



# **Joint stock company "Latvijas Gāze"**

Annual accounts for the year ended 31 December 2011

Prepared in accordance with the International Financial Reporting Standards

Translation from Latvian original\*

Riga, 2012

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

Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**ANNUAL ACCOUNTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011**

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**ANNUAL ACCOUNTS**  
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**INFORMATION ON THE COMPANY**

Name of the Company	JSC Latvijas Gāze
Legal status of the Company	Joint Stock Company
Registration number, place and date of registration	000300064 Riga, March 25, 1991  Reregistered in Commercial Register December 20, 2004 with common registration No 40003000642
Address	Vagonu street 20 Riga, LV-1009 Latvia
Names of major shareholders	E.ON Ruhrgas International GmbH (47.2%) JSC Gazprom (34.0%) LLC Itera Latvija (16.0%)
Names and positions of the Board members	Adrians Dāvis – Chairman of the Board Aleksandrs Mihejevs (Александр Михеев) – Member of the Board, Deputy Chairman of the Board Jörg Tumat – Member of the Board, Deputy Chairman of the Board Anda Ulpe – Member of the Board Gints Freibergs – Member of the Board
Names and positions of the Council members	Kiril Seleznov (Кирилл Селезнев) – Chairman of the Council Juris Savickis – Deputy Chairman of the Council Joachim Hockertz – Member of the Council Peter Frankenberg – Deputy Chairman of the Council Mario Nullmeier – Member of the Council Uwe Fip – Member of the Council Heinz Watzka – Member of the Council Jelena Karpel (Елена Карпель) – Member of the Council Igor Nazarov (Игорь Назаров) – Member of the Council Vlada Rusakova (Влада Русакова) – Member of the Council Aleksandr Krasnenkov (Александр Краснев) – Member of the Council
Financial year	1 January-31 December 2011
Name and address of the auditor and responsible certified auditor	PricewaterhouseCoopers SIA Audit company licence No.5 Kr. Valdemara Street 19 Riga, LV-1010 Latvia  Certified auditor in charge: Lolita Čapkeviča Certified auditor Certificate No.120

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**Report of the Board of Directors**

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

The Joint Stock Company "Latvijas Gāze" (hereinafter – the Company) is an energy supply company engaged in natural gas transmission, storage, distribution and sale. In 1997, the Energy Supply Regulation Council of the Republic of Latvia issued to the Company exclusive licences for the provision of regulated public services till February 10, 2017. On January 31, 2007, the Council of the Public Utility Commission (hereinafter – the PUC) issued to the Company a licence for natural gas sale till February 10, 2012. The licence for natural gas sale from February 11, 2012 thru February 10, 2017 was issued by the PUC Council on January 12, 2012. Under the Energy Law, the Company is a natural gas supply system operator, which ensures uninterrupted and safe natural gas supply to customers in Latvia, avoiding overloads of system capacity.

Over the reporting year, the users were supplied 1 561.4 million m<sup>3</sup> of natural gas. In comparison with 2010, natural gas sales in m<sup>3</sup> fell by 12.7%. The decrease of natural gas sales stemmed from the relatively high air temperatures in the 4th quarter of 2011, as well as the investments of heat supply companies in the use of renewable energy sources and partial replacement of fossil fuels with woodchip. For several years already, the natural gas purchase prices set for Latvia have reached the level of the natural gas market of European countries, and in 2011 they were only influenced by changes in oil product quotations at the stock exchange, currency rates and gas supply flows.

In 2011, natural gas was sold to the customers for the natural gas sale end-user tariffs set in the resolution No.247 "On natural gas supply tariffs of the Joint Stock Company "Latvijas Gāze"" of the PUC Council dated July 24, 2008, which under the resolution No.258 "On the procedure of application of resolution No.247" of the PUC Council dated June 2, 2010 are exclusive of excise tax.

