CO_2 emissions intensity compared to 2015 was determined by the 36% increase in electricity generated by HPPs and the reduction in electricity output in condensation mode at CHPP-2.

CO_2 emissions per unit of electricity generated (2012–2016)



G4-EN21 NO_x, SO_x and other significant air emissions

The emission of harmful substances into the atmosphere depends directly on the amount of energy generated, the type of fuel used, the efficiency of its consumption, and the technology. To generate electricity and thermal energy, Latvenergo Group uses renewable energy resources, such as water, wind and wood, as well as fossil fuel – primarily natural gas.

Natural gas is one of the most environmentally friendly types of fossil fuel, and Latvenergo Group uses it not only at its CHPPs, but also, where possible, at small boiler houses. However, apart from carbon dioxide, combustion of natural gas emits other harmful substances into the atmosphere: nitrogen oxides (NO_x) and carbon monoxide (CO).

Thermal energy generation at the Group's boiler houses and Liepaja bio-cogeneration plant is based on woodchips. Wood combustion produces NO_x, CO and particulate matter emissions.

Latvenergo Group uses diesel as the back-up fuel for the Riga CHPP-1 and Riga CHPP-2 water boilers and for one of the Liepaja plants. When burning diesel fuel, insignificant amounts of sulphur dioxide (SO_2) and particulate matter emissions are produced. Diesel fuel emits hydrocarbons during storage.

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

In 2016, the increase in pollutant emissions in comparison with previous years was due to larger amounts of energy generated by the Riga CHPPs using natural gas as the fuel and to the increased use of wood (primarily at the Liepaja plants). In 2016, the amount of electricity generated by the Riga CHPPs was the largest in five years.

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

NO_x, CO, SO_2 and other emission (2012–2016)

	Unit	2012	2013	2014	2015	2016
NO_x	t	674	792	623	737	803
NO_x from combustion plants	kg/MWh	0.18	0.18	0.16	0.17	0.16
NO_x Group combined	kg/MWh	0.09	0.11	0.11	0.12	0.11
CO	t	336	397	415	319	361
CO from combustion plants	kg/MWh	0.09	0.09	0.10	0.08	0.07
CO Group combined	kg/MWh	0.05	0.06	0.07	0.05	0.05
SO_2	t	0	3	1	4	4
Other*	t	10	14	17	4	17

* including emissions of solid particles and hydrocarbons.

G4-EN29 Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations

No breaches of environmental protection requirements were identified at Latvenergo Group facilities in 2016.

In 2016, eleven planned thematic inspections were performed by the State Environmental Service of the Ministry of Environmental Protection and Regional Development of the Republic of Latvia. No significant warnings or sanctions were issued by the regulatory bodies as a result of the inspections of the Group's operations and no fines were levied.

EU5 Allocation of CO_2 emissions allowances or equivalent, broken down by carbon trading framework

The third phase of the EU ETS was launched in 2013. In contrast to the previous arrangements, the new regulations grant free emissions allowance units only for thermal energy generation. By 2020, the number of allowance units granted will be gradually reduced to 30% of the necessary amount.

In 2016, the Riga CHPPs were granted 343,330 allowance units and the Liepaja generation facilities were granted 21,158 allowance units for thermal energy generation. One allowance unit is equivalent to one tonne of CO_2 emitted.

CO_2 emissions allowances granted (2012–2016)

	Unit	2012*	2013	2014	2015	2016
Riga CHPPs	number	1,401,375	502,865	442,778	392,255	343,330
Liepaja plants	number	111,023	36,536	29,025	29,855	21,158

* Different allowance granting principles.

2.5 Employees and the Work Environment

Management Approach

Latvenergo Group's management acknowledges that its employees – their diversity and competencies – provide a valuable opportunity to view things from different perspectives and thus achieve better results.

By accepting and supporting different interests, needs and abilities, the Group is improving the systems already in place to ensure employee development and engagement, including the flexibility of its motivation programmes. The Group attracts and develops managers and leaders capable of driving its advancement and ensuring that its employees' competences contribute to the achievement of goals and future needs. As priorities for 2016 the Group's management has set employee engagement and development and the creation of a work environment that promotes innovation as the basis for successful future growth of employees and the Group.

> The work environment promotes employee engagement, development and innovation

The principal tasks of Latvenergo Group's human resource management are subject to the Group's strategy and aimed at ensuring that the conduct of each and every employee is in line with the Group's values: responsibility, efficiency and openness. Latvenergo Group facilitates a safe and motivating work environment that promotes innovation and offers employees the possibility to engage in the Group's processes. This furthers exchange of information, employee development, knowledge continuity and work-life balance.

Employee engagement in the achievement of targets

Work performance and productivity depend on employees' sense of engagement and belonging. Therefore, anonymous annual surveys are conducted to find out their views on various aspects of the work environment. The 2016 survey data demonstrate a high level of activity, and the results confirm a positive trend in employee engagement indicators. In 2016, 55.3% of the Group's employees participated in the survey. The average rating of engagement aspects was higher than ever: 6.05 on a 7-point scale.

In 2016, the Group continued to improve its employee self-service system, which is available to all employees both within and outside the workplace. This system ensures fast and efficient exchange of information and allows employees to do the following:

- set goals and assign tasks;
- understand their role in the achievement of the Group's common goals;
- provide feedback on task monitoring and performance evaluation.

Latvenergo Group's Remuneration Policy was updated in 2016. It facilitates employee engagement in the achievement of business objectives by linking remuneration to performance results, at the same time ensuring efficient and sound use of financial resources. The Remuneration Policy defines the basic principles for determining remuneration:

- Support for the achievement of goals. Remuneration is determined and maintained in a way that attracts employees with the required competences and promotes excellent performance in achieving short-term and long-term goals;
- Consistency with performance results. A link between remuneration and individual performance results is created and maintained. Remuneration comprises a fixed part and a variable part;
- Competitiveness and justified use of financial resources. Competitive remuneration is ensured through efficient and justified use of the company's financial resources;
- Equal opportunities and fair treatment. Equal opportunities are ensured for all employees when determining remuneration, and no discrimination is tolerated.

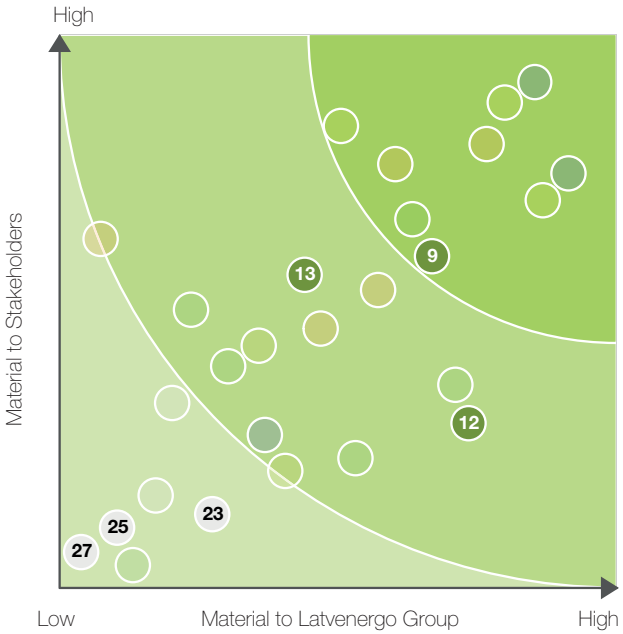
Safe work environment

Latvenergo Group pays special attention to creating a safe work environment. Through internal monitoring of the work environment and compliance with the requirements of laws and regulations of the Republic of Latvia, the Group develops an annual plan for occupational safety measures aimed at ensuring a safe work environment. As a responsible employer, Latvenergo Group provides its employees with workplaces, equipment and technical resources that are appropriate for their job. It also organises employee training on occupational safety and safe working methods. The current Occupational Health and Safety Management System, which is compliant with the OHSAS 18001 standard, aims to minimise occupational health and safety risks at the company and uphold policies and targets in line with regulatory requirements.

Occupational safety measures apply not only to Latvenergo Group employees, but also to employees of the Group's service providers. The Group instructs and trains the employees of all its contractors on safe work performance.

Latvenergo Group pays continuous attention to employees' views on the safety of the work environment, and these efforts were continued

Employees and Work Environment aspects in the Materiality Matrix*



* see Section 1.9: Materiality Assessment

also in 2016. A special attention was paid to training customer service employees on the impact of psychological and emotional factors on their health and performance results.

Employee development

Latvenergo Group takes care of employee development to ensure that employees are able to achieve their targets and develop competences that will be necessary in the nearest future. A model of strategic competences was revised in 2016 to support the development of a culture of innovation, continuous learning and personal development. A competency management programme has been developed to cultivate such strategic competences and includes:

- leadership development;
- promotion of employee excellence;
- knowledge sharing;
- development of mentors.

The Group offers its employees the possibility to improve their professional knowledge and skills through internal and external training, which consistently receives a high rating from employees. To identify the best learning methods, Latvenergo Group supports variety in the training process. The e-learning platform is being developed and use of information technologies is being broadened to ensure the efficacy of internal training and information exchange.

Knowledge continuity

Due to the operational specifics of Latvenergo Group, it is essential for employees to accumulate and transfer knowledge to ensure sustainable development and balanced succession. The Group encourages employees to accumulate knowledge and transfer it to colleagues, putting great emphasis on the training of new employees and timely preparation of successors at workplaces that require specific and unique technical knowledge.

One of the Group's priorities in terms of knowledge transfer is provision of quality practical training to students of higher and secondary vocational educational institutions through paid internship opportunities at the Group's companies. In 2016, Latvenergo Group provided 145 students with paid internship opportunities. The Group cooperates with educational institutions in Latvia, encouraging studies in the field of engineering sciences and carrying out socially responsible work for workforce development in Latvia in general. A special mentor training programme was launched in 2016 that develops mentoring skills in employees who conduct practical training, thus ensuring uniform quality standards for practical training throughout the Group. The Group ensures a balanced succession of generations (see the EU15 indicator).

It is important for any energy company in the EU to provide practical training for vocational school students and attract potential employees To introduce common quality standards for practical training at the EU level, Latvenergo Group participated in drafting the relevant framework paper and ensures full compliance with the standards set by the document.

Managing diversity

Latvenergo Group is aware that employee diversity is not an obstacle, but rather an opportunity to view things from different perspectives and thus achieve better results. Therefore, the Group encourages diversity at every level and throughout its internal processes.

In 2016, the Group initiated broad discussions on generational differences and conducted a study on this topic. As a result, several areas for improvement were selected to create a motivating work environment, make internal processes more effective, and continue optimising work-life balance, while taking account of various employee interests. The results of the study are now being used to diversify how work is organised, create a culture of learning, help employees plan their careers, and promote employee engagement in light of the values and priorities of each generation.

G4-10 Number of employees and the Collective Bargaining Agreement

G4-11 Latvenergo Group continuously improves its processes to ensure that its workforce is efficient and optimal in size. At the end of 2016, Latvenergo Group employed 4,131 people, and no significant changes in the number of employees have occurred compared to the previous year.

Latvenergo Group's workforce has a relatively high proportion of male individuals; it is 72% male and 28% female. This is related to industry specifics, which require a large number of technical positions.

The majority of employment contracts at Latvenergo Group are concluded on a full-time basis and for an indefinite period. Only 8 employees or 0.2% of the workforce had part-time agreements (0.1% of male and 0.5% of female employees at the Group). 2% of the employment contracts were concluded for a fixed term (1% of male and 5% of female employees). No significant changes in these indicators have occurred compared to previous years.

In the interest of the social security and well-being of its employees, the Group's companies Latvenergo AS, Sadales tīkls AS, Latvijas elektriskie tīkli AS and Enerģijas publiskais tirgotājs AS have signed a Collective Bargaining Agreement with the Enerģija trade union. In addition to meeting the requirements of legal acts, the Agreement provides protection for employees' economic and social interests. In 2016, the Collective Bargaining Agreement was applicable to 97% of the Group's employees, and in recent years this percentage has remained constant. The Collective Bargaining Agreement concluded by Latvenergo Group companies applies not only to trade union members, who currently constitute approximately 60% of the Group's total number of employees, but also to all employees of those companies. Thus, equal treatment of social guarantees is ensured for all employees and the likelihood of conflict between employees and the employer is reduced. As the previous Collective Bargaining Agreement expired in 2016, a new Agreement was signed for a five-year period.

Distribution of employees by operating segments (2012–2016)

	Unit	2012	2013	2014	2015	2016
Generation and trade	number	940	971	989	992	987
Distribution	number	2,502	2,505	2,545	2,568	2,521
Lease of transmission system assets*	number	438	444	443	11	10
Corporate functions	number	577	592	586	606	613
TOTAL	**number**	**4,457**	**4,512**	**4,563**	**4,177**	**4,131**

* A transfer of 430 Latvenergo Group employees to Augstsprieguma tīkls AS was made along with the transfer of transmission system asset construction and maintenance functions.

Contractors manage their own human resources, and the Group supervises their activities at its facilities. The Group maintains databases on the health and safety training of contractors' employees.

G4-LA4 Minimum notice periods regarding operational changes, including whether these are specified in collective agreements

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

G4-LA6 Type of injury and rates of injury, occupational diseases, lost days and absenteeism and total number of work-related fatalities by gender

Eight accidents occurred in 2016, seven of which were not serious. No work-related fatalities occurred at the Group in 2016. Accidents are registered, investigated and analysed in compliance with the regulatory acts of the Republic of Latvia. Appropriate additional training is also conducted for employees.

Three cases of accidents among contractors' employees were registered in 2016 (two in 2015).

Rates of injury and absenteeism (2012–2016)

	Unit	2012	2013	2014	2015	2016
Injury rate (IR)*	index	0.47	0.34	0.23	0.23	0.23
Occupational diseases rate (ODR)*	index	0.03	0.05	0.10	0.03	0.20
Lost day rate (LDR)*	index	12	15	8	15	8
Accidents (serious)	number	15	11	8	5	7
Accidents (not serious)	number	3	2	1	2	1
Accidents (fatal)	number	0	0	0	1	0
Occupational diseases	number	4	2	4	1	7
Absentee rate (AR) * and **	%	3.4	3.9	3.5	4.5	4.7

*

$$IR = \frac{\text{number of accidents}}{\text{total hours worked}} * 200{,}000$$

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

$$ODR = \frac{\text{number of occupational diseases}}{\text{total hours worked}} * 200{,}000$$

$$AR = \frac{\text{number of missed (absentee) days}}{\text{planned number of working days}} * 100$$

Rates of injury and absenteeism by gender (2015–2016)

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

** absences due to incapacity to work, including incapacity not related to accidents at work and occupational diseases; also includes maternity leave (data on Elektrum Eesti OÜ and Elektrum Lietuva UAB for 2012–2014 not included)

G4-LA8 Health and safety topics covered in formal agreements with trade unions

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

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

G4-LA9 Average hours of training per year per employee by gender, and by employee category

In 2016, a total of 72,123 hours were devoted to external training, with participation of 2,473 employees. An average of 17 hours per employee were devoted to training, including

- 31 hours for managers;
- 17 hours for specialists;
- 20 hours for skilled workers; and
- 6 hours per employee in other positions.

Concerning employee training by gender, male employees of the Group spent an average of 20 hours in training, while female employees spent an average of 12 hours in training.

Internal training, experience sharing events and discussions involving all employees are organised at least once a year.

The Group puts great emphasis on training its technical staff in the latest technologies through internal courses organised by equipment suppliers.

In 2016, 39 technical specialists were trained during a total of 944 hours. In 2016, 81 employees obtained professional qualifications through training financed by the employer, devoting 48,840 hours to training during the reporting year.

EU15 Percentage of employees eligible to retire in the next 5 and 10 years broken down by job category

The Group maintains a balanced succession and generational replacement according to the specifics of its work environment. Accordingly, no significant changes compared to 2015 have occurred in the share of employees who might retire within the next 10 years.

Retirement time

		5 years		10 years	
	Unit	**Women**	**Men**	**Women**	**Men**
Managers	%	0.2	1.2	0.5	2.0
Professionals	%	3.3	6.0	5.6	10.0
Craft and related trades workers	%	0.4	5.1	0.5	10.1
Other professions	%	0.9	0.3	1.8	0.4
TOTAL	**%**	**4.8**	**12.6**	**8.4**	**22.5**

EU18 Percentage of contractor and subcontractor employees that have undergone relevant health and safety training

The Group instructs and trains the employees of all its contractors on safe work performance, as required by Latvian laws and regulations, energy standards and mutual agreements. The Group's labour safety specialists instruct persons employed by contractors. Instructions and applicable documents on safe performance of work, with which the contractors' employees must familiarize themselves, are also available electronically. In this way, by using various methods, all the employees employed by the contractors and working at the Group's facilities receive instruction.

Green Bond Report

Green bond programme successfully completed

100 MEUR raised

A *green* bond programme was launched in June 2015, with the first tranche of EUR 75 million. Thus, Latvenergo AS became the first state-owned company in Eastern Europe to issue *green* bonds. On 14 April 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million. This issue was a continuation of the Latvenergo AS bond issue launched in 2015 and completed the bond programme of EUR 100 million. The maturity date of the bonds is 10 June 2022, with a fixed annual interest rate (coupon) of 1.9%.

The *green* bond programme was implemented as a continuation of the Latvenergo AS bond issue launched in 2012 and achieved a diversification of sources of financing. Currently, the total value of bonds issued is EUR 205 million, constituting about ¼ of the Group's total borrowings.

The total demand for the *green* bonds issued in April 2016 was record high, exceeding the offered amount 5.8 times and fixing the yield level at 1.3107%. The bonds issued by Latvenergo AS are listed on the Baltic Bond List and on Nasdaq Riga AS. The ISIN code of the *green* bonds is LV0000801777. The bond issuance is organised by SEB banka AS.

In June 2016, the first payment of the green bond coupon was made to a total of 137 bondholders. The investor structure and the geographical breakdown proportionally to the coupon payment is provided in the following charts.

The main requirement for green bonds is that the funds raised in the issuance process are used exclusively for specified environmental projects, promoting the use of renewable energy sources and improving energy efficiency, environmental protection and a sustainable environment. To ensure this, Latvenergo *Green* Bond Framework[1] was developed, stipulating the selection criteria for eligible projects, the selection procedure, creation of a special account and regular reporting.

In May 2015, before issuance of the first *green* bonds, Latvenergo was assessed by an independent environmental expert – CICERO[2] – and received Dark Green shading, the highest possible *green* bond assessment. This was an indication of the compliance of the planned eligible projects with long-term environmental protection and climate change reduction targets. It was also an indication of good corporate governance and transparency.

Moody's assigns the highest *green* bond assesment grade – GB1 (excellent)

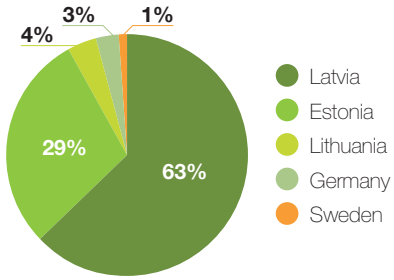
In October 2016, the international rating agency Moody's assigned the highest GB1 (excellent)[3] grade to the *green* bonds. Latvenergo was commended for its transparent and well-considered decision-making process, transparent and comprehensible management of proceeds from the bond issue, and effective reporting and disclosure practices. Moody's Investors Service has affirmed the Baa2 rating with a stable outlook for the *green* bonds, which corresponds to Latvenergo's credit rating.

In 2015 and 2016, the funds raised within *Green* Bond Framework the framework of *green* bonds were channelled to generation (66%), transmission (25%), and distribution projects (9%). At the project level, in turn, the main eligible projects are the *Kurzeme Ring* and the Daugava HPP hydropower unit reconstruction programme.

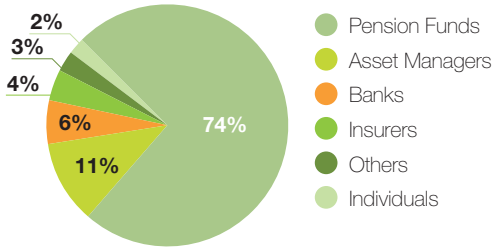
In January 2017, an internal audit[4] was conducted on the management of proceeds from the bond issue and the compliance of the selection of eligible projects within the *Green* Bond Framework. The audit determined that the processes had been implemented appropriately.

For more information on eligible projects, their eligible costs, objectives and benefits, see the table below.

Investors by region



Investors by type



[1] A full version of the *Green* Bond Framework is available on Latvenergo's website www.latvenergo.lv/files/news/Green%20Bond%20Framework_28.04.2015.pdf.
[2] CICERO – the Center for International Climate and Environmental Research, Oslo. A full version of the assesment is available on Latvenergo's website www.latvenergo.lv/files/news/Second%20opinion%20_2015.05.18.pdf.
[3] More information available on Latvenergo's website www.latvenergo.lv/eng/investors/announcements/9815-moodys-assigns-excellent-rating-to-latvenergo-green-bonds.
[4] More information available on Latvenergo's website www.latvenergo.lv/eng/investors/financial_information/bonds/.