The applied differential natural gas sale end-user tariffs consist of two parts: fixed regulated service tariffs and the natural gas sale price, which changes with a step of 5 LVL/thsd.nm<sup>3</sup> depending on the actual natural gas purchase costs. For users with the annual natural gas consumption over 25 thsd. nm<sup>3</sup>, the applicable natural gas sale end-user tariff changes monthly, whereas for users with the annual natural gas consumption up to 25 thous.nm<sup>3</sup> – once in six months, i. e., on January 1 and July 1.

During 2011, the natural gas sale end-user tariffs for the natural gas consumers also changed due to tax changes, because as of July 1, 2011 the reduced VAT rate for natural gas supplied to households was revoked, while natural gas used as fuel was applied an excise tax of 12 LVL/thsd. nm<sup>3</sup> (17.1 EUR/thous.nm<sup>3</sup>).

In 2011, the Company sold natural gas and provided services to customers for LVL 353.3 million (EUR 502.8 million), which does not significantly differ from the net turnover of 2010, with the expenditures (excluding administrative expenses) amounting to LVL 311.6 million (EUR 443.3 million) and the gross profit – LVL 41.7 million (EUR 59.5 million). The changes in the structure of net turnover resulted from changes in the natural gas sales volume and the natural gas sale price, as well as the increased efficiency of usage of the Inčukalns Underground Gas Storage Facility (hereinafter – Inčukalns UGS).

Over the season of 2011, 2.26 billion m<sup>3</sup> of natural gas was injected into the Inčukalns UGS and 2.02 billion m<sup>3</sup> was withdrawn. Compared with the season of 2010, the volume of natural gas injected grew by 11.3%, whereas that of natural gas withdrawn remained at the level of the previous season.

The Company completed the year 2011 with a net profit of LVL 25.7 million (EUR 36.6 million), which is LVL 0.1 million (EUR 0.1 million) or 0.4% below that of 2010 – LVL 25.8 million (EUR 36.7 million). The net profitability of business activity was 7.3% in 2011 and 2010.

In 2011, the Company invested LVL 19,7 million (EUR 28 million) in the modernization of the gas supply system and the creation of new fixed assets. 29.4% of the total investment was spent on the modernization of gas transmission pipeline system, 38.8% – on the improvement of operation safety and the modernization of equipment at the Inčukalns UGS, and 25.4% – on the expansion of distribution networks and the renewal of fixed assets. The total number of gas-enabled objects at the end of the year reached 442.6 thousand.

On August 17, 2010, the Company received the resolution No. C(2010) 5554 of the European Commission dated August 13, 2010 on the award of a financial grant to Action No. EEPR-2009-INTg-RF-LV-LT-I2.566527/I2.566531/ SI2.566541/ SI2.566543 under the EC Regulation No. 663/2009 on gas and electricity

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**Report of the Board of Directors** (continued)

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

interconnections. With this resolution, the modernization of 15 wells at the Inčukalns UGS and the construction of a gas passage under Daugava and a pig receiver was granted LVL 7 million (EUR 10 million) with a view to stabilize natural gas supplies between Lithuania and Latvia in emergency situations.

Four wells of the Inčukalns UGS were reconstructed in 2010 and eleven in the reporting period. LVL 5.5 million (EUR 7.8 million) was spent during the reporting year, and the reconstruction of a gas drying unit at the CS-1 was also completed in 2011. The object was commissioned in January 2012 with the total project costs amounting to LVL 8.8 million (EUR 12.5 million) whereof LVL 1.2 million (EUR 1.7 million) was spent in the reporting year.

The elimination of damage found during the diagnostics of gas transmission pipelines is in progress. LVL 1.3 million (EUR 1.8 million) has been spent on the renovation of gas pipelines. The construction of an underwater gas pipeline under Daugava and a pig receiver has been completed. LVL 2.1 million (EUR 3 million) was spent in the reporting year, with the total costs of the object amounting to LVL 5.8 million (EUR 8.3 million).

In 2011, LVL 0.7 million (EUR 1 million) was spent on the construction of gas distribution pipelines and the repair of coating on the gas pipeline from GRS „Rīga-2” to GRS „Ziemeļi” was completed – the total costs of the project amounted to LVL 0.8 million (EUR 1.1 million), with LVL 0.7 million (EUR 1million) spent in the reporting year.

The reconstruction of GRS „Rīga-2” also began in 2011, with two new container-type GRPs due to be built – the total costs of the project are LVL 0.9 million (EUR 1.3 million), with LVL 0.4 million (EUR 0.6 million) spent in the reporting year. The works are due for completion in 2012.

The year 2011 also saw completion of the replacement of gas pipeline in Liepāja, Brīvības Street, commenced in 2010. The total costs of the project amounted to LVL 0.5 million (EUR 0.7 million), and LVL 0.2 million (EUR 0.3 million) was spent in the reporting year.

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**Report of the Board of Directors** (continued)

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

Company's main ratios:

	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Revenue	353 338	353 345	329 705	502 755	502 765	469 128
EBITDA	50 102	49 433	42 228	71 290	70 337	60 085
EBITDA %	14.18%	13.99%	12.81%	14.18%	13.99%	12.81%
Profit from operating activities	28 888	28 406	21 193	41 105	40 418	30 155
Profitability of operating activities (%)	8.18%	8.04%	6.43%	8.18%	8.04%	6.43%
Profit for the year	25 729	25 792	19 165	36 610	36 699	27 269
Net profitability (%)	7.28%	7.30%	5.81%	7.28%	7.30%	5.81%
Total liquidity	2.15	2.51	1.70	2.15	2.51	1.70
Total assets	463 777	429 851	461 494	659 895	611 623	656 648
Equity	345 537	338 960	329 060	491 655	482 297	468 210
Return on assets (ROA)	5.76%	5.79%	4.03%	5.76%	5.79%	4.03%
Return on equity (ROE)	7.52%	7.72%	5.86%	7.52%	7.72%	5.86%
Number of shares	39 900	39 900	39 900	39 900	39 900	39 900
	<b>LVL</b>	<b>LVL</b>	<b>LVL</b>	<b>EUR</b>	<b>EUR</b>	<b>EUR</b>
Profit per share	0.645	0.646	0.480	0.918	0.920	0.683
P/E	8.76	7.58	8.54	8.76	7.58	8.54
BV	8.66	8.50	8.25	12.32	12.09	11.73
P/BV	0.65	0.58	0.50	0.65	0.58	0.50
Dividends per share*	0.50	0.50	0.40	0.71	0.71	0.57
Return on dividends (dividends per share/ profit per share)	0.78	0.77	0.83	0.78	0.77	0.83
Share price at the end of the period	5.65	4.90	4.10	8.04	6.97	5.83

\* The Board of the Company will propose to the Council to pay dividends in amount of LVL 0.55 (EUR 0.783) for each share in year 2011.

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**Report of the Board of Directors** (continued)

**2. Research and development measures**

In order to ensure uninterrupted natural gas supply to users and safe operation of the gas supply system in long term, the Company has developed the "Plan of measures for the improvement of safety of the gas supply system of the Joint Stock Company "Latvijas Gāze" 2010-2015". It has been prepared based on the conclusions made by the Russian companies "Gazobezopasnostj" and "Lentransgaz", the institutes "VNIIGAZ" and "Giprospecgaz", as well as the German companies "Pipeline Engineering GmbH", "Untergrundspeicher und Geotechnologie – Systeme GmbH", "E.ON Engineering GmbH", "E.ON Ruhrgas International AG" and other partners regarding the technical condition of the equipment and modernization options.

The plan of measures envisages investment in safety improvement for the total amount of LVL 50.6 million (EUR 72 million). This basically includes projects aimed at the improvement of system safety, the gasification of new objects and the enhancement of gas supply stability in the whole region.