Group Operating Segment (share of total eligible costs)	Eligible projects	Eligible costs, EUR million	Project group (share of total)	Project objectives and benefits*
GENERATION (66.0%)	Daugava HPP hydropower unit reconstruction programme and renovation of technological equipment	47.9 incl. **25.0 million EUR** raised in 2016	**RENEWABLE ENERGY (47.9%)**	Service life extension of Daugava HPP hydropower units while maintaining a high share of renewables in energy generation (in 2016 Latvenergo Group's share was 52%) Increasing the capacity and efficiency ratios of the hydropower units Increasing the safety of operation of Daugava HPPs
	Renovation of Daugava HPPs and Aiviekste HPP hydroengineering structures	18.1	**ENVIRONMENTAL PROTECTION (18.1%)**	Improvement of resilience and safety and service life extension of hydroengineering structures and dams Accident risk probability reduction at dams Reduction of oil leakage risk from hydropower units into the Daugava River Efficient flood risk management, reducing the potential impact on the public, property and the environment (water quality, species and habitats) Implementation of the programme will lead to a reduction of CO_2 emissions of 16,000 tons per year
	Study of migratory fish replenishment in the Daugava River	0.07	**SUSTAINABLE ENVIRONMENT (0.1%)**	Identifying possible measures to offset the impact of Daugava HPPs on fish stocks more efficiently
DISTRIBUTION (9.1%)	Annual monitoring of white storks	0.004		Reduction of the impact on biological diversity
	Smart electricity meters Building and reconstructing electricity lines and transformer points	9.1	**ENERGY EFFICIENCY (34.0%)**	Increasing the security of the electricity supply Since 2014, 270 thousand smart meters have been installed (25% of the total number of electricity meters, accounting for 75% of the total energy consumed by clients) Reduction of electricity losses Improving energy efficiency and operational efficiency: a decrease in SAIFI and SAIDI indicators since 2014 Network lifetime extension Integration into the supply networks of electricity generators using renewable sources and diversification of electricity supply sources, thus increasing competition in the electricity market Enlargement of interconnection capacity in order to facilitate progress towards a more competitive, safe and sustainable energy system
LEASE OF TRANSMISSION SYSTEM ASSETS (24.9%)	*Kurzeme Ring*, *Grobiņa–Ventspils* connection	24.9		
	Grand TOTAL	**100.0**		

Share of renewable energy generated

Potential reduction of CO_2 emissions**

SAIDI reduced in 2016

Renewable energy – building of new renewable energy capacities and reconstruction of existing ones – hydropower, bioenergy (non-food), wind energy and related infrastructure.
Energy efficiency – building and reconstruction of transmission and distribution networks to reduce network losses and ensure possibilities for the connection of renewable energy capacities; smart grid projects.
Environmental protection – flood protection, waste management and water resource management.
Sustainable environment (up to 10% of the issued amount) – environmental research and development, and programmes in the areas of environmental protection and biodiversity.
* For more information on the projects, see Section 1.10: Operating Segments.
** Potential reduction of CO_2 emissions as a result of reconstruction of Daugava HPPs hydropower units – 16,000 tons per year; CO_2 emissions reduction of 5,000 tons due to the lesser amount of distribution loss since 2014.

Materiality of Sustainability Aspects and Conformity to GRI Aspects

G4-20

Sustainability aspect	Corresponding GRI aspect	Importance of an aspect		
		Generation and trade	Distribution	Lease of transmission system assets
		Latvenergo AS, Enerģijas publiskais tirgotājs AS, Elektrum Eesti OÜ, Elektrum Lietuva UAB, Liepājas enerģija SIA	Sadales tīkls AS	Latvijas elektriskie tīkli AS
Efficiency of generation plants	System efficiency Access			
Emergency planning	Disaster/Emergency planning and response			
Contribution to the economy	Economic performance			
Public policy making	Public policy			
Availability and efficiency of distribution system	System efficiency Access			
Customer satisfaction	Product and service labeling			
Compliance and fair business	Anti-corruption Anti-competitive behaviour Compliance (society)			
Resource consumption in production	Materials Water			
Health and safety	Occupational health and safety Employment			
Data security	Customer privacy			
Environmental compliance	Compliance (society)			
Workplace compliance	Labor/Management relations			
Employee development	Training and education Employment			
Information availability	Compliance (product responsibility) Provision of information			
Air pollution	Emissions			
Impact on local communities	Local communities Customer health and safety			
Energy consumption	Energy			
Renewable energy	Materials Energy			
Fair marketing communication	Marketing communications			
Support received from state	Economic performance			
Community contribution	Economic performance			
Biodiversity	Biodiversity			

GRI Index

General Standard Disclosures

G4-32

		Page	External Assurance
	Strategy and analysis		
G4-1	Statement from the most senior decision-maker of the organization	4–5	√
	Organizational profile		
G4-3	Name of the organization	8	√
G4-4	Primary brands, products, and services	8	√
G4-5	Location of organization's headquarters	8	√
G4-6	Countries where there are relevant operations	8	√
G4-7	Nature of ownership and legal form	8	√
G4-8	Markets served	8	√
G4-9	Scale of the reporting organization	8–9	√
G4-10	Total workforce by employment type, employment contract, and region, broken down by gender	73	√
G4-11	Percentage of employees covered by collective bargaining agreements	73	√
G4-12	Supply chain	52–53	√
G4-13	Significant changes during the reporting period regarding size, structure, ownership or its supply chain	8–9, 40–50	√
G4-14	Precautionary approach or principle addressed by the organization	26–27	√
G4-15	Externally developed economic, environmental, and social charters, principles, or other initiatives to which the organization subscribes or endorses	37	√
G4-16	Memberships in associations and/or national or international advocacy organizations	36–37	√
EU1	Installed capacity, broken down by primary energy source and by regulatory regime	41	√
EU2	Net energy output broken down by primary energy source and by regulatory regime	41	√
EU3	Number of residential, industrial, institutional and commercial customer accounts	46	√
EU4	Length of above and underground transmission and distribution lines by regulatory regime	49–50	√
EU5	Allocation of CO_2 emissions allowances or equivalent, broken down by carbon trading framework	71	√
	Identified material aspects and boundaries		
G4-17	Entities included in the organization's consolidated financial statements	8	√
G4-18	Reporting principles for defining report content	38–39	√
G4-19	Material aspects identified	39	√
G4-20	Material aspects within the organization	39, 78	√
G4-21	Material aspects outside the organization	33–35, 39	√
G4-22	Effect of any restatements of information provided in previous reports, and the reasons for such restatements	7	√
G4-23	Significant changes from previous reporting periods in the Scope and Aspect Boundaries	7, 39	√
	Stakeholder engagement		
G4-24	List of stakeholder groups engaged by the organization	32–35	√
G4-25	Basis for identification and selection of stakeholders with whom to engage	32	√
G4-26	Approach to stakeholder engagement	32	√
G4-27	Key topics collected through stakeholder engagement	32–35	
	Report profile		
G4-28	Reporting period for information provided	7	√
G4-29	Date of most recent previous report	7	√
G4-30	Reporting cycle (annual, biennial, etc.)	7	√
G4-31	Contact point for questions regarding the report or its contents	7	√
G4-32	GRI Index	79–81	√
G4-33	External assurance	27, 83–84	√
	Governance		
G4-34	Governance structure	16, 25	√
	Ethics and integrity		
G4-56	Organization's values, principles, standards and norms of behavior	8,16–17, 25–26	√

Specific Standard Disclosures

Material Aspects	Disclosure on Management Approach and Indicators		Page	External Assurance
Economic Performance				
Aspect: Economic performance	G4-DMA		55	√
	G4-EC1	Direct economic value generated and distributed	56	√
	G4-EC3	Coverage of the organization's defined benefit plan obligations	56	√
	G4-EC4	Financial assistance received from government	56–57	√
Sector spesific aspect: System efficiency	G4-DMA		55	√
	EU11	Average generation efficiency of thermal plants by energy source and by regulatory regime	57	√
	EU12	Distribution losses as a percentage of total energy	57	√
Environmental Protection				
Aspect: Materials	G4-DMA		67	√
	G4-EN1	Materials used by weight or volume	68	√
Aspect: Energy	G4-DMA		67	√
	G4-EN3	Energy consumption within the organization	68	√
Aspect: Water	G4-DMA		67	√
	G4-EN8	Total water withdrawal by source	69	√
Aspect: Biodiversity	G4-DMA		68	√
	G4-EN12	Description of significant impacts of activities, products, and services on biodiversity	69	√
Aspect: Emissions	G4-DMA		68	√
	G4-EN15	Direct greenhouse gas (GHG) emissions (Scope 1)	70	√
	G4-EN18	Greenhouse gas (GHG) emissions intensity	70	√
	G4-EN21	NO_x, SO_x, and other significant air emissions	71	√
Aspect: Complience	G4-DMA		67	√
	G4-EN29	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations	71	√
Employmees and Work Environment				
Aspect: Labor/Management relations	G4-DMA		72	√
	G4-LA4	Minimum notice periods regarding operational changes, including whether these are specified in collective agreements	74	√
Aspect: Occupational health and safety	G4-DMA		72	√
	G4-LA6	Type of injury and rates of injury, occupational diseases, lost days and absenteeism and total number of work-related fatalities by gender	74	√
	G4-LA8	Health and safety topics covered in formal agreements with trade unions	74	√
Aspect: Training and education	G4-DMA		73	√
	G4-LA9	Average hours of training per year per employee by gender, and by employee category	75	√
Aspect: Employment	G4-DMA		73	√
	EU15	Percentage of employees eligible to retire in the next 5 and 10 years broken down by job category	75	√
	EU18	Percentage of contractor and subcontractor employees that have undergone relevant health and safety training	75	√

Society				
Aspect: Local communities	G4-DMA		59	√
	G4-SO1	Percentage of operations with implemented local community engagement, impact assessments, and development programs	60	√
Aspect: Anti-corruption	G4-DMA		58	√
	G4-SO4	Communication and training on anti-corruption policies and procedures	60	√
	G4-SO5	Confirmed incidents of corruption and actions taken	60	√
Aspect: Public policy	G4-DMA		59	√
	G4-SO6	Total value of political contributions by country and recipient/beneficiary	60	√
Aspect: Anti-competitive behaviour	G4-DMA		58	√
	G4-SO7	Total number of legal actions for anti-competitive behaviour, anti-trust, and monopoly practices and their outcomes	60	√
Aspect: Compliance	G4-DMA		58	√
	G4-SO8	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations	60	√
Aspect: Customer health and safety	G4-DMA		63	√
	EU25	Number of injuries and fatalities to the public involving company assets, including legal judgments, settlements and pending legal cases of diseases	65	√
Sector spesific aspect: Disaster/Emergency planning and response	G4-DMA		59	√
Product Responsibility				
Aspect: Product and service labeling	G4-DMA		61–63	√
	G4-PR5	Results of surveys measuring customer satisfaction	64	√
Aspect: Marketing communications	G4-DMA		63	√
	G4-PR7	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship, by type of outcomes	64	√
Aspect: Customer privacy	G4-DMA		63	√
	G4-PR8	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data	64	√
Aspect: Compliance	G4-DMA		63	√
	G4-PR9	Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services	65	√
Sector spesific aspect: Provision of information	G4-DMA		63	√
Sector spesific aspect: Access	G4-DMA		63	√
	EU26	Percentage of population unserved in licensed distribution or service areas	65	√
	EU28	Power outage frequency (SAIFI)	65	√
	EU29	Average power outage duration (SAIDI)	65–66	√
	EU30	Average plant availability factor by energy source and by regulatory regime	57	√

Glossary

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

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INDEPENDENT PRACTITIONER'S ASSURANCE REPORT ON SUSTAINABILITY REPORT

To the management of Latvenergo AS:

This report is intended for the management of Latvenergo AS for the purpose of reporting on sustainability report, including GRI Content Index as referred to and summarised on page 79-81, of Latvenergo AS and its subsidiaries (hereinafter 'the Group') for the year ended 31 December 2016 prepared in accordance with the G4 Sustainability Reporting Guidelines 'In accordance' – Core option ('GRI Guidelines') issued by the Global Reporting Initiative ('GRI'), a non-profit organisation with secretariat based in Amsterdam, the Netherlands (hereinafter – 'Sustainability Report').

Subject Matter Information and Applicable Criteria

As prescribed in our engagement letter dated 29 August 2016 we have performed limited assurance engagement on the Sustainability Report of the Group prepared in accordance with GRI Guidelines.

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

Specific Purpose of the Report

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

Responsible Party's Responsibilities

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

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

Practitioner's Responsibilities

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

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

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

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

Building a better working world

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

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

- interviews with the responsible management, at Group level, subsidiary level, and at selected business units in order to assess if the qualitative and quantitative information stated in the Sustainability Report is complete, accurate and sufficient;
- review of internal and external documents in order to assess if the information stated in the Sustainability Report is complete, accurate and sufficient;
- an evaluation of the design of the systems and processes used to obtain, manage and validate sustainability information;
- verifying the information included in the Sustainability Report through enquires to the relevant management of the Group;
- a reconciliation of financial information with the Group's Consolidated Annual Report for the financial year 2016;
- an assessment of the overall impression of the Sustainability Report, and its format, taking into consideration the consistency of the stated information with applicable criteria;
- testing performance data, on a selective basis, substantively at both an operational and corporate level;
- inspecting documentation to corroborate statements of management and senior executives in our interviews;
- a reconciliation of the reviewed information with the sustainability information in the Group's Consolidated Annual Report for the financial year 2016.

Practitioner's conclusion

Based on the procedures performed and evidence obtained, we are not aware of any material amendments that need to be made to the Sustainability Report, including GRI Content Index as referred to and summarised on page 79-81, for it to be in accordance with G4 Sustainability Reporting Guidelines 'In accordance' – Core option issued by the Global Reporting Initiative.

SIA Ernst & Young Baltic
Licence No. 17

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

Riga, 18 April 2017

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LATVENERGO CONSOLIDATED ANNUAL REPORT

Key Figures

Financial figures

	2016	2015	2014	2013	2012
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Revenue	931,619	929,128	1,010,757	1,099,893	1,063,691
EBITDA[1]	393,399	307,015	236,838	248,694	244,103
Operating profit[2]	160,773	108,188	49,243	61,091	70,234
Profit before tax[3]	148,945	92,535	31,510	48,841	59,859
Profit	130,593	85,039	29,790	46,149	50,856
Dividends[17]	90,142	77,413	31,479	23,605	40,618
Total assets	3,901,231	3,517,372	3,486,576	3,575,358	3,517,752
Non–current assets	3,388,955	3,113,719	3,109,253	3,128,064	3,102,019
Total equity	2,418,713	2,096,702	2,020,801	2,021,714	2,006,975
Borrowings	791,566	797,483	827,222	944,675	846,961
Net debt[4]	607,586	692,940	706,211	689,252	604,468
Net cash flows from operating activities	341,186	246,278	135,329	146,540	214,526
Investments	200,677	190,461	177,607	224,868	264,260

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) Net debt = borrowings at the end of the year minus cash and cash equivalents at the end of the year
17) Dividends to the equity holder of the Parent Company. Dividends are proposed as subject to approval by the Shareholder's meeting (see Note 20 b)

Financial ratios

	2016	2015	2014	2013	2012
EBITDA margin[5]	42.2%	33.0%	23.4%	22.6%	22.9%
Operating profit margin[6]	17.3%	11.6%	4.9%	5.6%	6.6%
Profit before tax margin[7]	16.0%	10.0%	3.1%	4.4%	5.6%
Profit margin[8]	14.0%	9.2%	2.9%	4.2%	4.8%
Equity–to–asset ratio[9]	62%	60%	58%	57%	57%
Net debt / EBITDA[10]	1.7	2.3	2.9	2.6	2.4
Net debt / equity[11]	0.25	0.33	0.35	0.34	0.30
Current ratio[12]	1.7	1.9	1.3	1.6	1.3
Return on assets (ROA)[13]	3.5%	2.4%	0.8%	1.3%	1.5%
Return on equity (ROE)[14]	5.8%	4.1%	1.5%	2.3%	2.6%
Return on capital employed (ROCE)[15]	5.3%	3.8%	1.7%	2.1%	2.6%
Dividend pay–out ratio[16]	66%	82%	90%	90%	90%

Operational figures

		2016	2015	2014	2013	2012
Retail electricity supply	GWh	7,580	7,869	8,688	7,954	8,287
Electricity generated	GWh	4,707	3,882	3,625	4,854	5,077
Thermal energy generated	GWh	2,675	2,408	2,560	2,566	2,712
Number of employees		4,131	4,177	4,563	4,512	4,457
Moody's credit rating		Baa2 (stable)	Baa2 (stable)	Baa3 (stable)	Baa3 (stable)	Baa3 (stable)

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

Management Report

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

Latvenergo Group (further also – the Group) is the largest power supply company in the Baltic States, operating in generation and trade of electricity and thermal energy, provision of electricity distribution services and lease of transmission system assets.

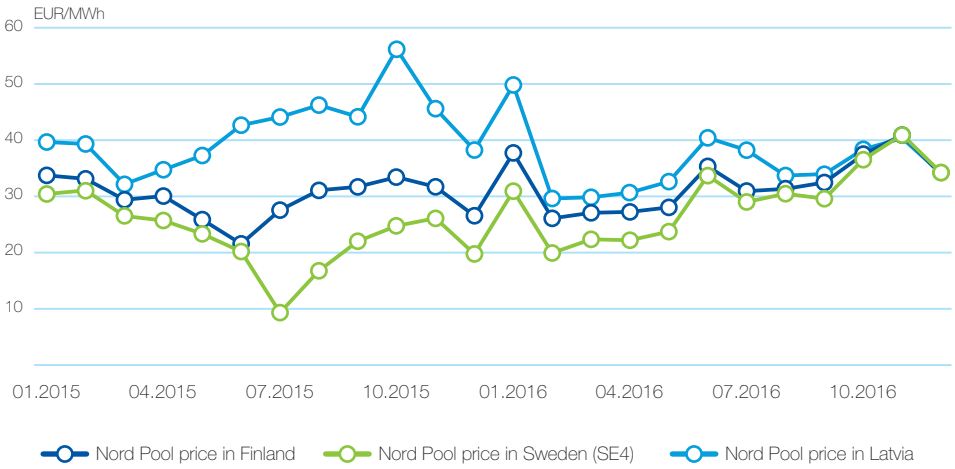
Operating Environment

Year 2016 was marked in the Baltic electricity market by stronger integration of the Baltic and Nordic regions. Two new international interconnections *NordBalt* (700 MW) and *LitPol* (500 MW) were launched. The launch of electricity interconnections contributed to liquidity improvement in the market and convergence of electricity spot prices between the bidding areas.

Operation of new interconnections contributes to electricity price convergence in the Baltics

Compared to the previous year, in 2016, the average electricity spot price was higher in the Nordics and Estonia. The price increase was influenced by colder weather conditions in January, repair works in the Nordic electricity transmission interconnection networks and largest nuclear power plants in summer months, as well as lower level of hydropower reservoir fill in Scandinavia in the last quarter of 2016. The average electricity spot price in Finland bidding area increased by 9% and reached 32.4 EUR/MWh, while in Estonia bidding area it raised by 6% to 33.1 EUR/MWh.

Electricity wholesale price on Nord Pool power exchange



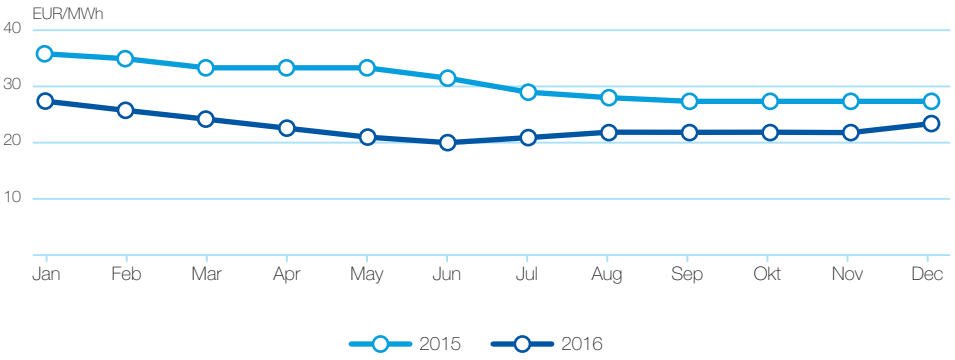
The electricity prices in Latvia and Lithuania in 2016 have decreased. Compared to 2015, the average electricity spot price in Latvia and Lithuania bidding areas decreased by 14% and 13% respectively, and reached 36.1 EUR/MWh in Latvia and 36.5 EUR/MWh in Lithuania bidding area. The decline in electricity price in Latvia and Lithuania was mainly driven by the launch of electricity interconnection NordBalt at the beginning of 2016, consequently contributing to the convergence of electricity spot prices between the bidding areas of the Baltic and Nordic countries. In addition, the decline in electricity price in Latvia and Lithuania was influenced by a fall in natural gas price in Latvia by 24% facilitating a more competitive electricity output of the Riga combined heat and power plants (hereinafter – CHPPs) thus precluding electricity price increase risk in the region. The average electricity price in Latvia bidding area in 2016 was on average by 3.0 EUR/MWh higher than in Estonia (in 2015: 10.7 EUR/MWh). The shortage of transmission capacity between power systems of Latvia and Estonia was an important factor affecting the market price.

Lower natural gas price

The natural gas price in Latvia (incl. the excise tax and transmission costs) for the user group with consumption above 100,000 thousand nm^3 was 23.0 EUR/MWh, which is by 24% lower than in 2015 when it was 30.4 EUR/MWh. The decline of natural gas price is related to the falling prices of crude oil – the average price of Brent oil in 2016 decreased by 17% compared to 2015 reaching 43.6 USD/bbl. (in 2015: 52.4 USD/bbl.).

The decrease in oil prices in 2016 was due to its persistent oversupply in the global oil market. Nevertheless, at the end of the year, after OPEC and other major oil-exporting countries agreed on output cuts, oil prices rose. In December, it reached an average of 53.3 USD/bbl.

Natural gas price in Latvia for the user group with consumption above 100,000 thousand nm^3



Operating Results

In 2016, Latvenergo Group has successfully maintained the leading electricity supplier position in the Baltics. Latvenergo Group has approximately 30% of the market share (2015: approximately 32%) of the Baltic electricity retail market.

Elektrum electricity products are the most purchased in the Baltics

In 2016, we have supplied 7,580 GWh of electricity to the Baltic retail customers (in 2015: 7,869 GWh). The decrease in the amount of electricity supplied is primarily related to intensify price competition environment in large business customers segment. The overall amount of retail electricity trade outside Latvia accounts for almost 1/3 of the total, reaching 2,376 GWh, which is by 20% higher than the amount provided by competing electricity suppliers in Latvia.

The total number of clients outside Latvia exceeds 34.7 thousand. Sales activities in Lithuania and Estonia were mainly focused on small and medium sized enterprises. The total number of our clients in this segment has increased by 3%.

Electricity and thermal energy generation increased

In 2016, the total amount generated by the power plants of Latvenergo Group comprised 4,707 GWh of electricity and 2,675 GWh of thermal energy. Overall, the amount of electricity generated compared to 2015 has increased by 21%.

In 2016, the amount of power generated by Riga CHPPs was increased by 9% , reaching 2,206 GWh. Favourable conditions for power generation at Riga CHPPs were fostered by the decline in average price of the natural gas by 24% compared to 2015. Riga CHPPs ensured effective and operative electricity generation thus precluding the risk of electricity price increase in the region. The role of Riga CHPPs was particularly significant during interruption periods in interconnection operation, as well as, at times when there were fluctuations in generation supply and demand in the neighbouring countries.

In 2016, the amount of power generated by Daugava hydropower plants (hereinafter – HPPs) has increased by 36%, reaching 2,449 GWh (in 2015: 1,805 GWh). The increase was fostered by higher water inflow in the Daugava River during the second half of 2016.

Due to optimal mix of Latvenergo Group's generation at Riga CHPPs and Daugava HPPs and the opportunities to import, consumers in the Baltic States benefit from both the price convergence to the Nordic price level and the price stability on the long-term.

In 2016, the total amount of thermal energy generated by Latvenergo Group increased by 11%. The increase was determined by a comparatively lower average ambient air temperature in January and November.

Financial Results

In 2016, Latvenergo Group's revenue has not changed significantly compared to last year, and comprises EUR 931.6 million. During the reporting period, Latvenergo Group's EBITDA increased by 28% reaching EUR 393.4 million. EBITDA has increased in all of the operating segments. Furthermore, the EBITDA margin has improved and reached 42% (in 2015: 33%). Latvenergo Group's profit in 2016 was EUR 130.6 million (2015: EUR 85.0 million).

EBITDA and profit of the Group increased

The results of the Group were mainly positively impacted by:

- 36% higher electricity output at Daugava HPPs;
- Lower prices of natural gas and electricity in Latvia. Compared to last year, the average natural gas was by 24% and the electricity price – by 14% lower;
- Increase in distribution service revenue by EUR 22.9 million. Growth was determined by the new rebalanced distribution system services tariff that came into force on 1 August 2016. Also, the revenue increase was impacted by 3% higher amount of electricity distributed.

Along with the profit growth, the return on equity has increased to 5.8% , while in the corresponding period last year it was 4.1%.

Investment

In 2016, the total amount of investments into non–current assets has increased by 5% compared to the last year and it is EUR 200.7 million. To ensure high quality of network service, technical parameters and operation safety, a significant amount is invested in the modernisation of power network. In 2016, the amount invested in the networks represented 64% of the total investment.

Investment in network assets – 2/3 of the total

Deeming environmentally friendly and environmental development projects as highly important – in 2016, EUR 35.2 million was invested in the reconstruction of Daugava HPPs hydropower units. Gradual overhaul of eleven Daugava HPPs hydropower units that have not been overhauled yet is planned for completion until 2022. It will provide for further 40–year operation of the units. The estimated total reconstruction costs will exceed EUR 200 million. The completed workload within the contract reached EUR 86.7 million as of 31 December 2016.

In 2016, electricity transmission infrastructure projects – *Kurzeme ring* and Estonia–Latvia third power transmission network interconnection – are continued.

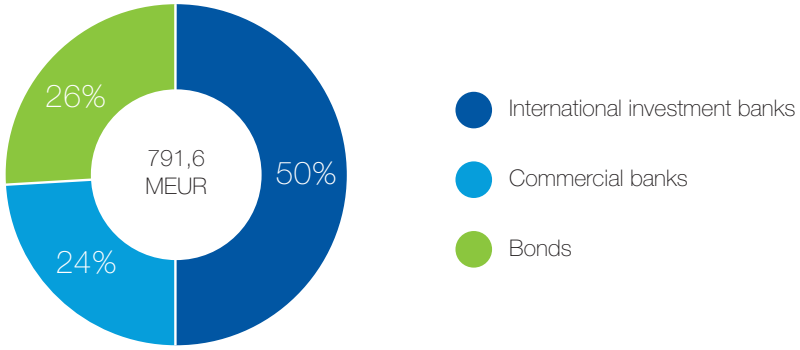
Financing

Latvenergo Group finances its investment projects from its own resources and external long-term borrowed funds, which are regularly and timely sourced and diversified in financial and capital markets.

Diversified borrowing sources

In April 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million, thus completing the second bond offering programme of EUR 100 million. In October 2016, Moody's assigned the highest Green Bond Assessment grade of GB1 (excellent). Moody's has also assigned a Baa2 (stable) credit rating for the bonds which corresponds to Latvenergo AS credit rating.

Borrowings



As of 31 December 2016, the borrowings of Latvenergo Group are EUR 791.6 million (2015: EUR 797.5 million). They comprise borrowings from international investment banks (50%), commercial banks (24%) and bonds in the amount of EUR 205 million, EUR 100 million of which are issued as green bonds.

As of 31 December 2016, the net borrowings (borrowings less cash and cash equivalents) of Latvenergo Group are EUR 607.6 million (2015: EUR 692.9 million), while the net debt / EBITDA ratio is 1.7 (2015: 2.3).

After the reporting period, on 16 February 2017, Moody's reconfirmed Latvenergo AS credit rating of Baa2 with stable outlook.

Corporate Governance

Latvenergo AS Supervisory Board elected

In accordance with the Law on Governance of Capital Shares of a Public Person and Capital Companies, and OECD recommendations, on 16 December 2016, the Shareholder's Meeting of Latvenergo AS elected the Supervisory Board of Latvenergo AS. Its main goal is to enhance efficiency of public assets' management. The Supervisory Board consists of five independent members: Andris Ozoliņš, Andris Liepiņš, Baiba Anda Rubesa, Mārtiņš Bičevskis, and Martin Sedlacky. The Chairman of the Supervisory Board is Andris Ozoliņš and Deputy Chairman – Andris Liepiņš. The Supervisory Board is elected for a five–year term.

The objectives stated in the strategy of 2013–2016 are fulfilled

Latvenergo Group has successfully fulfilled the goals set in Group strategy 2013–2016. Latvenergo Group is the largest electricity trader in Baltic electricity retail market with economically sound market share of approximately 30%. The Group successfully operates in open electricity market environment. The largest energetics project in the Baltics in decades – reconstruction of Riga CHPP-2 – has been completed. Also, Daugava HPPs hydropower unit reconstruction programme is successfully continued. It is planned for completion by 2022. Purposefully implementing the comprehensive long-term development plan of the distribution network that was developed during the strategic period, we have achieved significant improvement of electricity supply continuity indicators.

Further Development

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

Medium-term strategy approved

Taking into consideration the main challenges within the industry and business environment, three main operational objectives are defined in the strategy:

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

Along with the strategy also financial targets of Latvenergo Group have been set. The targets are subdivided in three groups – profitability, capital structure and dividend policy.

The financial targets are set to ensure:

- Ambitious, but at the same time achievable profitability, which is consistent with the average ratios of benchmark companies in European energy sector, and which provides for an adequate return for the business risk;
- Optimal and industry relevant capital structure that limits the potential financial risks;
- 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%
	Net debt to equity	< 50%
Capital structure	Net debt to EBITDA	< 3 times
Dividend policy	Dividend pay-out ratio	> 80%

Strategy development comprehended detailed industry and operating environment analysis, evaluation of business opportunities, and discussions with industry experts and stakeholders.

During the preparation process of the strategy requirements of OECD Guidelines on Corporate Governance of State-Owned Enterprises, Law on Governance of Capital Shares of a Public Person and Capital Companies, and requirements of Guidelines for Drawing up of the Medium-Term Operational Strategy for State-Owned Enterprises approved by Cross-Sectoral Coordination Centre were met.

Financial risk management

Activities of the Latvenergo Group are exposed to a variety of financial risks: market risks, credit risk, and liquidity and cash flow risk. The risk management policy of the Latvenergo Group focuses on the eliminating of potential adverse effects of uncertainty of financial markets on the financial performance of the Latvenergo Group. For maintaining financial stability the Latvenergo Group uses various financial risk control and hedging measures, including use of financial derivatives to hedge certain risk exposures.

Financial risks are managed in accordance with the principles of the 'Financial Risk Management Policy of Latvenergo Group'.

a) Market risks

I) Currency risk
Foreign currency exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency other than the Group's functional currency.

As of 31 December 2016 all significant balances and transactions of the Group, including borrowings are denominated in euros, therefore no significant currency risk exists.

In 2016 none of the Group's investments were exposed to substantial foreign currency risk.

Management of Latvenergo AS has set up the Financial Risk Management Policy inter alia to manage the Group's foreign currency exchange risk against functional currency. To manage the Group's foreign currency exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy envisages use of forward contracts.

II) Interest rate risk
The Latvenergo Group interest rate risk mainly arises from long–term borrowings at variable rates. They expose the Group to a risk that finance costs might increase significantly when interest rates rise up. Borrowings from financial institutions mostly have a variable interest rate, comprising 3, 6 or 12 month EURIBOR and a margin. The Group's policy is to maintain at least 35% of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between 2–4 years.

To hedge cash flow interest rate risk the Group has entered into interest rate swap agreements with total notional amount of EUR 174.2 million (2015: EUR 221.5 million) (Note 21 c, II). 62% of the total Group's borrowings as of 31 December 2016 (31/12/2015: 55%) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration was 2.1 years (2015: 2.4 years).

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

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 Latvenergo Group under the free market conditions, as well as the purchases of resources used in production is impacted by the price risk.

The electricity price risk is the Group's substantial price risk. The electricity price risk refers to change in market price of electricity, which could have negative impacts on the Group's financial results both because of falling revenue from generation and mismatch between floating market prices and fixed retail prices.

The Group limits the electricity price risk by entering into long–term fixed price customer contracts and by using electricity financial derivatives. Production is hedged gradually until 80%–90% of production sold before the current year. The 2016 production plan was sold at 100% of planned CHPP's generation and 75% of planned HPP's generation by 31 December 2015. The ratio of production hedge is limited by the seasonal production pattern of HPP's production, depending on weather conditions. Since retail portfolio volume exceeds the Group's production volume, the Group uses electricity financial derivatives for hedging purposes.

As of 31 December 2016 the Latvenergo Group has entered into electricity forward and future contracts with total outstanding volume of 2,195,685 MWh (31/12/2015: 2,880,436 MWh) and notional value of EUR 36.0 million (31/12/2015: EUR 64.1 million).

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 outstanding receivables. Credit risk exposure in connection with trade receivables is limited due to broad range of the Group's customers. The Latvenergo Group has no significant concentration of credit risk with any single counterparty or group of counterparties having 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 maintain the possibility to choose the best offers and to reduce probability to incur losses. No credit limits were exceeded during the reporting period, and the Group's management does not expect any losses due to occurrence of credit risk.

c) Liquidity risk and cash flow risk

The Latvenergo Group's policy of liquidity and cash flow risk management is to maintain sufficient amount of cash and cash equivalents, the availability of long and short term funding through an adequate amount of committed credit facilities to meet commitments according to the Group's strategic plans as well as to compensate the fluctuations in the cash flows due to occurrence of variety of financial risks.

The Group is continuously monitoring rolling forecasts of the Group's liquidity reserve, which comprises of 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 after the reporting period are disclosed in Note 27 of the Group's Financial Statements.

Statement of management responsibility

Based on the information available to the Management Board of Latvenergo AS, in all material aspects Latvenergo Consolidated Annual Report 2016 has been prepared in accordance with applicable laws and regulations and gives a true and fair view of assets, liabilities, financial position, profit or loss, equity and cash flows of the Latvenergo Group. All information included in the Management report is true.

Profit distribution

Fulfilling the requirements of the Article No. 41 of the law "On the State budget 2017" that determines the amount of dividends payable in the year 2017, the Management Board of Latvenergo AS proposes to pay out in dividends EUR 90.1 million, that consists from Latvenergo AS profit of 2016 in the amount of EUR 73.0 million and profit of 2015 in the amount of EUR 17.1 million, and the rest of Latvenergo AS profit of 2016 – EUR 64.4 million to transfer to Latvenergo AS reserves with a purpose to take the decision on pay out as dividends simultaneously with the decision on the distribution of Latvenergo AS profit of 2017.

The distribution of profit for 2016 is subject to a resolution of Latvenergo AS Shareholders' Meeting.

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	**Māris Kuņickis** Member of the Management Board	**Guntis Stafeckis** Member of the Management Board

18 April 2017

Consolidated Financial Statements

Consolidated Statement of Profit or Loss

	Notes	2016	2015
		EUR'000	EUR'000
Revenue	6	931,619	929,128
Other income	7	6,656	4,880
Raw materials and consumables used	8	(385,808)	(470,444)
Personnel expenses	9	(96,019)	(94,609)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	13a, 14a	(232,626)	(198,827)
Other operating expenses	10	(63,049)	(61,940)
Operating profit		**160,773**	**108,188**
Finance income	11a	2,328	2,926
Finance costs	11b	(14,156)	(18,579)
Profit before tax		**148,945**	**92,535**
Income tax	12	(18,352)	(7,496)
Profit for the year		**130,593**	**85,039**
Profit attributable to:			
– Equity holder of the Parent Company		129,045	83,509
– Non–controlling interests		1,548	1,530
Basic earnings per share (in euros)	20c	0.100	0.065
Diluted earnings per share (in euros)	20c	0.100	0.065

The notes on pages 97 to 136 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Other Comprehensive Income

	Notes	2016	2015
		EUR'000	EUR'000
Profit for the year		**130,593**	**85,039**
Other comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):			
Gains from change in hedge reserve	20a, 21c	2,847	4,077
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		**2,847**	**4,077**
Other 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	20a	269,485	20,485
Losses as a result of re–measurement on defined post–employment benefit plan	22a	(2,308)	(1,158)
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**267,177**	**19,327**
Other comprehensive income for the year, net of tax		**270,024**	**23,404**
Total other comprehensive income for the year		**400,617**	**108,443**
Attributable to:			
– Equity holder of the Parent Company		399,069	106,913
– Non–controlling interests		1,548	1,530

The notes on pages 97 to 136 are an integral part of these Consolidated Financial Statements.

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Māris Kuņickis
Member of the Management Board

Guntis Stafeckis
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

18 April 2017

Consolidated Statement of Financial Position

	Notes	31/12/2016	31/12/2015
		EUR'000	EUR'000
ASSETS			
Non–current assets			
Intangible assets	13a	14,534	14,405
Property, plant and equipment	14a	3,355,797	3,076,256
Investment property	14b	563	696
Non–current financial investments	15	41	41
Other non–current receivables		986	1,712
Investments in held–to–maturity financial assets	21a	17,034	20,609
Total non–current assets		**3,388,955**	**3,113,719**
Current assets			
Inventories	16	41,458	24,791
Trade receivables and other receivables	17a, b	273,957	263,452
Deferred expenses		3,227	3,008
Derivative financial instruments	21c	6,134	–
Investments in held–to–maturity financial assets	21a	3,520	7,859
Cash and cash equivalents	18	183,980	104,543
Total current assets		**512,276**	**403,653**
TOTAL ASSETS		**3,901,231**	**3,517,372**

	Notes	31/12/2016	31/12/2015
		EUR'000	EUR'000
EQUITY			
Share capital	19	1,288,715	1,288,531
Reserves	20a	937,074	669,596
Retained earnings		185,840	131,662
Equity attributable to equity holder of the Parent Company		**2,411,629**	**2,089,789**
Non–controlling interests		7,084	6,913
Total equity		**2,418,713**	**2,096,702**
LIABILITIES			
Non–current liabilities			
Borrowings	21b	635,620	714,291
Deferred income tax liabilities	12	315,759	273,987
Provisions	22	18,643	15,984
Derivative financial instruments	21c	7,946	8,291
Other liabilities and deferred income	23	195,407	196,386
Total non–current liabilities		**1,173,375**	**1,208,939**
Current liabilities			
Trade and other payables	24	117,817	103,774
Deferred income		14,022	13,475
Income tax payable		17,718	4,007
Borrowings	21b	155,946	83,192
Derivative financial instruments	21c	3,640	7,283
Total current liabilities		**309,143**	**211,731**
TOTAL EQUITY AND LIABILITIES		**3,901,231**	**3,517,372**

The notes on pages 97 to 136 are an integral part of these Consolidated Financial Statements.

Āris Žīgurs
Chairman of the Management Board

Guntars Baļčūns
Member of the Management Board

Uldis Bariss
Member of the Management Board

Māris Kuņickis
Member of the Management Board

Guntis Stafeckis
Member of the Management Board

Liāna Ķeldere
Accounting director of Latvenergo AS

18 April 2017

Consolidated Statement of Changes in Equity

	Notes	Attributable to equity holder of the Parent Company				Non-controlling interests	TOTAL
		Share capital	Reserves	Retained earnings	Total		
		EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
As of 31 December 2014		**1,288,446**	**645,829**	**79,995**	**2,014,270**	**6,531**	**2,020,801**
Increase in share capital	14a, 19	85	–	–	**85**	–	**85**
Dividends for 2014	20b	–	–	(31,479)	**(31,479)**	(1,148)	**(32,627)**
Total contributions and profit distributions recognised directly in equity		**85**	**–**	**(31,479)**	**(31,394)**	**(1,148)**	**(32,542)**
Profit for the year		–	–	83,509	**83,509**	1,530	**85,039**
Other comprehensive income / (loss)	20a	–	23,767	(363)	**23,404**	–	**23,404**
Total comprehensive income		**–**	**23,767**	**83,146**	**106,913**	**1,530**	**108,443**
As of 31 December 2015		**1,288,531**	**669,596**	**131,662**	**2,089,789**	**6,913**	**2,096,702**
Increase in share capital	14a, 19	184	–	–	**184**	–	**184**
Dividends for 2015	20b	–	–	(77,413)	**(77,413)**	(1,377)	**(78,790)**
Disposal of property, plant and equipment revaluation reserve net deferred income tax		–	(4,854)	4,854	–	–	–
Total contributions and profit distributions recognised directly in equity		**184**	**(4,854)**	**(72,559)**	**(77,229)**	**(1,377)**	**(78,606)**
Profit for the year		–	–	129,045	**129,045**	1,548	**130,593**
Other comprehensive income / (loss)	20a	–	272,332	(2,308)	**270,024**	–	**270,024**
Total comprehensive income		**–**	**272,332**	**126,737**	**399,069**	**1,548**	**400,617**
As of 31 December 2016		**1,288,715**	**937,074**	**185,840**	**2,411,629**	**7,084**	**2,418,713**

The notes on pages 97 to 136 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Cash Flows

	Notes	2016	2015
		EUR'000	EUR'000
Cash flows from operating activities			
Profit before tax		148,945	92,535
Adjustments:			
– Amortisation, depreciation and impairment of intangible assets and property, plant and equipment	13a, 14a	232,626	198,828
– Loss from disposal of non–current assets		4,143	4,075
– Interest costs	11b	14,156	18,693
– Interest income	11a	(2,302)	(1,578)
– Fair value gains on derivative financial instruments	8, 11	(7,275)	(902)
– Decrease in provisions	22	(287)	(762)
– Unrealised (income) / losses on currency translation differences	11b	(26)	27
Operating profit before working capital adjustments		*389,980*	*310,916*
Increase in inventories		(16,667)	(2,231)
Increase in trade and other receivables		(10,170)	(27,626)
Decrease in trade and other payables		(844)	(20,825)
Cash generated from operating activities		**362,299**	**260,234**
Interest paid		(15,529)	(19,189)
Interest received		2,457	1,606
(Paid) / repaid corporate income tax and real estate tax		(8,041)	3,627
Net cash flows from operating activities		**341,186**	**246,278**
Cash flows from investing activities			
Purchase of intangible assets and PPE		(185,674)	(188,915)
Proceeds on financing from EU funds and other financing		242	17,972
Proceeds from redemption of held–to–maturity assets		7,914	70
Net cash flows used in investing activities		**(177,518)**	**(170,873)**
Cash flows from financing activities			
Proceeds from issued debt securities (bonds)	21b	26,267	74,893
Proceeds on borrowings from financial institutions	21b	55,744	30,000
Repayment of borrowings	21b	(87,452)	(134,875)
Dividends paid to non–controlling interests		(1,377)	(1,148)
Dividends paid to equity holders of the Parent Company		(77,413)	(31,479)
Net cash flows used in financing activities		**(84,231)**	**(62,609)**
Net increase in cash and cash equivalents		**79,437**	**12,796**
Cash and cash equivalents at the beginning of the year	18	104,543	91,747
Cash and cash equivalents at the end of the year	**18**	**183,980**	**104,543**

The notes on pages 97 to 136 are an integral part of these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

1. Corporate Information

All shares of public limited company Latvenergo or Latvenergo AS (hereinafter – 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 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.