In the reporting year, the OJSC „Gazprom VNIIGAZ” prepared a programme of modernization of the Inčukalns UGS up to 2025. The concept covers two development scenarios – with and without increasing the natural gas storage capacity. The projected costs are LVL 253 million (EUR 360 million) and LVL 133.5 million (EUR 190 million) respectively.

**3. Financial Risk Management**

The operation of the Company is exposed to a variety of financial risks, including credit risk and risks of fluctuation of foreign currency rates and interest rates. The management of the Company strives to minimize the negative impact of potential financial risks on the financial state of the Company.

The Company is not directly subject to the risk of fluctuation of foreign currency rates as the gas purchase price is set in USD and subsequently recalculated into EUR, whereas gas sale tariffs are set in lats. Settlements for the supplied gas are made in EUR. The lats rate is pegged to the euro rate since January 1, 2005, so fluctuations of the LVL/EUR rate are limited and unlikely to have a notable influence on further financial results. Gas purchase price changes in USD depending on the oil products quotation are covered by the PUC-approved natural gas sale tariffs, which to a certain extent cover the fluctuations of both the LVL/EUR and EUR/USD rate. The risk of fluctuation of foreign currency rates as concerns debts to suppliers is kept under control by holding a considerable part of cash assets in deposits of the respective currency.

As of the end of the reporting year, the Company has no loans, thus it is not subject to interest rate risk.

The financial assets subject to credit risk basically consist of customer debts and cash. The Company is exposed to a considerable degree of credit risk because a notable share of the net turnover applies to a limited number of customers. Four of the Company's customers make up to 52.9% (in 2010 – 45.5%) of sales, and one of these debtors as at December 31, 2011 comprised 21.8% (in 2010 – 22.1%) of the total amount of customer debts, the second and third major debtors 6.9% and 6.7% respectively (in 2010 – 7.5% and 5.8%).

The Company has introduced and observes a credit policy that envisages selling goods on credit only to customers with a good credit history, controlling the amount of credit set for each customer.

The customer debts are shown at their recoverable value. The Company's partners in monetary transactions are local financial institutions with a proper credit history.

The Company observes cautious liquidity risk management, ensuring sufficient availability of credit resources for meeting liabilities in due time.

**4. Post balance sheet events**

There are no subsequent events since the last date of the reporting year that would have a significant effect on the financial position of the Company as at December 31, 2011.

On January 23, 2012 the Board of the Company agreed to sign an agreement with JSC „BDO” on revaluation of the Company's property, plant and equipment as at February 1, 2012, by using the amortised replacement cost method.

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**Report of the Board of Directors** (continued)

**5. Distribution of profit 2011 suggested by the Board**

Distribution of the profit is made based on net profit which is reported in the Company's financial statements prepared in accordance with the Law on Annual Reports of the Republic of Latvia.

Difference with the net profit shown in those financial statements is LVL 1.4 million (EUR 2 million) and it arose as a result of different accounting treatment for disposed revalued property, plant and equipment and related deferred income tax adjustment.

	<b>2011</b>	<b>2011</b>
	<b>LVL</b>	<b>EUR</b>
Profit of the reporting year (in accordance the Law on Annual Reports of the Republic of Latvia)	27 175 200	38 666 826
Share of profit not available for distribution (unrealized deferred tax gain related to the revaluation of property, plant and equipment)	(1 478 951)	(2 104 358)
Share of profit available for distribution	25 696 249	36 562 468
Suggested distribution of profit:		
dividends to shareholders (80.8%)	21 945 000	31 224 922
dividends per share (LVL/1 share)	0.55	0.783
Statutory reserves	3 751 249	5 337 546

Some members of the Council and the Board of the Company hold shares and interests at numerous companies registered in the Registry of Enterprises of the Republic of Latvia, and they perform managerial functions there. Over the reporting year, the Company has not executed transactions of considerable amount (except for those listed in the financial statement) with these companies.

Information of the shares of the Company held by members of the Board and the Council of the Company is available at the Board of the Company.

**6. Shares and shareholders**

Composition of shareholders<sup>1</sup> of the Company as on December 31, 2011 and previous periods:

Shareholder	31.12.2011.	31.12.2010.	31.12.2009.
"E.ON Ruhrgas International" GmbH	47.2%	47.2%	47.2%
"Gazprom" AAS	34.0%	34.0%	34.0%
"Itera Latvija" SIA	16.0%	16.0%	16.0%
Other	2.8%	2.8%	2.8%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>1</sup> Shareholders owning not less than 5% of capital



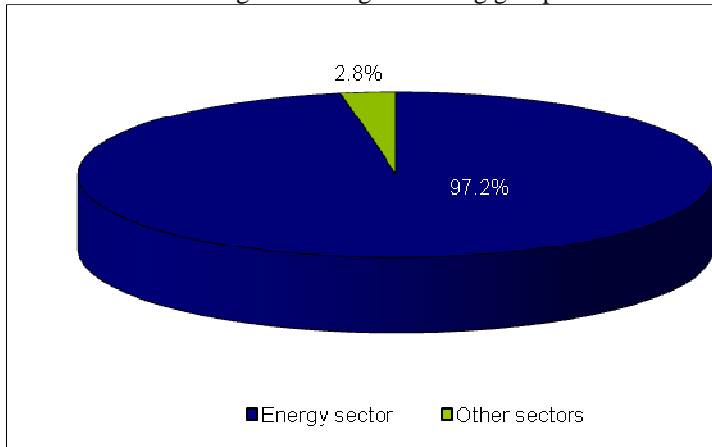
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**Report of the Board of Directors** (continued)

**6. Shares and shareholders** (continued)

Distribution of holdings according to holding groups as on December 31, 2011:



List of shareholders with special control rights as on December 31, 2011:

Members of the Board		Number of shares
Chairman of the Board	Adrians Dāvis	417
Vice-Chairman of the Board	Jörg Tumat M.A.	900
Vice-Chairman of the Board	Alexander Mihejev	417
Member of the Board	Anda Ulpe	729
Member of the Board	Gints Freibergs	416

Members of the Council		Number of shares
Chairman of the Council	Kirill Seleznev	0
Vice-chairman of the Council	Peter Frankenberg	0
Vice-chairman of the Council	Juris Savickis	0
Members of the Council:	Joachim Hockertz	0
	Uwe Fip	0
	Mario Nullmeier	0
	Heinz Watzka	0
	Yelena Karpel	0
	Alexander Krasnenkov	0
	Vlada Rusakova	0
	Igor Nazarov	0

Since February 15, 1999 the shares of the Company are quoted at the NASDAQ OMX Riga Stock Exchange. and its share trade code since August 1, 2004 is GZE1R.

ISIN	LV0000100899
Stock exchange code	GZE1R
List	Second list
Nominal value	1.00 LVL
Total shares	39 900 000
Shares traded	25 328 520
Liquidity provider	None

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**Report of the Board of Directors** (continued)

**6. Shares and shareholders** (continued)

Shares price of the Company as on December 31, 2011 and previous periods:

	2011	2010	2009	2008	2007
Shares price (LVL):					
First	4.80	4.57	4.55	7.25	10.35
Highest	7.00	6.00	6.00	8.20	11.25
Lowest	4.60	4.57	3.32	3.62	7.05
Average	5.32	5.15	4.31	6.77	10.34
Last	5.65	4.90	4.10	4.55	7.12
Change	17.73%	7.22%	-9.89%	-37.24%	-31.21%
Share turnover, number	218 132	85 493	64 319	46 565	154 825
Share turnover, million LVL	1.160	0.440	0.277	0.315	1.600
Number of deals	1 284	988	1 267	1 711	1 074
Capitalisation (million LVL)	225.475	195.510	163.590	181.545	284.088

Source: NASDAQ OMX Riga

The capitalization value of the Company during 12 month of 2011 reached LVL 225.47 million – by 29.96 million more than during 12 months of previous reporting period. By share market capitalization of the Company took the 1<sup>st</sup> place among companies quoted at the NASDAQ OMX RIGA and the 4<sup>th</sup> place among companies quoted at the NASDAQ OMX Baltic Stock Exchange (2010: 1<sup>st</sup> and 8<sup>th</sup> place respectively).