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

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

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

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

The Parent Company's 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 the date of approving of the Latvenergo Consolidated Annual Report 2016 was comprised of the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Guntars Baļčūns and Guntis Stafeckis.

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

The Supervisory body – Audit Committee since 4 December 2015 until the date of approving of the Latvenergo Consolidated Annual Report 2016 was comprised of the following members: Torben Pedersen (Chairman), Svens Dinsdorfs and Marita Salgrāve, and since 3 March 2017 until the date of approving of the Latvenergo Consolidated Annual Report 2016 also of Andris Ozoliņš and Andris Liepiņš.

The Consolidated Financial Statements for year 2016 include the financial information in respect of the Parent Company and its subsidiaries for the year ending 31 December 2016 and comparative information for year 2015. Where it has been necessary, comparatives for year 2015 are reclassified using the same principles applied for preparation of the Consolidated Financial Statements for 2016.

The Management Board of Latvenergo AS has approved the Consolidated Financial Statements for year 2016 on 18 April 2017. The Group's Consolidated 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 Consolidated Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. Where it is necessary comparatives are reclassified.

2.1. Basis of Preparation

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

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

All amounts shown in these Consolidated Financial Statements are presented in thousands of euros (EUR).

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

Adoption of new and/or changed IFRS and International Financial Reporting Interpretations Committee (IFRIC) interpretations

The following new and/or amended International Financial Reporting Standards or interpretations published or revised during the reporting year, which became effective for the reporting period started from 1 January 2016, have been adopted by the Group:

- Amendments to IAS 1 *Presentation of financial statements: Disclosure* Initiative. The amendments aim at clarifying IAS 1 to address perceived impediments to preparers exercising their judgment in

presenting their financial reports. The amendments are effective for annual periods beginning on or after 1 January 2016. The Group's Management has not made use of this amendment because the Group already complied with the amended requirements.

- Amendments to IAS 16 *Property, Plant & Equipment and IAS 38 Intangible assets: Clarification of Acceptable Methods of Depreciation and Amortization*. The amendment is effective for annual periods beginning on or after 1 January 2016 and provides additional guidance on how the depreciation or amortisation of property, plant and equipment and intangible assets should be calculated. It is clarified that a revenue-based method is not considered to be an appropriate manifestation of consumption. The Group's Management has not made use of this assessment.
- Amendments to IAS 19 *Employee Benefits*. The amendment is effective for annual periods beginning on or after 1 February 2015. The amendment addresses accounting for the employee contributions to a defined benefit plan. The objective of the amendment is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of salary. The Group does not have any employee benefit plans that fall within the scope of this amendment.
- Amendment to IFRS 11 *Joint arrangements: Accounting for Acquisitions of Interests in Joint Operations*. The amendment is effective for annual periods beginning on or after 1 January 2016. IFRS 11 addresses the accounting for interests in joint ventures and joint operations. The amendment adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business in accordance with IFRS and specifies the appropriate accounting treatment for such acquisitions. The Group had no transactions within the scope of this amendment.
- The IASB has issued the *Annual Improvements to IFRSs 2010 – 2012 Cycle*, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 February 2015. None of these had an effect on the Group's financial statements: IFRS 2 *Share-based Payment*, IFRS 3 *Business Combinations*, IFRS 8 *Operating Segments*, IFRS 13 *Fair value Measurement*, IAS 16 *Property, Plant and Equipment*, IAS 24 *Related Party Disclosures* and IAS 38 *Intangible Assets*.
- The IASB has issued the *Annual Improvements to IFRSs 2012 – 2014 Cycle*, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2016. None of these had an effect on the Group's financial statements: IFRS 5 *Non-current Assets Held for Sale and Discontinued Operation*, IFRS 7 *Financial Instruments: Disclosures*, IAS 19 *Employee Benefits* and IAS 34 *Interim Financial Reporting*.

Standards issued but not yet effective

The Group has not applied the following amendments to IAS, IFRS and its amendments that have been issued as of the date of authorisation of these financial statements for issue, but which will become effective for the reporting periods started from 1 January 2017 or later. At present the Management of the Group evaluates the impact or expected effect from adoption of these standards, but does not consider that these amendments will have significant effect to the Consolidated Financial Statements, except IFRS 9 "Financial Instruments", IFRS 15 "Revenue from Contracts with Customers" and IFRS 16 "Leases".

- IFRS 9 *Financial Instruments* (effective for financial years beginning on or after 1 January 2018). IFRS 9 replaces IAS 39 and introduces new requirements for classification and measurement, impairment and hedge accounting. The Group will adopt IFRS 9 for the financial year beginning as of 1 January 2018 and is currently assessing the impacts of its adoption on the Consolidated Financial Statements. Based on preliminary assessment made by the Management, implementation of the standard is expect to have limited or no impact because the Group has only the type of financial instruments for which classification and measurement is not expected to change, mainly trade receivables and payables, derivatives and bank loans taken. Considering that historically there have been very rare cases of impairments of receivables transferring from incurred credit loss model to expected credit loss model is considered to have limited or no impact to the Consolidated Financial Statements. More detailed assessment will be made in 2017.
- IFRS 15 *Revenue from Contracts with Customers* (effective for financial years beginning on or after 1 January 2018). IFRS 15 establishes a five–step model that will apply to revenue earned from a contract with a customer, regardless of the type of revenue transaction or the industry. Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgments and estimates. The Group plans to adopt the standard for the financial year beginning as of 1 January 2018 retrospectively, i.e. the comparable period will be presented in accordance with IFRS 15. Currently, it is expected that implementation of the standard will change the total amount of revenue to be recognised for customer contract, as well as timing of revenue recognition. Based on the preliminary analyses, the Group does not expect significant impacts on its Consolidated Financial Statements as the Group does not have many long–term contracts with multi–element arrangements. The Group's Management will make the detailed analysis on implementation of the standard in 2017.
- IFRS 15: *Revenue from Contracts with Customers (Clarifications)* (effective for annual periods beginning on or after 1 January 2018, once endorsed by the EU). The objective of the Clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 Revenue from Contracts with Customers, particularly the accounting of identifying performance obligations amending the wording of the "separately identifiable" principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The Clarifications also provide additional practical expedients for entities that either applies IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach. The Group's Management currently assesses the impact of the Clarifications on its Consolidated Financial Statements.
- IFRS 16 *Leases* (effective for financial years beginning on or after 1 January 2019, once endorsed by the EU). IFRS 16 replaces IAS 17 and specifies how to recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessor accounting is substantially unchanged. The Group will adopt IFRS 16 for the financial year beginning as of 1 January 2019, once adopted by the EU, and is currently assessing the impacts of its adoption on the Consolidated Financial Statements. Upon implementation of IFRS 16, among other considerations, the Group will make an assessment on the identified lease assets, non–cancellable lease terms (including the extension and termination options) and lease payments (including fixed and variable payments, termination option penalties etc.). Detailed analysis on implementation of IFRS 16 will be made in 2017 and 2018.
- Amendments to IAS 7 *Statement of Cash Flows: Disclosure Initiative* (effective for financial years beginning on or after 1 January 2017, once endorsed by the EU). The Amendments improve information provided to users of financial statements about an entity's financing activities. Entities are required to disclose changes in liabilities arising from financing activities, including both changes arising from cash flows and non–cash changes, for example, by providing reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. The implementation of the Amendments will not have any impact on the financial position or performance of the Group but may result in changes in disclosures.

- Amendments to IAS 12 *Income Taxes: Recognition of Deferred Tax Assets for Unrealized Losses* (effective for financial years beginning on or after 1 January 2017, once endorsed by the EU). The amendments clarify how to account for deferred tax assets for unrealized losses on debt instruments measured at fair value. The Group has not yet evaluated the impact of the implementation of the Amendments, but considers that they will not have a significant effect on the Consolidated Financial Statements.
- Amendments to IAS 40: *Transfers to Investment Property* (effective for financial years beginning on or after 1 January 2018, once endorsed by the EU). The Amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The Amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The Group has not yet evaluated the impact of the implementation of the Amendments, but does not consider that any of them will have a significant effect to the Consolidated Financial Statements.
- IFRIC *Interpretation 22: Foreign Currency Transactions and Advance Consideration* (effective for financial years beginning on or after 1 January 2018, once endorsed by the EU). The Interpretation clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation covers foreign currency transactions when an entity recognizes a non–monetary asset or a non–monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income. The Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non–monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The Group's Management has not yet evaluated the impact of the implementation of the IFRIC Interpretation, but does not consider that it will have a significant effect to the Consolidated Financial Statements.

The Management of the Group plans to adopt the above mentioned standards and amendments that were applicable for the Group on their effectiveness date.

Standards issued but not yet effective and not applicable for the Group

- Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (In December 2015 the IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting). The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business and partial gain or loss is recognised when a transaction involves assets that do not constitute a business. The implementation of these Amendments will not have any effect to the Consolidated Financial Statements, because the Group has not investments in associates or joint ventures.
- IFRS 2: *Classification and Measurement of Share based Payment Transactions (Amendments)* (effective for financial years beginning on or after 1 January 2018, once endorsed by the EU). The Amendments provide requirements on the accounting for the effects of vesting and non–vesting conditions on the measurement of cash–settled share–based payments, for share–based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share–based payment that changes the classification of the transaction from cash–settled to equity–settled.

The Management of the Group will not adopt these amendments because they will not be applicable for the Group.

Improvements to IFRSs

The IASB has issued the Annual Improvements to *IFRSs 2014 – 2016 Cycle*, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2017 for IFRS 12 *Disclosure of Interests in Other Entities* and on or after 1 January 2018 for IFRS 1 *First–time Adoption of International Financial Reporting Standards* and for IAS 28 *Investments in Associates and Joint Ventures*. Earlier application is permitted for IAS 28 *Investments in Associates and Joint Ventures*. These annual improvements have not yet been endorsed by the EU.

- IFRS 1 *First-time Adoption of International Financial Reporting Standards:* This improvement deletes the short–term exemptions regarding disclosures about financial instruments, employee benefits and investment entities, applicable for first–time adopters.
- IAS 28 *Investments in Associates and Joint Ventures:* The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment–by–investment basis, upon initial recognition.
- IFRS 12 *Disclosure of Interests in Other Entities:* The amendments clarify that the disclosure requirements in IFRS 12, other than those of summarized financial information for subsidiaries, joint ventures and associates, apply to an entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale, as held for distribution, or as discontinued operations in accordance with IFRS 5.

The adoption of these amendments may result in changes to accounting policies or disclosures but will not have any impact on the financial position or performance of the Group.

2.2. Consolidation

a) Subsidiaries

Subsidiaries, which are those entities where the Group has control over the financial and operating policies of the entity, financial reports are consolidated. 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 Consolidated Statement of Profit or Loss as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in business combination are measured initially at their fair values at the acquisition date.

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

b) Transactions with non–controlling interests and owners

The Group treats transactions with non–controlling interests as transactions with equity owners of the Group's Parent Company. Changes in a Parent's ownership interest in a subsidiary that do not result in the Parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). For purchases from non–controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in the Group's equity.

c) Associates

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20 % and 50 % of the voting rights. Currently the Group has not investments in associates (Note 15).

2.3. Disclosures of reportable segments

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

The Group allocates its operations into three main reportable segments – generation and trade, distribution and lease of transmission system assets. In addition Corporate Functions, that covers administration and other support services, are presented separately.

2.4. Foreign currency translation

a) Functional and presentation currency

Items included in the Consolidated Financial Statements are measured using the currency of the primary economic environment in which the Group's entity operates ("the functional currency"). The Consolidated Financial Statements have been prepared in 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 Consolidated Statement of Profit or Loss.

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.

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.

b) Greenhouse gas emission allowances

Emission rights for greenhouse gases (or allowances) are recognised at purchase cost. Allowances received from the Government free of charge are recognised at zero cost as off–balance sheet assets. Emission rights are recognised at cost when the Group is able to exercise the control. In those cases when the quantity of emitted greenhouse gases exceeds the quantity of allowances allocated by the state free of charge, the Group purchases additional allowances and carrying value of those allowances is determined on the basis of the market price of greenhouse gas emission allowances at the reporting period. Allowances are accounted for within 'Intangible assets' (see Note 13 b).

2.6. Property, plant and equipment

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

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 and the cost of an item can be measured reliably. All other repair and maintenance expenses are charged directly to the Consolidated Statement of Profit or Loss when the expenditure is incurred. Borrowing costs are capitalised proportionally to the part of the cost of fixed assets under construction over the period of construction. Effective part of the changes in the fair value of forward foreign currencies exchange contracts, the purpose of which is to hedge currency exchange risk on PPE items, are also capitalised and included in the Consolidated Statement of Profit or Loss along with the expenses of depreciation over the useful life of the asset or at the disposal of the asset.

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

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

Type of property, plant and equipment (PPE)	Estimated useful life, years
Buildings and facilities, including	
Hydropower plants, combined heat and power plants	15 – 100
Electricity transmission lines	30 – 50
Electricity distribution lines	30 – 40
Technology equipment and machinery, including (TEM)	
Hydropower plants	10 – 40
Combined heat and power plants	3 – 25
Transmission and distribution machinery and equipment	10 – 40
Other property, plant and equipment	2 – 25

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

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

All fixed assets under construction are stated at historical cost and comprised costs of construction of assets. The initial cost includes construction and installation costs and other direct costs related to construction of fixed assets. Assets under construction are not depreciated as long as the relevant assets are completed and ready for intended use, but are tested for impairment annually, either individually or at the cash-generating unit level. The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

2.7. Investment property

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

2.8. Revaluation of property, plant and equipment

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

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

a) Revalued buildings and facilities:
- Daugava hydropower plants' buildings and facilities,
- Buildings and facilities of transmission system,
- Buildings and facilities of distribution system;

b) Revalued technology equipment and machinery:
- Daugava hydropower plants' technology equipment and machinery,
- Technology equipment and machinery of transmission system,
- Technology equipment and machinery of distribution system;

c) Revalued other equipment:
- Other equipment of Daugava hydropower plants',
- Other equipment of transmission system,
- Other equipment of distribution system..

Increase in the carrying amount arising on revaluation net of deferred tax is credited to the 'Other comprehensive income' as "Property, plant and equipment revaluation reserve" in shareholders' equity. Decreases that offset previous increases of the same asset are charged in 'Other comprehensive income' and debited against the revaluation reserve directly in equity; all other decreases are charged to the current year's Consolidated Statement of Profit or Loss.

Any gross carrying amounts and accumulated depreciation at the date of revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after the revaluation equals its revalued amount.

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

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

2.9. Impairment of assets

Assets that are subject to depreciation or amortisation and land are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre–tax discount rate that reflects the current market expectations regarding the time value of money and the risks specific to the asset. For an asset that does not generate

largely independent cash inflows, the recoverable amount is determined for the cash–generating unit to which the asset belongs. Impairment losses are recognised in the Other Comprehensive Income within PPE revaluation reserve for the assets accounted at revalued amount and in the Consolidated 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 Consolidated Statement of Profit or Loss. Reversal of impairment loss for revalued assets is recognised in the Consolidated Statement of Profit or Loss to the extent that an impairment loss on the same revalued asset was previously recognised in the Consolidated Statement of Profit or Loss; the remaining reversals of impairment losses of revalued assets are recognised in Other Comprehensive Income.

2.10. Leases

a) The Group is the lessee

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

b) The Group is the lessor

Assets leased out under operating leases are recorded within investment property at historic cost less depreciation and accumulated impairment loss. Depreciation is calculated on a straight–line basis to write down each asset to its estimated residual value over estimated useful life. Rental income from operating lease and advance payments received from clients (less any incentives given to lessee) are recognised in the Consolidated Statement of Profit or Loss on a straight–line basis over the period of the lease (Note 14e).

2.11. Inventories

Inventories are stated at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Cost is determined using the weighted average method.

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

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

At the end of each reporting year the inventories are reviewed for any indications of obsolescence. In cases when obsolete or damaged inventories are identified allowances are recognised. During the reporting year at least each month revaluation of the inventories is performed with the purpose to identify obsolete and damaged inventories. Allowances for an impairment loss are recognised for those inventories.

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

a) Inventories (smaller spare parts or stocks) for machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 12 months are impaired in amount of 90%,
b) Inventories (smaller spare parts or stocks) for machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 6 months are impaired in amount of 45%,
c) Other inventories that haven't turned over during last 6 months are impaired in amount of 50%,
d) Allowances are not calculated for the inventory of hydropower plants and heating materials necessary to ensure uninterrupted operations of hydropower and combined heat and power plants, for natural gas and scraps.
e) All other inventories that haven't turned over during last 12 months are fully impaired.

2.12. Trade and other receivables

Trade receivables are recognised initially at fair value and subsequently carried at amortised cost. An allowance for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of repayment. Significant financial difficulties of the debtor, probabilities that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue) are considered as indicators that the trade receivable is impaired.

Trade receivables are classified in groups:

a) Electricity supply and electricity services receivables, including distribution system services,
b) Heating receivables,
c) Other services trade receivables (IT & telecommunication services, connection service fees, transmission system assets lease and other services).

An allowance for impairment of doubtful debts is calculated on the basis of trade receivables aging analysis according to estimates defined by the Group entities management and the Parent Company's management, which are revised at least once a year. Allowances for electricity supply and electricity services receivables are calculated for debts overdue 45 days, and, if the debt is overdue for more than 181 day, allowances are established at 100%. For other trade receivables allowances are calculated for debts overdue 31 day, and, if the date of payment is overdue for more than 91 day, allowances are established at 100% (see Note 17 a).

Individual impairment assessments are performed for the debtors:

a) In Latvia – if their debt balance exceeds EUR 700 thousand or they have a financial difficulties and debt repayment schedule has been individually agreed, allowances are calculated individually,

b) In Lithuania and Estonia – if their debt balance exceeds EUR 200 thousand or they have a financial difficulties and debt repayment schedule has been individually agreed, allowances are calculated individually,

c) If debtor has been announced as insolvent, allowances are established at 100%.

The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the Consolidated Statement of Profit or Loss within 'Other operating expenses' as selling expenses and customer service costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against selling and customer services costs in the Consolidated Statement of Profit or Loss.

2.13. Cash and cash equivalents

Cash and cash equivalents include cash balances on bank accounts, demand deposits at bank and other short–term deposits with original maturities of three months or less. Cash and cash equivalents also are consisting of restricted cash, that are excluded from cash and cash equivalents in the Consolidated Statement of Cash Flows (see Note 18).

2.14. Dividend distribution

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

2.15. Pensions and employment benefits

a) Pension obligations

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

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

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

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

The liability recognised in the Consolidated Statement of Financial Position in respect of post–employment benefit plan is the present value of the defined benefit obligation at the end of the reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds. The Group uses projected unit credit method to establish its present value of fixed benefit obligation and related present and previous employment expenses. According to this method it has been stated that each period of work makes benefit obligation extra unit and the sum of those units comprises total Group's obligations of post–employment benefits. The Group uses objective and mutually compatible actuarial assumptions on variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts).

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

2.16. Income tax

a) Corporate income tax

Latvia and Lithuania

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 and 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 tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity. However, the deferred income tax is not accounted if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred

income tax is determined using tax rates (and laws) that have been enacted by the end of reporting period and are expected to apply when the related deferred income tax asset is 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.

Tax incentives for new technological equipment are not considered when calculating deferred income tax.

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

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

2.17. Subsidised Energy Tax

In order to limit the increase of the mandatory procurement PSO fee for electricity consumers in Latvia, a Subsidised Energy Tax (SET) has been introduced for a four–year period as of 1 January 2014, which applies to state support for generators of subsidised electricity. The SET applies both to income from electricity supplied under the mandatory procurement process as well as to mandatory procurement capacity payments for installed capacity at cogeneration plants. The tax is differentiated according to the type of energy sources used. For cogeneration plants that use fossil energy sources a 15% tax rate applies to the received support (taxable income) amount, 10% tax rate – plants that use renewable energy sources, 5% – cogeneration plants that use gas, biogas and biomass energy sources and installed electrical capacity in cogeneration plants is below 4 MW. Payers of SET are all producers of subsidised electricity. Revenues from SET are used as a funding for the grant included in the State Budget programme "Electricity user support" to limit the increase of mandatory procurement PSO fee. SET applied for the subsidised electricity produced by the Group are recognised in the Consolidated Statement of Profit or Loss as 'Other operating expenses' (Note 10) at gross amount, but SET for subsidised electricity produced by other producers – as 'Other financial current payables' in the Consolidated Statement of Financial Position (Note 24).

2.18. Borrowing costs

General and specific borrowing costs directly attributable to the acquisition or construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

2.19. Provisions

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

Provisions are presented in the Consolidated Statement of Financial Position at the best estimate of the expenditure required to settle the present obligation at the end of reporting period. Provisions are used only for expenditures for which the provisions were originally 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 past environmental policies have demonstrated that the Group has a constructive present obligation to liquidate this environmental damage. Experts' opinions and prior experience in performing environmental work are used to set up the provisions (see Note 22 b).

2.20. Grants

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. A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled. Government grants are received with the purpose to reduce the increase of mandatory procurement PSO fee partly compensating the increase of mandatory procurement costs.

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 Consolidated Statement of Profit or Loss on a straight–line basis over the expected lives of the related assets.

Financing provided by European Union funds

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

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

2.21. Financial instruments – initial recognition, subsequent measurement and de–recognition

a) Financial assets

I) Initial recognition and measurement

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held–to–maturity investments, available–for–sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss.

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

II) Subsequent measurement

Financial assets at fair value through profit or loss

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

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

Loans and receivables

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

Held–to–maturity investments

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

The Group follows the IAS 39 guidance on classifying non–derivative financial assets with fixed or determinable payments and fixed maturity as held–to–maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity (see Note 4 g).

If the Group fails to keep these investments to maturity other than for specific circumstances explained in IAS 39, it will be required to reclassify the whole class as available–for–sale. Therefore the investments would be measured at fair value not at amortised cost.

Purchases and sales of financial assets held–to–maturity are recognised on trade date – the date on which the Group commits purchase of the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired. Held–to–maturity financial assets are carried at amortised cost using the effective interest rate method, net of accumulated impairment losses. Gains and losses arising from changes in the amortised value of the financial instruments are included in the Consolidated Statement of Profit or Loss in the period in which they arise.

Available–for–sale financial assets

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

III) De–recognition

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

1) the rights to receive cash flows from the asset have expired,
2) the Group 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 has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

b) Financial liabilities

I) Initial recognition and measurement

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective

hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

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

The Group's financial liabilities include trade and other payables, bank overdrafts, loans and borrowings, financial guarantee contracts, and derivative financial instruments.

II) Subsequent measurement

Financial liabilities at fair value through profit or loss

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

Loans and borrowings

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

Trade and other payables

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

III) De–recognition

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

2.22. Derivative financial instruments and hedging activities

The Group uses derivatives such as interest rate swaps and electricity forward and future contracts to hedge risks associated with the interest rate and purchase price fluctuations.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re–measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate (see point 2.23.).

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

The Group designates certain derivatives as hedges of a particular risk associated with specific variable rate borrowings (cash flow hedge). Other derivatives are accounted for at fair value through profit or loss.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an on–going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

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

a) Cash flow hedge

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

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

The gain or loss relating to the ineffective portion of interest rate swaps hedging variable rate borrowings is recognised in the Consolidated Statement of Profit or Loss.

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

b) Fair value changes of derivatives through profit and loss

Changes in the fair value of derivatives at fair value through profit or loss, ineffective part of changes in the fair value of hedging derivatives and amounts accumulated in equity that are recycled to the Consolidated Statement of Profit or Loss, are classified according to the purpose of the derivatives – gains/losses from electricity forward and future contracts are recognised within 'Raw materials and consumables used', while gains / losses from interest rate swap agreements and forward foreign currencies exchange contracts are recognised within 'Finance costs' or 'Finance income'.

2.23. Fair value measurement

The Group measures financial instruments, such as, derivatives, at fair value at each balance sheet date. Such non–financial assets as investment properties are measured at amortised cost, but some items of property, plant and equipment at revalued amounts. Also fair values of financial instruments measured at amortised cost are disclosed in Note 21 d.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair values are estimated based on market prices and discounted cash flow models as appropriate (see Note 4 c).

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of reporting period. The quoted market prices used for financial assets held by the Group is the current bid prices.

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

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments.

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

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

2.24. Revenue recognition

Revenue comprises the value of goods sold and services rendered in the ordinary course of the Group's activities. The Latvian regulatory authority (Public Utilities Commission) determines mandatory procurement public service obligation (PSO) fees, tariffs for electricity distribution system services and heat. Revenue is measured at the fair value of the consideration received or receivable, net of value–added tax, estimated returns, rebates and discounts. Revenue is recognised as follows:

a) Electricity sales

The Group records electricity sales to residential customers on the basis of reported meter readings. Where relevant, this includes an estimate of the electricity supplied between the date of the last meter reading and the year–end. Electricity sales to corporate and private customers are recognised on the basis of issued invoices according to meter readings of customers considering contractual prices included in electricity trade agreements. Revenues from trade of electricity in Nord Pool power exchange are based on the calculated market prices.

b) Heat sales

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

c) Connection fees

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

d) Sales of distribution services

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

e) Lease of transmission system assets

Revenues from lease of transmission system assets are recognised on the basis of invoices which are prepared for transmission system operator accordingly to lease agreement. Lease services are rendered in the ordinary course of the Group's activities.

f) Sales of IT & telecommunication services

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

g) Interest income

Interest income is recognised using the effective interest method. Interest income is recorded in the Consolidated Statement of Profit or Loss as "Finance income".

h) Dividend income

Revenue is recognised when the Group's right to receive the payment is established, which is generally when shareholders approve the dividend.

i) Mandatory procurement PSO fees

Revenue from mandatory procurement PSO fees is recognised as assets or liabilities in the Consolidated Statement of Financial Position by applying agent accounting principle as subsidiary Enerģijas publiskais tirgotājs AS (hereinafter – the entity) is acting in management of the mandatory procurement process as an agent. Features that indicate that an entity is acting as an agent include:

- The entity does not have the primary responsibility for including the mandatory procurement PSO fee as a part of the services or products ordered or purchased by customers;
- The entity has no latitude in establishing prices, either directly or indirectly,
- The entity does not bear the customer's credit risk for the amount receivable from the customer.

By applying agent principle revenue from sale of electricity (generated by subsidised electricity producers) in Nord Pool power exchange by market price, received mandatory procurement PSO fee, received government grant for compensating the increase of mandatory procurement costs, costs of purchased electricity under the mandatory procurement from electricity producers who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants (over 4 MW), are recognised in net amount in assets as unsettled revenue on mandatory procurement PSO fee or in net amount in liabilities. Fee from mandatory procurement administration or agent fee is recognised in the Consolidated Statement of Profit or Loss in 'Other revenue' (Note 6).

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 are associates, Shareholder of the Parent Company who could control or who has significant influence over the Group's entities in accepting operating business decisions, members of Management boards and Supervisory boards of the Group's entities, members of Supervisory body – Audit Committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence. As the shares of Latvenergo AS belong 100% to the Republic of Latvia, the related parties also include entities under the control or significant influence of the state (Note 25).

2.26. Non–current assets held for sale

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

2.27. Share capital

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

2.28. Events after the reporting period

Events after the reporting period that provide additional information about the Group's 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.

3. Financial Risk Management

3.1. Financial risk factors

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

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

Financial assets by categories:

	Notes	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through the profit or loss	Held–to–maturity assets
		EUR'000	EUR'000	EUR'000	EUR'000
Financial assets as of 31 December 2016					
Trade receivables, net	17a	122,832	–	–	–
Other non–current receivables		986	–	–	–
Accrued income and other financial current receivables	17b	145,953	–	–	–
Derivative financial instruments	21c, l	–	2,154	3,980	–
Held–to–maturity financial assets	21a	–	–	–	20,554
Cash and cash equivalents	18	183,980	–	–	–
		453,751	**2,154**	**3,980**	**20,554**
Financial assets as of 31 December 2015					
Trade receivables, net	17a	112,163	–	–	–
Other non–current receivables		1,712	–	–	–
Accrued income and other financial current receivables	17b	144,182	–	–	–
Held–to–maturity financial assets	21a	–	–	–	28,468
Cash and cash equivalents	18	104,543	–	–	–
		362,600	**–**	**–**	**28,468**

Financial liabilities by categories:

	Notes	Derivatives used for hedging	Other financial liabilities at amortised cost	Financial liabilities at fair value through the profit or loss
		EUR'000	EUR'000	EUR'000
Financial liabilities as of 31 December 2016				
Borrowings	21b	–	791,566	–
Derivative financial instruments	21c, l	11,563	–	23
Trade and other payables	24	–	88,555	–
		11,563	**880,121**	**23**
Financial liabilities as of 31 December 2015				
Borrowings	21b	–	797,483	–
Derivative financial instruments	21c, l	12,256	–	3,318
Trade and other payables	24	–	80,948	–
		12,256	**878,431**	**3,318**

a) Market risk

I) Foreign currencies exchange risk

The introduction of euro in Latvia as of 1 January 2014 prevented the euro currency risk, which primarily was arising from settlements in foreign currencies for borrowings, capital expenditures and imported electricity. As of 31 December 2016 the Group had borrowings denominated only in euros (Note 21 b).

Management has set up a Financial Risk Management Policy inter alia to manage the Group's foreign currencies exchange risk against functional currency. To manage the Group's foreign currencies exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy is to use forward contracts. Foreign currencies exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency that is not the Group's 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 2016 the Group had no capital expenditure project which expected transactions would create significant currency risk.

In 2016 the Parent Company had no certain investments, which were exposed to foreign currency risks. The introduction of euro in Lithuania as of 1 January 2015 prevented the euro currency risk arising from Parent Company's investments in subsidiary in Lithuania.

II) Cash flow and fair value interest rate risk

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

During 2016, if euro interest rates had been 50 basis points higher or lower with all other variables held constant, the Group's income from the cash reserves held at bank for the year would have been EUR 906 thousand higher or lower (2015: EUR 638 thousand).

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

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

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

To hedge cash flow interest rate risk the Group has entered into rate swap agreements with total notional amount of EUR 174.2 million (2015: EUR 221.5 million) (Note 21 c, II). 62 % of the total Group's borrowings as of 31 December 2016 (31/12/2015: 55 %) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration was 2.1 years (2015: 2.4 years).

During 2016, if interest rates on euro denominated borrowings at floating base interest rate (after considering hedging effect) had been 50 basis points higher with all other variables held constant, the Group's profit for the year net of taxes would have been EUR 1,465 thousand lower (2015: EUR 1,929 thousand), while if the rates had been 50 basis points lower – profit for the year net of taxes would have been EUR 974 thousand higher (2015: EUR 1,894 thousand).

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

As of 31 December 2016, 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 3,238 thousand higher (31/12/2015: EUR 4,126 thousand), which would have been attributable to the Consolidated Statement of Other Comprehensive Income as hedge accounting item, while if the rates had been 50 basis points lower, fair value of interest rate swaps would have been EUR 3,346 thousand lower (31/12/2015: EUR 4,269 thousand), which would have been attributable to the Consolidated Statement of Other Comprehensive Income as hedge accounting item.

III) Price risk

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

The most significant price risk is related to purchase of electricity. To hedge the risk related to changes in the price of electricity the Parent Company during 2016 has purchased electricity forward and future contracts (Note 21 c, III).

b) Credit risk

Credit risk is managed at the Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, outstanding receivables. Credit risk exposure in connection with trade receivables is limited due to broad range of the Group's customers. The Group has no significant concentration of credit risk with any single counterparty or group of counterparties having similar characteristics. Impairment loss has been deducted from gross accounts receivable (Note 17).

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 18), trade and other receivables (Note 17), derivative financial instruments (Note 21 c) and held–to–maturity financial assets (Note 21 a).

Assessment of maximum possible exposure to credit risk

	Notes	31/12/2016	31/12/2015
		EUR'000	EUR'000
Trade receivables	17a	122,832	112,163
Accrued income	17b	1,024	1,148
Other non–current financial receivables		986	1,712
Other current financial receivables	17b	2,797	1,974
Cash and cash equivalents	18	183,980	104,543
Derivative financial instruments	21c	6,134	–
Held–to–maturity financial assets	21a	20,554	28,468
		338,307	**250,008**

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

For estimation of the credit quality of fully performing trade receivables two rating categories are used:

- Customers with no overdue receivables,
- Customers with overdue receivables.

Credit limits are regularly monitored.

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

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

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Investment level credit rating*	175,911	99,069
No or non–investment level credit rating	8,069	5,474
	183,980	**104,543**

* investment level credit rating assigned for the parent companies of Baltic banks

No credit limits were exceeded during the reporting period, and the Group management does not expect any losses due to occurrence of credit risk.

c) Liquidity risk

The Group's policy of liquidity risk management is to maintain sufficient amount of cash and cash equivalents, the availability of long and short term funding through an adequate amount of committed credit facilities to meet commitments according to the Group's strategic plans as well as to compensate the fluctuations in the cash flows due to occurrence of variety of financial risks.

The Group entities' management is monitoring rolling forecasts of the Group's liquidity reserve, which comprises of undrawn borrowing facilities (Note 21 b), and cash and cash equivalents (Note 18).

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

Liquidity analysis (contractual undiscounted cash flows)

	Less than 1 year	From 1 to 2 years	From 3 to 5 years	Over 5 years	TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
At 31 December 2016					
Borrowings from banks	88,142	109,663	279,637	135,335	**612,777**
Issued debt securities (bonds)	74,915	2,880	42,389	102,577	**222,761**
Derivative financial instruments	3,737	2,894	4,594	779	**12,004**
Financial liabilities (Note 24)*	88,555	–	–	–	**88,555**
	255,349	**115,437**	**326,620**	**238,691**	**936,097**
At 31 December 2015					
Borrowings from banks	88,727	81,556	307,390	175,820	**653,493**
Issued debt securities (bonds)	4,365	74,519	41,864	77,751	**198,499**
Derivative financial instruments	17,320	4,950	5,727	1,683	**29,680**
Financial liabilities (Note 24)*	80,948	–	–	–	**80,948**
	191,360	**161,025**	**354,981**	**255,254**	**962,620**

* excluding advances received, tax related liabilities and other non–current or current non–financial payables

3.2. Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern as well as to ensure necessary financing for investment program and to avoid breaches of covenants, which are linked to capital structure and are stipulated in the majority of loan agreements.

In order to maintain or adjust the capital structure, the Group may evaluate the amount and timing of raising new debt due to investment programs or initiate new investments in the share capital by

shareholder. Also asset revaluation directly influences the capital structure. To comply with loan covenants, the Group monitors capital on the basis of the capital ratio.

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

The capital ratio figures were as follows:

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Total equity	2,418,713	2,096,702
Total assets	3,901,231	3,517,372
Capital ratio	**62%**	**60%**

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 makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

a) Estimates concerning property, plant and equipment

I) Useful lives of property, plant and equipment

The Group makes estimates concerning the expected useful lives and residual values of property, plant and equipment. These are reviewed at the end of each reporting period and are based on the past experience as well as industry practice. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. As of 31 December 2016, the net book amount of property, plant and equipment of the Group totalled EUR 3,356 million (31/12/2015: EUR 3,076 million), and the depreciation charge for the reporting period was EUR 183.5 million (2015: EUR 179.1 million) (Note 14 a). If depreciation rates were changed by 10% , the annual depreciation charge would change by EUR 18.4 million (2015: EUR 17.9 million).

II) Recoverable amount of property, plant and equipment

When the events and circumstances indicate a potential impairment, the Group performs impairment tests for items of property, plant and equipment. According to these tests assets are written down to their recoverable amounts, if necessary. When carrying out impairment tests management uses various estimates for the cash flows arising from the use of the assets, sales, maintenance, and repairs of the assets, as well as in respect of the inflation and growth rates. The estimates are based on the forecasts of the general economic environment, consumption and the sales price of electricity. If the situation changes in the future, either additional impairment could be recognised, or the previously recognised impairment could be partially or fully reversed. Such factors as high maintenance and reconstruction costs, low load of several auxiliaries, comparatively substantial maintenance expense, limited facilities to sell property, plant and equipment in the market and other essential factors have an impact of decreasing of the recoverable amounts. If discount rate used for the purposes of impairment charge calculation would be lower or higher by one per cent point the current year's impairment charge on technological equipment would be by EUR 23.2 million higher or lower (2015: EUR 29.0 million). Impairment charges recognised during the current reporting year are disclosed in Note 14 d.

III) Revaluation

External, certified valuers have performed revaluation for part of the Group's property, plant and equipment by applying the depreciated replacement cost model. Valuation has been performed according to international standards on property valuation and *IAS 36, Impairment of assets*, based on current use of property, plant and equipment that is estimated as the highest and best use of these assets. As a result of valuation, depreciated replacement cost was determined for each asset. Depreciated replacement cost is calculated as property, plant and equipment instant market value at its current use, increased by the replacement cost of existing buildings, machinery and equipment as well as refinements on the said property, plant and equipment decreased by the depreciation expenses and impairment losses. In 2016 the Group finished revaluation process for property, plant and equipment of distribution system (electrical lines) that was started in 2015 with revaluation of categories of distribution system technology equipment and machinery. Amounts of revalued electrical lines had been determined as of 1 April 2016 (amounts of revalued categories of distribution system technology equipment and machinery – as of 1 January 2015). In 2016 the Group also revalued transmission system assets and amounts of revalued assets had been determined as of 1 April 2016. For property, plant and equipment of Daugava hydropower plants last revaluation was performed as of 1 January 2012 and next revaluation is planned in 2017. For detailed revaluation results see Note 14 c.

b) Recoverable amount of trade receivables

The estimated collectability of accounts receivable is assessed on the basis of trade receivables aging analysis according to estimates defined by the Group entities management and the Parent Company's management. In case individual assessment is not possible due to the large number of individual balances, receivables are classified into groups of similar credit risk characteristics and are collectively assessed for impairment, using historical loss experience. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The circumstances indicating an impairment loss may include initiated insolvency of the debtor and inability to meet payment terms (point 2.12.). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss incurred (Note 17).

c) Fair value estimation for financial instruments

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

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2),
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

As of 31 December 2016	Notes	Level 1	Level 2	Level 3	Total balance
		EUR'000	EUR'000	EUR'000	EUR'000
Assets					
Financial assets at fair value through profit or loss:					
– Electricity trading derivatives	21c, III	–	3,980	–	3,980
Electricity trading derivatives used for hedging	21c, III	–	2,154	–	2,154
TOTAL assets		**–**	**6,134**	**–**	**6,134**
Liabilities					
Financial liabilities at fair value through profit or loss:					
– Electricity trading derivatives	21c, III	–	23	–	23
Interest rate derivatives used for hedging	21c, II	–	11,563	–	11,563
TOTAL liabilities		**–**	**11,586**	**–**	**11,586**

As of 31 December 2015	Notes	Level 1	Level 2	Level 3	Total balance
		EUR'000	EUR'000	EUR'000	EUR'000
Liabilities					
Financial liabilities at fair value through profit or loss:					
– Electricity trading derivatives	21c, III	–	2,558	–	2,558
– Interest rate derivatives	21c, II	–	760	–	760
Interest rate derivatives used for hedging	21c, II	–	12,256	–	12,256
TOTAL liabilities		**–**	**15,574**	**–**	**15,574**

d) Recognition of connection service fees

Connection and other service fees are recognised as income over the estimated customer relationship period, which is 20 years (see Note 23). The estimated customer relationship period is based on the Company's Management estimate. Income from connection and other service fees is deferred as an ongoing service is identified as part of the agreement with customers. Thus period over which revenue is recognised is based on Company's Management estimate and is 20 years. In 2016 the Group's received connection fees totalled EUR 13.6 million (2015: EUR 16.2 million), from which to the Consolidated Statement of Profit or Loss credited EUR 12.3 million (2015: EUR 11.6 million), see Note 23.

If the estimated customer relationship period is reduced/increased by 25%, the annual income from connection service fees would increase/decrease by EUR 3.1 million (2015: EUR 2.9 million).

e) Recognition and revaluation of provisions

As of 31 December 2016, the Group had set up provisions for environmental protection and post–employment benefits totalling EUR 18.6 million (31/12/2015: EUR 16.0 million) (Note 22). The amount and timing of the settlement of these obligations is uncertain. A number of assumptions and estimates have been used to determine the present value of provisions, including the amount of future expenditure, inflation rates, and the timing of settlement of the expenditure. The actual expenditure may also differ from the provisions recognised as a result of possible changes in legislative norms, technology available in the future to restore environmental damages, and expenditure covered by third parties. For revaluation of provisions for post–employment obligations probabilities of retirement in different employees' aging groups as well as variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts) have been estimated. The probabilities and other factors are determined on the basis of previous experience.

f) Evaluation of effectiveness of hedging instruments

The Group has concluded significant number of forward and future contracts and swap agreements to hedge the risk of the changes in prices of electricity and interest rate fluctuations to which cash flow hedge risk accounting is applied and the gains and losses from changes in the fair value of the effective hedging instruments and items secured against risk are included in respective equity reserve. The evaluation of the effectiveness of the hedging is based on Management's estimates with regard to future purchase transactions of electricity and signed variable interest loan agreements. When hedging instruments turn out to be ineffective, gains/losses from the changes in the fair value are recognised in the Consolidated Statement of Profit or Loss (Note 21 c).

g) Held–to–maturity financial assets

The management of the Group applies judgement in assessing whether financial assets can be categorised as held–to–maturity at initial recognition, in particular (a) its intention and ability to hold the assets to maturity and (b) whether the assets are quoted in an active market. If the Group fails to keep these investments to maturity other than in certain specific circumstances – for example, selling an insignificant amount or settle a position close to maturity – it will be required to reclassify the entire category as available–for–sale. The investments would therefore be measured at fair value rather than amortised cost. For the estimated fair value of investment securities held–to–maturity as of 31 December 2016 refer to Note 21a.

Evidence of an active market exists if quoted prices are readily and regularly available from an exchange, dealer, broker, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

h) Financial investments

The Group has applied judgement in determining that it has a financial investment with 48.15% interest held in the company Pirmais Slēgtais Pensiju Fonds AS that manages closed pension plan in Latvia as investment that has been valued at cost without applying equity method. The Group is only a nominal shareholder as all risks and benefits arising from management of pension plan will accrue to the Group's employees who are members of the pension plan and the Group does not have

existing rights that give it the current ability to direct the relevant activities of the investee. Therefore this investment has been determined as financial investment in Pirmais Slēgtais Pensiju Fonds AS and not as investment in associate.

i) Use of agent principle

The Group has applied significant judgement for use of agent principle for recognition of net revenue on mandatory procurement PSO fee (difference between revenue from sale of electricity in Nord Pool power exchange by market price, received mandatory procurement PSO fee, received government grant for compensating the increase of mandatory procurement costs and costs of purchased electricity under the mandatory procurement from electricity generators who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants). Since 1 April 2014 net revenue from mandatory procurement PSO fees is not recognised in the Consolidated Statement of Profit or Loss, but as assets or liabilities in the Consolidated Statement of Financial Position by applying agent accounting principle as subsidiary Enerģijas publiskais tirgotājs AS is acting in management of the mandatory procurement process as an agent because it does not have exposure to the significant risks and rewards associated with mandatory procurement PSO fees according to IAS 18. PSO fee by its nature is considered as part of service that is compensated to administrator of the mandatory procurement process by electricity suppliers and distribution system operators.

5. Operating Segment Information

Operating segments

For segment reporting purposes, the division into operating segments is based on the Group'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. In addition, Corporate Functions, that cover administration and other support services, are presented separately.

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 supply (including electricity wholesale), in the Baltics carried out by Latvenergo AS, Elektrum Eesti OÜ and Elektrum Lietuva UAB, as well as administration of the mandatory procurement process provided by Enerģijas publiskais tirgotājs AS.

The operations of the distribution operating segment relates to the provision of electricity distribution services in Latvia and is managed by the subsidiary Sadales tīkls AS (the largest distribution system operator in Latvia) and by Latvenergo AS – the owner of real estate assets related to distribution system assets.

The operations of the lease of transmission system assets operating segment is managed both by Latvijas elektriskie tīkli AS – the owner of transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points), which provides financing of investments in these assets, and Latvenergo AS – the owner of real estate assets related to the transmission system assets, providing the lease of these assets to the transmission system operator Augstsprieguma tīkls AS.

The following table presents revenue, profit information and segment assets and liabilities of the Group's operating segments. Inter–segment revenue is eliminated on consolidation.

	Generation and trade	Distribution	Lease of transmission system assets	Corporate Functions	TOTAL segments	Adjustments and eliminations	Consolidated
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Year ended 31 December 2016							
Revenue							
External customers	570,828	306,700	45,879	8,212	**931,619**	–	**931,619**
Inter–segment	13,310	1,712	2,538	46,330	**63,890**	(63,890)	**–**
Total revenue	**584,138**	**308,412**	**48,417**	**54,542**	**995,509**	**(63,890)**	**931,619**
Results							
Amortisation, depreciation and property, plant and equipment impairment loss	(86,308)	(98,317)	(36,416)	(11,585)	**(232,626)**	–	**(232,626)**
Segment profit	**138,185**	**7,154**	**10,642**	**4,792**	**160,773**	**(11,828)**	**148,945**
Segment assets at the end of the year	**1,557,032**	**1,629,107**	**448,707**	**88,431**	**3,723,277**	**177,954**	**3,901,231**
Segment liabilities at the end of the year	**63,404**	**190,371**	**46,218**	**7,380**	**307,373**	**1,175,145**	**1,482,518**
Capital expenditure	59,964	106,436	25,513	12,664	**204,577**	(3,900)	**200,677**
Year ended 31 December 2015							
Revenue							
External customers	593,937	282,752	44,151	8,288	**929,128**	–	**929,128**
Inter–segment	16,173	1,599	2,459	46,198	**66,429**	(66,429)	**–**
Total revenue	**610,110**	**284,351**	**46,610**	**54,486**	**995,557**	**(66,429)**	**929,128**
Results							
Amortisation, depreciation and property, plant and equipment impairment loss	(76,709)	(85,865)	(24,206)	(12,047)	**(198,827)**	–	**(198,827)**
Segment profit / (loss)	**87,221**	**(4,177)**	**20,750**	**4,394**	**108,188**	**(15,653)**	**92,535**
Segment assets at the end of the year	**1,555,399**	**1,336,611**	**432,030**	**89,350**	**3,413,390**	**103,982**	**3,517,372**
Segment liabilities at the end of the year	**63,880**	**179,257**	**45,818**	**6,685**	**295,640**	**1,125,030**	**1,420,670**
Capital expenditure	57,305	101,997	17,453	14,423	**191,178**	(717)	**190,461**

Adjustments and eliminations

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

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

Reconciliation of profit

	Notes	2016	2015
		EUR'000	EUR'000
Segment profit		**160,773**	**108,188**
Finance income	11a	2,328	2,926
Finance costs	11b	(14,156)	(18,579)
Profit before tax		**148,945**	**92,535**

Reconciliation of assets

	Notes	31/12/2016	31/12/2015
		EUR'000	EUR'000
Segment operating assets		**3,723,277**	**3,413,390**
Connection usage rights		(32,791)	(30,852)
Non–current financial investments	15	41	41
Held–to–maturity financial assets	21a	20,554	28,468
Derivative financial instruments	21c	6,134	–
Other assets and assets held for sale		36	1,782
Cash and cash equivalents	18	183,980	104,543
Group operating assets		**3,901,231**	**3,517,372**

Reconciliation of liabilities

	Notes	31/12/2016	31/12/2015
		EUR'000	EUR'000
Segment operating liabilities		**307,373**	**295,640**
Deferred income tax liabilities	12	315,759	273,987
Current corporate income tax liabilities		17,718	4,007
Borrowings	21b	791,566	797,483
Derivative financial instruments	21c	11,586	15,574
Trade and other payables		38,516	33,979
Group operating liabilities		**1,482,518**	**1,420,670**

Geographical information on segments

	2016	2015
	EUR'000	EUR'000
Revenue from external customers		
Baltics	897,449	914,927
Scandinavian countries	34,170	14,201
TOTAL revenue	**931,619**	**929,128**

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

Revenue from major customer in 2016 amounted to EUR 79,467 thousand (2015: EUR 83,137 thousand) arising from sales by the generation and supply segment.

6. Revenue

	2016	2015
	EUR'000	EUR'000
Electricity supply and electricity services	483,960	495,010
Distribution system services	290,084	267,189
Heat sales	82,709	92,525
Lease of transmission system assets	45,371	43,630
Other revenue	29,495	30,774
TOTAL revenue	**931,619**	**929,128**

7. Other Income

	2016	2015
	EUR'000	EUR'000
Net gain from sale of assets held for sale and PPE	635	291
Net gain from sale of current assets and other income	6,021	4,589
TOTAL other income	**6,656**	**4,880**

8. Raw Materials And Consumables Used

	2016	2015
	EUR'000	EUR'000
Electricity:		
Purchased electricity	148,448	196,602
Fair value loss / (income) on electricity forwards and futures (Note 21c, III)	(6,515)	446
Electricity transmission services costs	72,584	73,849
	214,517	**270,897**
Energy resources cost	137,720	164,397
Raw materials, spare parts and maintenance costs	33,571	35,150
TOTAL raw materials and consumables used	**385,808**	**470,444**

Decrease was impacted by lower average natural gas and electricity spot prices (see Management report).

9. Personnel Expenses

	2016	2015
	EUR'000	EUR'000
Wages and salaries	71,848	70,437
Expenditure of employment termination	1,522	2,031
Pension costs – defined contribution plan	2,301	2,599
State social insurance contributions and other benefits defined in the Collective Agreement	17,887	17,374
Life insurance costs	2,670	2,286
Capitalised personnel expenses	(209)	(118)
TOTAL personnel expenses, including remuneration to the management	**96,019**	**94,609**
Including remuneration to the management:		
Wages and salaries	1,531	1,509
Expenditure of employment termination	22	171
Pension costs – defined contribution plan	36	45
Life insurance costs	22	34
State social insurance contributions and other benefits defined in the Collective Agreement	367	235
TOTAL remuneration to the management*	**1,978**	**1,994**

	2016	2015
Number of employees at the end of the year	4,131	4,177
Average number of employees during the year	4,176	4,162

* remuneration to the management includes remuneration to the members of the Management Boards, Supervisory Board of the Parent Company and Supervisory body of the Group entities

10. Other Operating Expenses

	2016	2015
	EUR'000	EUR'000
Selling expenses and customer services	7,524	7,873
Information technology maintenance	4,974	4,428
Transportation expenses	6,125	6,120
Environment protection and work safety	4,507	4,431
Real estate maintenance and utilities expenses	6,226	5,760
Telecommunications services	1,974	2,009
Electric power transit and capacity services	294	272
Real estate tax	1,091	1,064
Public utilities regulation fee	1,486	1,172
Subsidised energy tax (SET)*	14,847	15,284
Audit fee	89	88
Other expenses	13,912	13,439
TOTAL other operating expenses	**63,049**	**61,940**

* subsidised energy tax according to the "Subsidised energy tax Law" has been introduced for a four–year period as of 1 January 2014 and applies to state support for generators of subsidised electricity (Note 2.17.)

11. Finance Income And Costs

a) Finance income

	2016	2015
	EUR'000	EUR'000
Interest income on bank accounts and deposits	45	33
Interest income from held–to–maturity financial assets	1,414	1,545
Fair value gain on interest rate swaps (Note 21c, II)	760	1,348
Net gain on issued debt securities (bonds)	83	–
Net gain from currency exchange rate fluctuations	26	–
TOTAL finance income	**2,328**	**2,926**

b) Finance costs

	2016	2015
	EUR'000	EUR'000
Interest expense on borrowings	5,185	8,013
Interest expense on issued debt securities (bonds)	4,701	3,748
Interest expense on interest rate swaps	4,922	6,932
Net losses on redemption of held–to–maturity financial assets	58	60
Net losses on issued debt securities (bonds)	–	9
Capitalised borrowing costs (Note 14a)	(780)	(268)
Net losses on currency exchange rate fluctuations	–	27
Other finance costs	70	58
TOTAL finance costs	**14,156**	**18,579**

12. Income Tax

	2016	2015
	EUR'000	EUR'000
Current tax	23,498	5,011
Deferred tax	(5,146)	2,485
TOTAL income tax	**18,352**	**7,496**

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

	2016	2015
	EUR'000	EUR'000
Profit before tax	**148,945**	**92,535**
Corporate income tax at the statutory rate 15 %	22,342	13,880
Expense non–deductible for tax purpose	266	253
Impairment of receivables	417	640
Previous years losses that reduce the tax base covered by profit of the year	(1,059)	1,276
Deferred tax on re–measurement of defined post–employment benefit plan in subsidiaries	(285)	(174)
Deferred tax on disposal of property, plant and equipment revaluation reserve	(857)	–
Real estate tax	–	(160)
Tax discounts on donations	(27)	(141)
Other expenses	(53)	(76)
Tax incentives for new technological equipment*	(2,392)	(8,002)
TOTAL income tax:	**18,352**	**7,496**

* increase in the amount of depreciation of PPE applying coefficients for additions of PPE and calculation of depreciation for tax purposes as defined in article No. 13 of the Law of Corporate Income Tax of the Republic of Latvia

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

The movement on the deferred income tax accounts

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**273,987**	**268,026**
(Income) credited / expense charged to the Consolidated Statement of Profit or Loss	(5,146)	2,485
Attributable to re–measurement on defined post–employment benefit plan (Note 22a)	(638)	–
Attributable to non–current assets revaluation reserve in equity (Note 20a)	47,556	3,476
Deferred tax liabilities at the end of the year	**315,759**	**273,987**

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

	2016	2015
	EUR'000	EUR'000
DEFERRED TAX LIABILITIES		
	Accelerated tax depreciation	
At the beginning of the year	**279,126**	**278,453**
Income credited to the Consolidated Statement of Profit or Loss	(2,773)	(2,803)
Attributable to re–measurement on defined post–employment benefit plan (Note 22a)	(638)	–
Attributable to non–current assets revaluation reserve in equity (Note 20a)	47,556	3,476
At the end of the year	**323,271**	**279,126**
DEFERRED TAX ASSETS		
	Accruals/provisions	
At the beginning of the year	**(5,139)**	**(10,427)**
(Income) credited / expense charged to the Consolidated Statement of Profit or Loss	(2,373)	5,288
At the end of the year	**(7,512)**	**(5,139)**

13. Intangible Assets

a) Intangible assets

	Usage rights, licences	Software	Assets under develop-ment	TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000
At 31 December 2014				
Cost	2,490	38,992	328	41,810
Accumulated amortisation	(1,648)	(27,151)	–	(28,799)
Net book amount	**842**	**11,841**	**328**	**13,011**
Year ended 31 December 2015				
Additions	17	720	4,350	5,087
Transfers	–	4,335	(4,335)	–
Disposals	(211)	–	–	(211)
Amortisation charge	–	(3,482)	–	(3,482)
Closing net book amount	**648**	**13,414**	**343**	**14,405**
At 31 December 2015				
Cost	2,507	44,038	343	46,888
Accumulated amortisation	(1,859)	(30,624)	–	(32,483)
Net book amount	**648**	**13,414**	**343**	**14,405**
Year ended 31 December 2016				
Additions	–	966	2,737	3,703
Transfers	–	1,568	(1,568)	–
Disposals	(211)	–	–	(211)
Amortisation charge	–	(3,363)	–	(3,363)
Closing net book amount	**437**	**12,585**	**1,512**	**14,534**
At 31 December 2016				
Cost	2,507	45,631	1,512	49,650
Accumulated amortisation	(2,070)	(33,046)	–	(35,116)
Net book amount	**437**	**12,585**	**1,512**	**14,534**

b) Greenhouse gas emission allowances:

	2016	2015
	Number of allowances	Number of allowances
At the beginning of the year	**1,516,203**	**2,021,259**
Allowances allocated free of charge	364,488	427,669
Purchased allowances	117,400	18,000
Used allowances	(1,129,538)	(932,725)
Sold allowances	(73,400)	(18,000)
At the end of the year	**795,153**	**1,516,203**

Allowances are allocated free of charge in accordance with the law "On Pollution" and Directives of the Ministry of Environmental Protection and Regional Development of the Republic of Latvia and are recognised as off–balance sheet assets.

As of 31 December 2016 the number of allowances in the Group received in 2016 from the Government free of charge was 364,488 (31/12/2015: 427,669). Therefore their carrying amount as of 31 December 2016 was nil (31/12/2015: nil).

The fair value of greenhouse gas emission allowances as of 31 December 2016 was EUR 5,208 thousand (31/12/2015: EUR 12,509 thousand). For estimation of the fair value of allowances was used fixed daily price in NASDAQ Commodities Exchange for European Union Allowances (EUA) on 30 December 2016 what was the last trade date in 2016 – 6.55 EUR/t (30/12/2015: 8.25 EUR/t).

Received European Union Allowances (EUA) must be used until the end of 2020.

From greenhouse gas emission allowances purchased in 2016 are sold 73.4 thousand (31/12/2015: nil).

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:

	Land, buildings and facilities	Technology equipment and machinery	Other PPE	Assets under construction and advance payments	PPE TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
As of 31 December 2014					
Cost or valuation	4,458,341	2,091,623	158,262	60,709	6,768,935
Accumulated depreciation and impairment	(2,445,607)	(1,134,781)	(116,184)	(6,047)	(3,702,619)
Net book amount	**2,012,734**	**956,842**	**42,078**	**54,662**	**3,066,316**
Year ended 31 December 2015					
Increase due to PPE revaluation (Note 20a)	–	23,782	179	–	23,961
Impairment charge due to PPE revaluation	–	(30,657)	(137)	–	(30,794)
Additions	53	1,483	15,652	168,076	185,264
Invested in share capital (Note 19)*	85	–	–	–	85
Transfers	84,132	43,897	6,874	(134,903)	–
Reclassified to investment property	(12)	–	–	–	(12)
Disposals	(2,202)	(1,645)	(141)	(25)	(4,013)
Impairment charge	–	14,564	–	(58)	14,506
Depreciation	(80,562)	(85,624)	(12,871)	–	(179,057)
Closing net book amount	**2,014,228**	**922,642**	**51,634**	**87,752**	**3,076,256**
As of 31 December 2015					
Cost or valuation	4,469,448	2,072,520	173,118	93,858	6,808,944
Accumulated depreciation and impairment	(2,455,220)	(1,149,878)	(121,484)	(6,106)	(3,732,688)
Net book amount	**2,014,228**	**922,642**	**51,634**	**87,752**	**3,076,256**

	Land, buildings and facilities	Technology equipment and machinery	Other PPE	Assets under construction and advance payments	PPE TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Year ended 31 December 2016					
Increase due to PPE revaluation (Note 20a)	303,933	12,954	154	–	317,041
Impairment charge due to PPE revaluation	(25,816)	(9,909)	(49)	–	(35,774)
Additions	135	1,644	18,507	176,552	196,838
Invested in share capital (Note 19)*	177	7	–	–	184
Transfers	72,164	38,036	6,277	(116,477)	–
Reclassified to investment property	(214)	–	–	–	(214)
Disposals	(2,819)	(1,987)	(199)	(40)	(5,045)
Impairment charge	–	(10,140)	–	116	(10,024)
Depreciation	(89,432)	(79,609)	(14,424)	–	(183,465)
Closing net book amount	**2,272,356**	**873,638**	**61,900**	**147,903**	**3,355,797**
At 31 December 2016					
Cost or valuation	4,615,210	2,059,129	186,442	153,893	7,014,674
Accumulated depreciation and impairment	(2,342,854)	(1,185,491)	(124,542)	(5,990)	(3,658,877)
Net book amount	**2,272,356**	**873,638**	**61,900**	**147,903**	**3,355,797**

* in December 2016, in accordance with the Directive No. 693 of the Cabinet of Ministers of the Republic of Latvia, dated 22 November 2016 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 184 thousand was invested in the share capital of Latvenergo AS (in December 2015: real estate in the amount of EUR 85 thousand)

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

As of 31 December 2016 cost of fully depreciated PPE which are still in use amounted to EUR 266,463 thousand (31/12/2015: EUR 801,427 thousand).

In 2016 the Group has capitalised borrowing costs in the amount of EUR 780 thousand (2015: EUR 268 thousand) (see Note 11 b). Rate of capitalised borrowing costs was of 1.29 % (2015: 1.50 %).

Information about the Group's pledged property, plant and equipment is disclosed in Note 21 b, I.

b) Investment property

Land or a building or part of a building held by the Group as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business, after decision of the Group'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.).

	Land		Buildings		TOTAL Investment property	
	2016	2015	2016	2015	2016	2015
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Net book amount at the beginning of the year	**425**	**430**	**271**	**913**	**696**	**1,343**
Reclassified from property, plant and equipment	30	7	184	5	214	12
Sold	(101)	(12)	(403)	(373)	(504)	(385)
Disposal	–	–	(1)	(5)	(1)	(5)
Impairment charge	–	–	187	(235)	187	(235)
Depreciation	–	–	(29)	(34)	(29)	(34)
Net book amount at the end of the year	**354**	**425**	**209**	**271**	**563**	**696**

c) Property, plant and equipment revaluation

In 2015 the Group started revaluation process for property, plant and equipment of distribution system with revaluation of categories of technology equipment and machinery, and in 2016 finished revaluation process with the revaluation of categories of distribution system buildings and facilities, including electricity lines and all property, plant and equipment categories of transmission system, considering the substantial changes of carrying amounts of these categories. Valuation have been done by independent certified valuator by applying the depreciated replacement cost model, which provides, that the assets value comprises replacement or renewal costs of similar asset at the date of revaluation adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence. To determine changes in initial replacement costs for transmission system assets were taken into consideration changes in cost of workforce and materials since revaluation of the assets in 2011, accordingly as well determining the ratio of workforce costs for each group. Replacement cost for distribution system electrical lines is based on Sadales tīkls AS aggregate construction costs in 2015, by electricity lines type and region. Physical depreciation was determined proportionally the age of the property, plant and equipment item. In assessment for property, plant and equipment items for which planned reconstruction in the near future additionally was calculated physical depreciation. Remaining useful lifetime of property, plant and equipment items after revaluation was estimated according to estimated total depreciation. To determine original cost replacement value of the revaluated asset current acquisition or purchase cost is used. Amounts of revalued property, plant and equipment categories of transmission system and distribution system had been determined as of 1 April 2016. Latvenergo AS revalued assets of Daugava hydropower plants as of 1 January 2012 and next revaluation is planned in 2017.

As a result of revaluation in 2016 the carrying amounts of revalued distribution system property, plant and equipment increased by EUR 262,541 thousand, but the carrying amounts of revalued transmission system property, plant and equipment increased by EUR 18,726 thousand. Increase of property, plant and equipment in the amount of EUR 317,041 thousand, less deferred income tax, is included in the Group's equity as non-current assets revaluation reserve (2015: EUR 23,961 thousand) (see Note 20 a), while impairment charge due to property, plant and equipment revaluation in the amount of EUR 35,774 thousand – in the Consolidated Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment' (2015: EUR 30,794 thousand). In 2015 the impairment charge in the amount of EUR 14,564 thousand for distribution system technology equipment and machinery category – Transformers for AC voltage lowering recognised in 2014 had been reversed.

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:

	Revalued property, plant and equipment groups*			
	Revalued buildings and facilities	Revalued technology equipment and machinery	Revalued other equipment	Total revalued PPE
	EUR'000	EUR'000	EUR'000	EUR'000
AT REVALUED AMOUNTS				
At 31 December 2015				
Revalued	4,011,849	1,447,771	29,821	5,489,441
Accumulated depreciation	(2,330,972)	(827,097)	(18,633)	(3,176,702)
Revalued net book amount	**1,680,877**	**620,674**	**11,188**	**2,312,739**
At 31 December 2016				
Revalued	4,150,707	1,433,417	30,406	5,614,530
Accumulated depreciation	(2,205,076)	(815,208)	(18,084)	(3,038,368)
Revalued net book amount	**1,945,631**	**618,209**	**12,322**	**2,576,162**
AT AMOUNTS STATED ON HISTORICAL COST BASIS				
At 31 December 2015				
Cost	1,088,555	725,157	25,286	1,838,998
Accumulated depreciation	(323,428)	(350,822)	(17,626)	(691,876)
Net book amount	**765,127**	**374,335**	**7,660**	**1,147,122**
At 31 December 2016				
Cost	1,151,577	755,462	26,403	1,933,442
Accumulated depreciation	(324,536)	(347,718)	(16,092)	(688,346)
Net book amount	**827,041**	**407,744**	**10,311**	**1,245,096**

* for revalued property, plant and equipment groups see Note 2.8

d) Impairment

In 2016 in the Group has been performed impairment evaluation and additional impairment in the amount of EUR 10,140 thousand (2015: nil) was recognised for Riga combined heat and power plants. In 2015 was reversed partial impairment charge on PPE category's 'Technology equipment and machinery' subcategory 'Transformers for AC voltage lowering' in the amount of EUR 14,564 (carried in revalued distribution system's technology equipment and machinery). Additional impairment is due to the forecasted tighter competition in the Riga heat market, which in turn have a negative impact on the cogeneration electricity output of the Riga combined heat and power plant. Forecasted period is 2017 – 2028 and the terminal value appraisal is included. Revenue stream forecast corresponds to support period and intensity of cogeneration plants 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 2017, the service maintenance agreements and the annual growth rate of 2.5%. The accumulated impairment as of 31 December 2016 amounted to EUR 103,910 thousand and consists of impairment charge on technological equipment and machinery of the Riga combined heat and power plant (carried in non–revalued technology equipment and machinery) (31/12/2015: impairment charge in the amount of EUR 93,770 thousand on technological equipment and machinery of the Riga combined heat and power plant).

Impairment review performed in accordance with *IAS 36 Impairment of Assets* and based on value in use calculations. The recognised impairment charge is included in the Consolidated Statement of Profit or Loss position 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'. The cash–generating unit is defined as the assets of Riga combined heat and power plant. Nominal pre–tax discount rate used to determine value in use of cash–generating unit by discounting cash flows is 7.8 % (2015: 7.5 %). If discount rate used for the purposes of impairment charge calculation would be higher or lower by one per cent point the current year's impairment charge on technological equipment would be by EUR 23.2 million higher or respectively – EUR 25.3 million lower.

Impairment review is also performed for electricity distribution system assets and electricity transmission system assets and there is no additional impairment loss recognised. The cash–generating unit is defined as the distribution system assets and transmission system assets. Nominal pre–tax discount rate used to determine value in use of cash–generating units by discounting cash flows is 4.43% (2015: 4.43%) as included in the electricity distribution system and in the electricity transmission system service tariff calculation methodologies. Performance of impairment review also considered pricing forecast for major revenue streams, which are contingent on regulatory pre–approvals, and assumptions related to capital investment plans.

For other significant accounting estimates, judgements and sensitivity analysis see Note 4 a, II.

e) Leases

	2016	2015
	EUR'000	EUR'000
Rental income (the Group is the lessor)	47,233	45,208
of which,		
Transmission system assets lease	45,371	43,630
Rental expense (the Group is the lessee)	**1,274**	**1,310**

Future minimum lease receivables under non–cancellable operating lease contracts by due dates (the Group is the lessor):

	2016	2015
	EUR'000	EUR'000
– < 1 year	48,206	46,471
– 1–5 years	195,914	185,885
– > 5 years	240,732	232,356
TOTAL rental income	**484,852**	**464,712**

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

Future minimum lease payments under non–cancellable operating lease contracts by due dates (the Group is the lessee):

	2016	2015
	EUR'000	EUR'000
– < 1 year	1,420	1,417
– 1–5 years	6,018	5,913
– > 5 years	9,038	8,129
TOTAL rental expense	**16,476**	**15,459**

15. Non–Current Financial Investments

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	41	41
At the end of the year	**41**	**41**

Participating interest in subsidiaries and other non–current financial investments:

Name	Country of incorporation	Business activity held	Interest held, % 31/12/2016	Interest held, % 31/12/2015
Subsidiaries:				
Latvijas elektriskie tīkli AS	Latvia	Lease of transmission system assets	100%	100%
Sadales tīkls AS	Latvia	Electricity distribution	100%	100%
Enerģijas publiskais tirgotājs AS*	Latvia	Management of the mandatory procurement process	100%	100%
Elektrum Eesti OÜ	Estonia	Electricity supply	100%	100%
Elektrum Latvija SIA	Latvia	Electricity supply	100%	100%
Elektrum Lietuva UAB	Lithuania	Electricity supply	100%	100%
Liepājas enerģija SIA	Latvia	Thermal energy generation and supply in Liepaja city, electricity generation	51%	51%
Other non–current financial investments:				
Pirmais Slēgtais Pensiju Fonds AS	Latvia	Management of pension plans	48.15%	48.15%
Rīgas siltums AS	Latvia	Thermal energy generation and supply in Riga, electricity generation	0.0051%	0.0051%

* in order to improve the transparency of administration of electricity mandatory procurement process, new subsidiary Enerģijas publiskais tirgotājs AS was established on 25 February 2014. The subsidiary as of 1st of April 2014 has taken over the mandatory procurement administration functions from Latvenergo AS

The Group owns 48.15% of the shares of the closed pension fund Pirmais Slēgtais Pensiju Fonds AS. However, the Group is only a nominal shareholder as all risks and benefits arising from associate's activities will accrue to the Group's employees who are members of the pension fund. Therefore, investment in Pirmais Slēgtais Pensiju Fonds AS is valued at cost and equity method is not applied.

16. Inventories

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Raw materials and materials	17,438	17,983
Natural gas	17,506	–
Other inventories	8,173	8,422
Allowance for raw materials and other inventories	(1,659)	(1,614)
TOTAL inventories	**41,458**	**24,791**

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

Movement on the allowance for raw materials, and other inventories:

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**1,614**	**1,387**
Inventories written off	(87)	(106)
Charged to the Consolidated Statement of Profit or Loss	132	333
At the end of the year	**1,659**	**1,614**

17. Trade Receivables And Other Current Receivables

a) Trade receivables, net

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Receivables		
– Electricity supply and electricity services customers	147,808	130,531
– Heating customers	11,629	11,735
– Other trade receivables	11,027	15,986
	170,464	**158,252**
Allowances for impairment of receivables		
– Electricity supply and electricity services customers	(44,801)	(43,710)
– Heating customers	(391)	(423)
– Other trade receivables	(2,440)	(1,956)
	(47,632)	**(46,089)**
Receivables, net		
– Electricity supply and electricity services customers	103,007	86,821
– Heating customers	11,238	11,312
– Other trade receivables	8,587	14,030
	122,832	**112,163**

There is no significant concentration of credit risk with respect to trade receivables, as the Group has a large number of customers except the major heating customer the net debt of which as of 31 December 2016 amounted to EUR 9,040 thousand (31/12/2015: EUR 9,683 thousand).

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

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Electricity supply and electricity services receivables:		
Fully performing receivables	92,450	75,942
Receivables past due but not impaired:		
– Receivables past due by 1–45 days	7,277	8,210
Impaired receivables:		
– Receivables past due by 46–90 days	1,608	2,102
– Receivables past due by 91–180 days	2,154	2,842
– Receivables past due by more than 181 day	15,988	12,507
– Individually impaired receivables with scheduled payments*	28,331	28,928
	147,808	**130,531**
Allowances for impaired electricity supply and electricity services receivables:		
– Receivables past due by 46–90 days	(744)	(1,056)
– Receivables past due by 91–180 days	(1,480)	(2,133)
– Receivables past due by more than 181 day	(15,988)	(12,507)
– Individually impaired receivables with scheduled payments*	(26,589)	(28,014)
	(44,801)	**(43,710)**
Electricity supply and electricity services receivables, net:		
Fully performing receivables	92,450	75,942
Receivables past due but not impaired:		
– Receivables past due by 1–45 days	7,277	8,210
Net impaired receivables:		
– Receivables past due by 46–90 days	864	1,046
– Receivables past due by 91–180 days	674	709
– Individually impaired receivables with scheduled payments*	1,742	914
	103,007	**86,821**

* receivables under insolvency process and other individually impaired receivables

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

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Heating and other trade receivables:		
Fully performing receivables	19,516	24,952
Receivables past due but not impaired:		
– Receivables past due by 1–30 days	213	184
Impaired receivables:		
– Receivables past due by 31–90 days	196	165
– Receivables past due by more than 91 day	2,603	2,135
– Individually impaired receivables with scheduled payments*	128	285
	22,656	**27,721**
Allowances for impaired heating and other trade receivables:		
– Receivables past due by 31–90 days	(100)	(83)
– Receivables past due by more than 91 day	(2,603)	(2,135)
– Individually impaired receivables with scheduled payments*	(128)	(161)
	(2,831)	**(2,379)**
Heating and other trade receivables, net		
Fully performing receivables	19,516	24,952
Receivables past due but not impaired:		
– Receivables past due by 1–30 days	213	184
Net impaired receivables:		
– Receivables past due by 31–90 days	96	82
– Individually impaired receivables with scheduled payments*	–	124
	19,825	**25,342**

* receivables under insolvency process and other individually impaired receivables

The Group's Management has estimated allowances for impairment of receivables on the basis of aging of trade receivables and by evaluating liquidity and history of previous payments of each significant debtor (see point 2.12). The carrying amount of trade receivables, less allowances for impairment, is assumed to approximate their fair values.

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

Receivables credit quality:

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Fully performing electricity supply and electricity services receivables:		
– customers with no overdue receivables	73,236	61,351
– customers with overdue receivables	19,214	14,591
	92,450	**75,942**
Fully performing heating and other receivables:		
– customers with no overdue receivables	18,700	24,647
– customers with overdue receivables	816	305
	19,516	**24,952**

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

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

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**46,089**	**44,003**
Receivables written off during the year as uncollectible	(1,511)	(2,143)
Allowance for impaired receivables	3,054	4,229
At the end of the year	**47,632**	**46,089**

The charge and release of allowance for impaired trade receivables due to delayed payments have been recorded in the Consolidated Statement of Profit or Loss position 'Other operating expenses' as selling expenses and customer services costs (Note 10).

b) Other current receivables

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Unsettled revenue on mandatory procurement PSO fee recognised as assets*	142,132	141,060
Other accrued income	1,024	1,148
Pre–tax and overpaid taxes	4,008	4,387
Other current financial receivables	2,797	1,974
Other current receivables	1,164	2,720
TOTAL other current receivables	**151,125**	**151,289**

* 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)

The growth of other current financial receivables is affected by accounting of accepted, but unsettled financing from European Union funds for The European Energy Development Program – 330 kV Kurzeme Ring.

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

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Cash at bank	176,626	89,391
Short–term bank deposits	7,000	10,000
Restricted cash and cash equivalents*	354	5,152
TOTAL cash and cash equivalents	**183,980**	**104,543**

* restricted cash and cash equivalents as of 31 December 2016 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

Cash at bank balances earns daily interest mostly based on floating interbank deposit rates. Short–term deposits are placed for different periods between several days and three months depending on the immediate cash needs of the Group and cash flow forecasts. During 2016 the average annual effective interest rate earned on short–term cash deposits was 0.16% (2015: 0.16%). See also Note 3.1.b.

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

19. Share Capital

As of 31 December 2016, the registered share capital of the Latvenergo AS is EUR 1,288,715 thousand (31/12/2015: EUR 1,288,531 thousand) and consists of 1,288,715 thousand ordinary shares (31/12/2015: 1,288,531 thousand) with the nominal value of EUR 1 per share (31/12/2015: EUR 1 per share). All shares have been fully paid.

In December 2016, in accordance with the Directive No. 693 of the Cabinet of Ministers of the Republic of Latvia, dated 22 November 2016 – "On the Investment of the State's property units in the Share Capital of Latvenergo AS", real estate in the amount of EUR 184 thousand was invested in the share capital of Latvenergo AS (in December 2015: real estate in the amount of EUR 85 thousand). The value of real estate was determined by independent certified valuation experts applying depreciated replacement cost model, based on construction or acquisition costs of similar assets. Increase in the share capital was approved by the Latvenergo AS Shareholder's Meeting on 28 November 2016 and registered with the Commercial Register of the Republic of Latvia on 19 December 2016.

20. Reserves, Dividends And Earnings Per Share

a) Reserves

As of 31 December 2016 the Group's reserves are in the amount EUR 937,074 thousand (31/12/2015: EUR 669,596 thousand) and consist of the property, plant and equipment revaluation reserve, hedge reserve, currency translation reserve and other reserves. The Group cannot distribute as dividends the property, plant and equipment revaluation reserve, currency translation and hedge reserves. Other reserves are maintained with the aim to maintain stability in the operations of the Group entities.

	Notes	Non–current assets revaluation reserve	Hedge reserve	Currency translation	Other reserves	TOTAL
		EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
As of 31 December 2014		**662,052**	**(16,333)**	**97**	**13**	**645,829**
Increase of non–current assets revaluation reserve as a result of revaluation	14a	23,961	–	–	–	23,961
Disposal of non–current assets revaluation reserve net of deferred tax		(795)	–	–	–	(795)
Deferred tax related to non–current assets revaluation reserve	12	(3,476)	–	–	–	(3,476)
Gains from fair value changes in derivative financial instruments	21c, l	–	4,077	–	–	4,077
As of 31 December 2015		**681,742**	**(12,256)**	**97**	**13**	**669,596**
Increase of non–current assets revaluation reserve as a result of revaluation	14a	317,041	–	–	–	317,041
Disposal of non–current assets revaluation reserve net of deferred tax		(4,854)	–	–	–	(4,854)
Deferred tax related to non–current assets revaluation reserve	12	(47,556)	–	–	–	(47,556)
Gains from fair value changes in derivative financial instruments	21c, l	–	2,847	–	–	2,847
As of 31 December 2016		**946,373**	**(9,409)**	**97**	**13**	**937,074**

b) Dividends

The dividends declared to equity holders of the Parent Company for 2015 were EUR 77,413 thousand or EUR 0.06008 per share (2014: EUR 31,479 thousand or EUR 0.02443 per share) and to non–controlling interests – EUR 1,377 thousand or EUR 0.403 per share (2014: EUR 1,148 thousand or EUR 0.336 per share).

The Management Board of Latvenergo AS proposes to allocate profit of Latvenergo AS in the amount of EUR 90,142 thousand to be paid out in dividends, that consists from Latvenergo AS profit of 2016 in the amount of EUR 73,021 thousand and from retained profit of 2015 in the amount of EUR 17,121 thousand, and the rest of Latvenergo AS profit of 2016 – EUR 64,420 thousand to transfer to Latvenergo AS reserves with a purpose to take the decision on pay out as dividends simultaneously with the decision on the distribution of Latvenergo AS profit of 2017. These financial statements do not reflect this amount as a liability as the dividends have not been approved as of 31 December 2016.

The distribution of net profit for the 2016 is subject to a resolution of the Parent Company's Shareholder's Meeting.

c) Earnings per share

Basic earnings per share are calculated by dividing profit attributable to the equity holder 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.

	2016	2015
Profit attributable to the equity holder of the Parent Company (in thousand EUR)	129,045	83,509
Weighted average number of shares (thousand)	1,288,623	1,288,489
Basic earnings per share (in euros)	0.100	0.065
Diluted earnings per share (in euros)	0.100	0.065

21. Financial Assets And Liabilities

a) Held–to–maturity financial assets

As of 31 December 2016 the entire Group's held–to–maturity financial assets were State Treasury bonds with 5 year and 10 year maturity, which were purchased with the purpose to invest liquidity reserve in the low risk financial instruments with higher yield. During 2016 in association with the disposal of held–to–maturity financial assets are recognised net losses in the amount of EUR 58 thousand (2015: EUR 60 thousand) (Note 11 b). All held–to–maturity financial assets are denominated in euros. The maximum exposure to credit risk at the reporting date is the carrying amount of held–to–maturity financial assets.

In 2016 the fair value of held–to–maturity financial assets is greater than the carrying amount by EUR 4,991 thousand (2015: EUR 5,959 thousand). The fair value of financial assets is calculated by discounting their future cash flows and using as discount factor the banks quoted prices of a corresponding financial instrument at the end of the reporting period.

Held–to–maturity financial assets carrying amount:

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Held–to–maturity financial assets:		
– current	3,520	7,859
– non–current	17,034	20,609
TOTAL held–to–maturity financial assets	**20,554**	**28,468**

b) Borrowings

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Non–current borrowings from financial institutions	500,215	534,586
Issued debt securities (bonds)	135,405	179,705
Total non–current borrowings	**635,620**	**714,291**
Current portion of non–current borrowings from financial institutions*	82,762	80,842
Current portion of issued debt securities (bonds)	70,075	–
Current borrowings from financial institutions	744	–
Accrued interest on non–current borrowings	594	848
Accrued coupon interest on issued debt securities (bonds)	1,771	1,502
Total current borrowings	**155,946**	**83,192**
TOTAL borrowings	**791,566**	**797,483**

* in 2017, Liepājas Enerģija SIA has signed an agreement with Swedbank AS on prolongation of the loan repayment stipulating final term on 31 August 2019, thus reducing the current portion and increasing the non–current portion of borrowings by EUR 2,529 thousand

Movement in borrowings:

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**797,483**	**827,222**
Borrowings received	55,744	30,000
Borrowings repaid	(87,452)	(134,875)
Change in accrued interest on borrowings	15	234
Issued debt securities (bonds)	25,776	74,902
At the end of the year	**791,566**	**797,483**

Borrowings by categories of lenders:

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Foreign investment banks	394,917	432,978
Commercial banks	189,398	183,298
Issued debt securities (bonds)	207,251	181,207
TOTAL borrowings	**791,566**	**797,483**

Borrowings by maturity (excluding the effect of derivative financial instruments):

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Fixed rate non–current and current borrowings:		
– < 1 year (current portion of non–current borrowings)	71,921	1,703
– 1–5 years	152,911	172,985
– > 5 years	100,676	74,902
Total fixed rate borrowings	**325,508**	**249,590**
Floating rate non–current and current borrowings:		
– < 1 year (current borrowings)	744	–
– < 1 year (current portion of non–current borrowings)	83,281	81,489
– 1–5 years	255,126	300,669
– > 5 years	126,907	165,735
Total floating rate borrowings	**466,058**	**547,893**
TOTAL borrowings	**791,566**	**797,483**

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

	31/12/2016	31/12/2015
	EUR'000	EUR'000
– < 1 year	376,099	360,578
– 1–5 years	264,791	282,003
– > 5 years	150,676	154,902
TOTAL borrowings:	**791,566**	**797,483**

As of 31 December 2016 and as of 31 December 2015 all of the Group's borrowings were denominated in euros.

The fair value of current and non–current borrowings with floating rates and twelve–month–fixed rates equals their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group, and the effect of fair value revaluation is not significant.

I) Pledges

As of 31 December 2016 the Group'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 29 million (31/12/2015: EUR 31 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 26.6 million and the claims on the receivables accounts in the amount of EUR 2.4 million (31/12/2015: EUR 28.5 million and EUR 2.5 million, respectively).

II) Un–drawn borrowing facilities

As of 31 December 2016 the un–drawn portion of committed non–current credit facilities amounts to EUR 235 million (31/12/2015: EUR 290 million).

As of 31 December 2016 the Group had entered into three overdraft agreements with total notional amount of EUR 34.2 million (31/12/2015: EUR 34.2 million) and in respect of those all conditions precedent had been met. At the end of the reporting year overdrafts were not used.

III) Weighted average effective interest rate

During the reporting year the weighted average effective interest rate (including interest rate swaps) on non–current borrowings was 1.91 % (2015: 2.40 %), weighted average effective interest rate for current borrowings was 0.87 % (2015: 0.87 %). At 31 December 2016 interest rates for non–current borrowings in euros were 3, 6 and 12 month EURIBOR+1.13 % (31/12/2015: +1.06 %). At 31 December 2016 the total notional amount of interest rate swap agreements concluded by the Group amounts to EUR 174.2 million (31/12/2015: EUR 221.5 million) and the interest rate was fixed for the initial periods from 6 to 10 years.

IV) Bonds issued

The Parent company (Latvenergo AS) in 2012 and 2013 issued bonds in the amount of EUR 70 million with the maturity date – 15 December 2017 (ISIN code – LV0000801090) in the amount of EUR 35 million with maturity date – 22 May 2020 (ISIN code – LV0000801165), both of them 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%. Thus the total nominal amount of issued bonds amounts to EUR 205 million. All issued bonds are quoted in NASDAQ Baltic Stock Exchange. At the end of reporting year the issued debt securities (bonds) are measured at amortised cost.

As of 31 December 2016 the fair value of issued debt securities (bonds) exceeds their carrying amount by EUR 8,293 thousand (31/12/2015: EUR 5,040 thousand). The fair value of debt securities (bonds) issued is calculated by discounting their future cash flows and using the banks' quoted prices of the financial instruments at the end of the reporting year as discount factor.

c) Derivative financial instruments

I) Outstanding fair values of derivatives and their classification

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

	Notes	31/12/2016		31/12/2015	
		EUR'000		EUR'000	
		Assets	**Liabilities**	**Assets**	**Liabilities**
Interest rate swaps	21c, II	–	11,563	–	13,016
Electricity forwards and futures	21c, III	(6,134)	23	–	2,558
TOTAL outstanding fair values of derivatives		**(6,134)**	**11,586**	**–**	**15,574**

	31/12/2016		31/12/2015	
	EUR'000		EUR'000	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Non–current	–	7,946	–	8,291
Current	(6,134)	3,640	–	7,283
TOTAL fair values of derivative financial instruments	**(6,134)**	**11,586**	**–**	**15,574**

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

	Notes	2016	2015
		EUR'000	EUR'000
Included in the Consolidated Statement of Profit or Loss			
Interest rate swaps	11a	(760)	(1,348)
Electricity forwards and futures	8	(6,515)	446
		(7,275)	**(902)**
Included in the Statement of Other Comprehensive Income			
Interest rate swaps	20a	(693)	(4,077)
Electricity forwards and futures	20a	(2,154)	–
		(2,847)	**(4,077**

According to *IAS 1* a financial liability or asset that is not held for trading purposes should be presented as current or non–current on the basis of its settlement date. Derivatives that have a maturity of more than twelve months and are expected to be held for more than twelve months after the end of the reporting period have been classified as non–current assets or liabilities.

II) Interest rate swaps

As of 31 December 2016 the Group had interest rate swap agreements with total notional amount of EUR 174.2 million (31/12/2015: EUR 221.5 million). Interest rate swaps are concluded with 6 to 10 year initial maturities and hedged floating rates are 6 month EURIBOR. As of 31 December 2016 fixed interest rates vary from 0.7725% to 4.4925% (31/12/2015: from 0.7725% to 4.4925%).

At the end of the year all of outstanding interest rate swap agreements or agreements with notional amount of EUR 174.2 million are designated to comply with hedge accounting and were re–measured prospectively and retrospectively to test whether they are effective within the hedging period (31/12/2015: 91% with notional amount of EUR 201.5 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 Consolidated Statement of Profit or Loss.

Fair value changes of interest rate swaps:

	Notes	2016		2015	
			EUR'000		EUR'000
		Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year		**–**	**13,016**	**–**	**18,441**
Included in the Consolidated Statement of Profit or Loss, net	11a	–	(760)	–	(1,348)
Included in other comprehensive income	20a	–	(693)	–	(4,077)
Outstanding fair value at the end of the year		**–**	**11,563**	**–**	**13,016**

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 2016 62% (31/12/2015: 55%) of the Group's borrowings had fixed interest rates (taking into account the effect from the interest rate swaps), and average remaining time to interest re–pricing was 2.1 years (2015: 2.4 years).

III) Electricity forwards and futures

As of 31 December 2016 the Group has entered into electricity forward and future contracts with total outstanding volume of 2,195,685 MWh (31/12/2015: 2,880,436 MWh) and notional value of EUR 36.0 million (31/12/2015: EUR 64.1 million). Electricity forward and future contracts are concluded for the maturities from one quarter to one year during the period from 1 January 2017 to 31 December 2019.

The Parent company (Latvenergo AS) 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 1,626,285 MWh as of 31 December 2016 are designated to comply with hedge accounting treatment (31/12/2015: no such contracts) and were re–measured prospectively and retrospectively to test whether they are effective within the hedging period. All contracts are designed as cash flow hedges. For the contracts which are ineffective fair value changes are recorded through profit or loss in the Consolidated Statement of Profit or Loss (Note 8), and for fully effective contracts fair value gains are included in other comprehensive income (Note 20 a).

Fair value changes of electricity forward and future contracts:

	2016		2015	
	EUR'000		EUR'000	
	Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year	**–**	**2,558**	**–**	**2,112**
Included in the Consolidated Statement of Profit or Loss (Note 8)	(3,980)	(2,535)	–	446
Included in other comprehensive income (Note 20a)	(2,154)	–	–	–
Outstanding fair value at the end of the year	**(6,134)**	**23**	**–**	**2,558**

d) Fair values and fair value measurement

In this Note are disclosed the fair value measurement hierarchy for the Group's assets and liabilities.

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

		Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobserv-able inputs (Level 3)	TOTAL
		EUR'000	EUR'000	EUR'000	EUR'000
Assets measured at fair value					
Revalued property, plant and equipment (Note 14c)	31/12/2016	–	–	2,576,162	**2,576,162**
	31/12/2015	–	–	2,312,739	**2,312,739**
Derivative financial instruments, including:					
Electricity forwards and futures (Note 21c, III)	31/12/2016	–	6,134	–	**6,134**
	31/12/2015	–	–	–	**–**
Assets for which fair values are disclosed					
Investment property held for capital appreciation (Note 14b)	31/12/2016	–	–	1,660	**1,660**
	31/12/2015	–	–	1,726	**1,726**
Held–to–maturity financial assets (Note 21a)	31/12/2016	–	25,545	–	**25,545**
	31/12/2015	–	34,427	–	**34,427**

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

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

		Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobserv-able inputs (Level 3)	TOTAL
		EUR'000	EUR'000	EUR'000	EUR'000
Liabilities measured at fair value					
Derivative financial instruments, including:					
Interest rate swaps (Note 21c, II)	31/12/2016	–	11,563	–	**11,563**
	31/12/2015	–	13,016	–	**13,016**
Electricity forwards and futures (Note 21c, III)	31/12/2016	–	23	–	**23**
	31/12/2015	–	2,558	–	**2,558**
Liabilities for which fair values are disclosed					
Issued debt securities (bonds) (Note 21b, IV)	31/12/2016	–	213,774	–	**213,774**
	31/12/2015	–	184,745	–	**184,745**
Floating rate borrowings (Note 21b)	31/12/2016	–	584,314	–	**584,314**
	31/12/2015	–	616,074	–	**616,074**
Fixed rate borrowings (Note 21b)	31/12/2016	–	–	–	**–**
	31/12/2015	–	206	–	**206**

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

The fair value hierarchy for the Group's financial instruments that are measured at fair value, by using specific valuation methods, is disclosed in Note 4 c.

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

	Carrying amount		Fair value	
	31/12/2016	31/12/2015	31/12/2016	31/12/2015
	EUR'000	EUR'000	EUR'000	EUR'000
Financial assets				
Held–to–maturity financial assets	20,554	28,468	25,545	34,427
Derivative financial instruments not designated for hedging, including:				
– electricity forwards and futures	3,980	–	3,980	–
Derivative financial instruments used for hedging, including:				
– electricity forwards and futures	2,154	–	2,154	–
Financial liabilities				
Interest–bearing liabilities, including:				
– issued debt securities (bonds)	205,480	179,705	213,774	184,745
– floating rate borrowings	584,314	616,074	584,314	616,074
– fixed rate borrowings	–	202	–	206
Derivative financial instruments not designated for hedging, including:				
– electricity forwards and futures	23	2,558	23	2,558
– interest rate swaps	–	760	–	760
Derivative financial instruments used for hedging, including:				
– interest rate swaps	11,563	12,256	11,563	12,256

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

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

a) The fair values of borrowings with floating interest rates are equal their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group;

b) The borrowings with fixed interest rates had the fixed repayment period and the financial instrument is not traded in the active market; the financial instrument, which is not traded in the active market, the fair value is measured, using valuation techniques. The Groups uses various methods and models and make assumptions, which are based on the market conditions regarding the interest rates and other market conditions, existing at the end of reporting period. The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by the Group`s credit risk margin;

c) The Group enters into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. The derivative financial instruments are determined by using various valuation methods and models with market observable inputs. The models incorporate the credit quality of counterparties, foreign exchange spot and forward rates; the fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments. The fair value of electricity forward and future contracts is calculated as discounted difference between actual market and settlement prices for the volume set in the agreements. If counterparty is a bank, calculated fair values of financial instruments are compared to bank's revaluation reports and the bank's calculated fair values of the financial instruments are used in the financial reports;

d) The fair value of the bonds issued and held–to–maturity financial assets are calculated, based on the bank's quoted prices of the financial instruments at the end of the reporting period.

22. Provisions

a) Provisions for post–employment benefits

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**13,619**	**12,650**
Provisions transferred to transmission system operator*	–	(1,254)
Current service cost	1,649	1,604
Interest cost	204	195
Post–employment benefits paid	(1,352)	(734)
Losses as a result of changes in actuarial assumptions	2,946	1,158
Deferred income tax on re–measurement on defined post–employment benefit plan	(638)	–
At the end of the year	**16,428**	**13,619**

* provisions were transferred due transmission system assets construction and maintenance functions transfer as of 1 January 2015 that also comprised transition of 430 employees from the Group to transmission system operator

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

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**13,619**	**12,650**
Charged to the Consolidated Statement of Other Comprehensive Income net of tax	2,308	1,158
Charged to the Consolidated Statement of Profit or Loss	501	(189)
At the end of the year	**16,428**	**13,619**

Weighted average discount rate used for discounting benefit obligations was 1.50% (2015: 1.71%), 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% (2015: 3.5%) 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 as of the end of the year is as shown below:

Assumptions		Date of valuation	Discount rate		Future salary changes		Retirement probability changes	
			1% increase	1% decrease	1% increase	1% decrease	1% increase	1% decrease
	EUR'000	31/12/2016	1,945	(1,590)	1,886	(1,577)	2,071	(1,709)
Impact on provisionsfor post–employment benefits	EUR'000	31/12/2015	1,464	(1,199)	1,426	(1,194)	1,581	(1,305)

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

b) Environmental provisions

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**2,365**	**2,938**
Charged to the Consolidated Statement of Profit or Loss	(150)	(573)
At the end of the year	**2,215**	**2,365**

The environmental provision in the amount of EUR 2,215 thousand (31/12/2015: EUR 2,365 thousand) represents the estimated cost of cleaning up Riga TEC–1 combined heat and power plant ash–fields in accordance with the requests made by the regional Environmental Authority of Riga and feasibility study on this project in the amount of EUR 1,191 thousand (31/12/2015: EUR 1,160 thousand) and Liepājas Enerģija SIA provision for the environmental recovery measures in the amount of EUR 1,024 thousand (31/12/2015: EUR 1,205 thousand). The amount of the provisions is calculated taking into account the construction cost index (data from the Central Statistical Bureau of the Republic of Latvia).

23. Other Liabilities And Deferred Income

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Deferred non–current income from connection fees	150,086	149,378
Deferred income on financing from European Union funds	45,013	46,681
Deferred income from plant and equipment received free of charge	308	327
TOTAL other liabilities and deferred income	**195,407**	**196,386**

Movement in deferred connection fees (non–current and current part):

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**160,933**	**156,382**
Received fees	13,587	16,172
Credited to the Consolidated Statement of Profit or Loss (Note 6 "Other revenue")	(12,324)	(11,621)
At the end of the year	**162,196**	**160,933**

24. Trade And Other Payables

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Financial liabilities:		
Payables for materials and services	54,366	44,499
Payables for electricity	20,275	22,518
Accrued expenses	7,315	7,514
Other financial current payables	6,599	6,417
Total financial liabilities	**88,555**	**80,948**
Non–financial liabilities:		
State social security contributions and other taxes	12,536	10,318
Advances received	12,845	8,612
Other current payables	3,881	3,896
Total non–financial liabilities	**29,262**	**22,826**
TOTAL trade and other current payables	**117,817**	**103,774**

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

25. Related Party Transactions

The Parent Company and, indirectly, the other Group entities are controlled by the Latvian state. Related parties of the Group are Shareholder of the Parent Company who controls or who has significant influence over the Group's entities in accepting operating business decisions, members of Management boards and Supervisory boards of the Group's entities, members of Supervisory body – 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, for which the IAS 24 exemptions have been applied and which do not represent a significant portion of a type of transaction, are excluded from the scope of related party disclosures. Quantification of transactions with those related parties is impossible due to broad range of the Group's customers.

Balances at the end of the year arising from sales/purchases:

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Trade payables to related parties:		
– Other related parties*	236	252
TOTAL payables	**236**	**252**

* Pirmais Slēgtais Pensiju Fonds AS

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

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

Remuneration to the key management personnel that is defined as members of the Management Boards and members of the of Supervisory Boards of the Group entities, and Supervisory body is 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.

26. Capital Commitments And Contingent Liabilities

As of 31 December 2016 the Group had commitments amounting to EUR 264.7 million (31/12/2015: EUR 235.8 million) for capital expenditure contracted but not delivered at the end of the reporting period.

In 2017 Latvenergo AS has issued support letters to its subsidiaries Enerģijas publiskais tirgotājs AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS acknowledging that its position as shareholders is to ensure that subsidiaries are managed so that they have sufficient financial resources and are able to carry their operations and settle their obligations.

27. Events After The Reporting Year

On 7 February 2017 Enerģijas publiskais tirgotājs AS received a part of state budget compensation in the amount of 19,7 million EUR.

On 16 February 2017 Enerģijas publiskais tirgotājs AS submitted to Public Utilities Commission calculation of mandatory procurement public service obligation fees as of 1 April 2017 in the amount of EUR 2.679 cents/kWh.

On 16 February 2017 international credit rating agency Moody's Investors Service has affirmed the credit rating of Latvenergo AS to Baa2 (stable).

According to Energy Law, since 3 April 2017 natural gas market in Latvia is fully open for all users.

There have been no other significant events subsequent to the end of the reporting year that might have a material effect on the Group's Consolidated Financial Statements for the year ended 31 December 2016.

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INDEPENDENT AUDITOR'S REPORT

To the shareholder of Latvenergo AS

Opinion

We have audited the accompanying consolidated financial statements of Latvenergo AS and its subsidiaries (the Group)set out on pages 93 to136 of the accompanying consolidated annual report, which comprise the consolidated statement of financial position as at 31 December 2016 and the consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2016 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the independence requirements included in the Law on Audit Services of Republic of Latvia that are relevant to our audit of the consolidated financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with the Law on Audit Services of Republic of Latvia and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

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Key audit matter	How we addressed the key audit matter
Revenue recognition	
During the financial year the Group recognized in the statement of profit or loss the revenue amounting to 931 619 thousand EUR, as disclosed in *Note 6. Revenue*. Accurate revenue recognition is inherently more complex in the energy sector when compared to some other industries due to the large number of the Group's customers, including both residential and corporate customers, and various pricing arrangements included in the range of products and services provided to different groups. Given the variety of contractual terms with the Group's customers, as well as different revenue streams and product types included in each stream, revenue recognition is considered to be relatively complex and requires, among other things, continual operating effectiveness of controls over the various categories of revenue streams. Revenue recognition was significant to our audit due to the materiality of revenue to the consolidated financial statements and the variety of products and price components included in revenue.	We performed following procedures, among others: • we tested a sample of IT dependent manual controls implemented over revenue recognition and measurement for electricity supply, electricity services and distribution system services revenue streams; • we tested relevant IT system controls over revenue recording, calculation of amounts billed to the Group's customers and matching of cash receipts to the Group's customers' accounts; • we obtained external customer confirmations regarding heat sales and lease and the management of the transmission system assets revenue stream amounts recognized by the Group; • we performed analytical review procedures by forming an expectation of revenue based on the key performance indicators, including taking into consideration the number and composition of the Group's customers, electricity supply volumes, changes in electricity prices and also comparing the results of our analysis against the prior reporting period and • we tested a sample of revenue transactions near the financial year end for appropriate accounting period. We also assessed the adequacy of the revenue related disclosures contained in *Note 2.24. Revenue recognition, Note 5. Operating Segment Information* and *Note 6. Revenue*.
Revaluation of electricity distribution system buildings and facilities and transmission system property, plant and equipment (PPE)	
Property, plant and equipment (PPE) as at 31 December 2016 constitutes 3 355 797 thousand EUR, which corresponds to 86% of the Group's total assets recognized in the statement of the financial position. PPE, as disclosed in *Note 2.6. Property, plant and equipment*, is carried at historical cost or revalued amounts less accumulated depreciation and accumulated impairment loss. As per the Group's policy outlined in *Note 2.8. Revaluation of property, plant and equipment* certain groups of PPE are revalued regularly but not less frequently than every five years. During the financial year certain PPE groups - electricity distribution system buildings and facilities and transmission system PPE - were revalued by applying the depreciated replacement cost model (*Note 14. c) Property, plant and equipment revaluation*). The management of the Group used an external appraisal to carry out the revaluation of these PPE groups with the revaluation date of 1 April 2016.	We involved our valuation specialists to assess the revaluation models, assumptions and methods used by the management in the revaluations. We discussed the revaluation model with the management and the external appraiser. We also assessed the information and assumptions used and we tested the data used in the revaluation models on sample basis to the source data. We evaluated the recognition and measurement of the results of the revaluation as shown in the consolidated financial statements *Note 14 a) Property, plant and equipment* and compared the accounting treatment applied to the requirements of International Financial Reporting Standards as adopted by the European Union. For a sample of revalued PPE items, we tested the accounting treatment on individual transaction level in the Group's accounting system.

As a result of upward revaluation of the electricity distribution system buildings and facilities as at the revaluation date a gross revaluation reserve of 286 528 thousand EUR (excluding the effect of deferred income tax) was recognized in equity and the result of downward revaluation of 23 988 thousand EUR was charged to the statement of profit or loss in the year 2016. For the electricity transmission system PPE these amounts were 30 513 thousand EUR and 11 786 thousand EUR, respectively.

Revaluation of these PPE involves significant estimates and assumptions, such as the selection of appropriate valuation method, estimation of remaining useful lifetime and condition of PPE items, market knowledge and data on the historical transactions provided by the management to the external experts.

This matter is one of the most significance to the audit given the size and complexity of the revaluation of the PPE of distribution and transmission system and the importance of the disclosures relating to the assumptions used in the revaluation.

Finally, we also evaluated the disclosures relating to the revaluation model, revaluation outcome and the assumptions used as disclosed in *Note 4. Critical Accounting estimates and judgements sub-section a) III) Revaluation* and *in Note 14. c) Property, plant and equipment revaluation.*

Impairment assessment of property, plant and equipment

As at 31 December 2016, the Group has recognized PPE amounting to 3 355 797 thousand EUR reported in the statement of the financial position and disclosed in *Note 14 a) Property, plant and equipment*. The Group performed impairment tests based on the value in use estimation for distribution system assets, transmission system assets and assets of Riga Combined Heat and Power Plant, each representing a separate cash generating unit (CGU). An additional impairment of charge of 10 140 thousand EUR was recorded in the statement of profit or loss for Riga Combined Heat and Power Plant CGU in the year 2016, while for other CGU's no impairment charge has been recognized as a result of impairment tests (*Note 14. d) Impairment*).

In relation to the impairment tests for the assets of the distribution and transmission systems significant assumptions used by the management include the selection of discount rate, pricing forecast for major revenue streams, which are contingent on regulatory pre-approvals, and assumptions related to capital investment plans.

For all three CGU impairment tests we involved our valuation specialists to assist with the assessment of the impairment test models, discount rates applied in each model and other significant management assumptions as described.

We discussed with the management the appropriateness of the information and data used in the impairment tests. We compared the most significant inputs to the source data. We also compared the amounts used by the management in the cash flow forecasts with the historical results and compared the estimated cash flows with the long term budgets approved by the management.

Finally, we evaluated the adequacy of the Group's disclosures in relation to the impairment tests and the outcome of these tests as disclosed in *Note 4. Critical Accounting estimates and judgements sub-section a) II) Recoverable amount of property, plant and equipment* and in *Note 14. d) Impairment.*

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Riga Combined Heat and Power Plant CGU impairment test is based on significant assumptions in relation to the selection of discount rate, variable revenue stream forecast in view of legislation regulating the cogeneration unit capacity component payments and the terminal value calculation.

Impairment test was significant to our audit as it involves significant management judgements applied in the cash flow forecasts.

Other information included in the Group's 2016 Annual Report

Management is responsible for the other information. Other information consists of:

- the Management Report as set out on pages 88 to 89 of the accompanying consolidated annual report and
- the Statement of Corporate Governance for the year 2016, set out in separate statement provided by Latvenergo AS management and available on the Latvenergo AS website http://www.latvenergo.lv section *Investors*,

but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except as described in the *Other reporting responsibilities in accordance with the legislation of the Republic of Latvia* section of our report.

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

If, based on the work we have performed and in light of the knowledge and understanding of the Group and its environment obtained in the course of our audit, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Other reporting responsibilities in accordance with the legislation of the Republic of Latvia

We have other reporting responsibilities in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Management Report. These additional reporting responsibilities are beyond those required under the ISAs.

Our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

Based solely on the work required to be undertaken in the course of our audit, in our opinion:

- information given in the Management Report for the financial year for which the consolidated financial statements are prepared is consistent with the consolidated financial statements, and
- the Management Report has been prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports of the Republic of Latvia.

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In addition, in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Statement of Corporate Governance, our responsibility is to consider whether the corporate governance report includes the information required in the clause 56.[1] first paragraph clauses 3, 4, 6, 8 and 9 and the section 56.[2] second paragraph clause 5 of the Law on Financial Instruments Market of the Republic of Latvia.

In our opinion, the Statement of Corporate Governance includes the information required in the 56.[1] first paragraph clauses 3, 4, 6, 8 and 9 and the section 56.[2] second paragraph clause 5 of the Law on Financial Instruments Market of the Republic of Latvia.

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

Management is responsible for the preparation and fair presentation of the consolidated financial statements 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing 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 Group or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's 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 consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated 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 consolidated 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.

The partner in charge of the audit resulting in this independent auditor's report is Diāna Krišjāne.

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

Riga,

18 April 2017