LG share prices OMX Riga GI un OMX Baltic GI index changes (01.01.2008 - 31.12.2011):



Source: NASDAQ OMX Riga

Indexes/shares	01.01.2008.	31.12.2011.	Change
OMX Riga GI	595.30	371.16	-37.65%
OMX Baltic GI	515.40	325.54	-36.84%
LG share price (LVL)	7.12	5.65	-20.63%

**7. Future prospect**

Having regard of the investments in the improvement of the system operation safety, the expansion of the gas pipeline network and the attraction of new customers made in previous years and in the reporting year, as well as considering the situation in the fuel market of Latvia, the Board of the Company believes that in 2012 the Company will continue successful development and take a stable place in the fuel supply market.

Chairman of the Board

A. Dāvis

Board meeting minutes No. 18 (2012)  
Riga, April 27, 2012

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**STATEMENT OF DIRECTORS' RESPONSIBILITY**

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

The financial statements on pages 14 to 59 are prepared in accordance with the accounting records and source documents and present fairly the financial position of the Company as of 31 December 2011 and the results of its operations and cash flows for the year ended 31 December 2011.

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

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

On behalf of the Board of Directors,

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Adrians Dāvis  
Chairman of the Board

Riga, April 27, 2012

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**AUDITORS' REPORT**

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**BALANCE SHEET AS AT 31 DECEMBER 2011**

	Note	31.12.2011. LVL'000	31.12.2010. LVL'000	31.12.2011. EUR'000	31.12.2010. EUR'000
<b>Assets</b>					
<u>Non-current assets</u>					
Property, plant and equipment	3	315 130	316 990	448 390	451 036
Intangible assets	4	2 076	2 229	2 954	3 172
Trade receivables	5	1 898	3	2 701	4
		<u>319 104</u>	<u>319 222</u>	<u>454 045</u>	<u>454 212</u>
<u>Current assets</u>					
Inventories	6	38 591	10 975	54 910	15 616
Trade receivables	5	28 881	37 035	41 094	52 696
Current income tax receivable	21	2 432	-	3 460	-
Other receivables	7	49 712	25 046	70 733	35 637
Cash and cash equivalents	8	25 057	37 573	35 653	53 462
		<u>144 673</u>	<u>110 629</u>	<u>205 850</u>	<u>157 411</u>
<b>Total assets</b>		<b><u>463 777</u></b>	<b><u>429 851</u></b>	<b><u>659 895</u></b>	<b><u>611 623</u></b>
<b>Equity and liabilities</b>					
<u>Equity</u>					
Share capital	9	39 900	39 900	56 773	56 773
Share premium		14 320	14 320	20 376	20 376
Revaluation reserve		185 105	185 754	263 381	264 303
Other reserves		76 883	71 910	109 395	102 319
Retained earnings		29 329	27 076	41 730	38 525
<b>Total equity</b>		<b><u>345 537</u></b>	<b><u>338 960</u></b>	<b><u>491 655</u></b>	<b><u>482 296</u></b>
<u>Liabilities</u>					
<u>Non-current liabilities</u>					
Deferred income tax liabilities	21	26 444	27 822	37 626	39 587
Accruals for post employment benefits and other employee benefits	22	4 082	4 896	5 809	6 966
Deferred income	11	20 341	13 855	28 942	19 714
		<u>50 867</u>	<u>46 573</u>	<u>72 377</u>	<u>66 267</u>
<u>Current liabilities</u>					
Trade payables		35 660	11 735	50 740	16 698
Corporate income tax liability	21	-	1 230	-	1 750
Deferred income	11	5 438	7 565	7 738	10 764
Other payables	12	26 275	23 788	37 385	33 848
		<u>67 373</u>	<u>44 318</u>	<u>95 863</u>	<u>63 060</u>
<b>Total liabilities</b>		<b><u>118 240</u></b>	<b><u>90 891</u></b>	<b><u>168 240</u></b>	<b><u>129 327</u></b>
<b>Total equity and liabilities</b>		<b><u>463 777</u></b>	<b><u>429 851</u></b>	<b><u>659 895</u></b>	<b><u>611 623</u></b>

The notes on pages 19 to 59 are an integral part of these financial statements.

Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2011**

**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2011**

	Note	2011 LVL'000	2010 LVL'000	2011 EUR'000	2010 EUR'000
Revenue	13	353 338	353 345	502 755	502 765
Cost of sales	14	(311 576)	(314 673)	(443 333)	(447 740)
<b>Gross profit</b>		<b>41 762</b>	<b>38 672</b>	<b>59 422</b>	<b>55 025</b>
Administrative expenses	15	(10 775)	(7 073)	(15 329)	(10 064)
Other income	16	2 781	2 777	3 957	3 952
Other expenses	17	(4 880)	(5 970)	(6 945)	(8 495)
<b>Operating profit</b>		<b>28 888</b>	<b>28 406</b>	<b>41 105</b>	<b>40 418</b>
Finance income	19	331	1 493	471	2 124
<b>Profit before income tax</b>		<b>29 219</b>	<b>29 899</b>	<b>41 576</b>	<b>42 542</b>
Income tax expense	21	(3 490)	(4 107)	(4 966)	(5 844)
<b>Profit for the year</b>		<b>25 729</b>	<b>25 792</b>	<b>36 610</b>	<b>36 698</b>
<b>Earnings per share</b>		<b>LVL</b>	<b>LVL</b>	<b>EUR</b>	<b>EUR</b>
Basic	23a	0.645	0.646	0.918	0.920
Diluted	23a	0.645	0.646	0.918	0.920

**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2011**

OTHER COMPREHENSIVE INCOME

<b>Tax sections, net</b>					
Revaluation of property, plant and equipment - gross		938	81	1 335	115
Deferred income tax liability arising on the revaluation of property, plant and equipment	21	(141)	(12)	(200)	(17)
<b>Other comprehensive income for the year, net of tax</b>		<b>797</b>	<b>69</b>	<b>1 135</b>	<b>98</b>
Profit for the year		25 729	25 792	36 610	36 698
<b>Total comprehensive income for the year</b>		<b>26 526</b>	<b>25 861</b>	<b>37 745</b>	<b>36 796</b>

The notes on pages 19 to 59 are an integral part of these financial statements.

The financial statements on pages 14 to 59 were approved by the Board of Directors and were signed on its behalf by:

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

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

April 27, 2012

Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2011**

	Share capital LVL'000	Share premium LVL'000	Revaluation reserve LVL'000	Other reserves LVL'000	Retained earnings LVL'000	Total LVL'000
<b>Balance as at 31 December 2009</b>	<b>39 900</b>	<b>14 320</b>	<b>186 360</b>	<b>69 540</b>	<b>18 940</b>	<b>329 060</b>
<i>Other comprehensive income</i>						
Revaluation of property, plant and equipment - gross	-	-	81	-	-	81
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(12)	-	-	(12)
Disposal of revalued property, plant and equipment	-	-	(794)	-	794	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	119	-	(119)	-
<i>Total other comprehensive income</i>	-	-	(606)	-	675	69
Profit for the year	-	-	-	-	25 792	25 792
<b>Total comprehensive income for 2010</b>	<b>-</b>	<b>-</b>	<b>(606)</b>	<b>-</b>	<b>26 467</b>	<b>25 861</b>
<i>Transactions with owners</i>						
Transfers to reserves	-	-	-	2 370	(2 370)	-
Dividends for 2009	-	-	-	-	(15 960)	(15 960)
Rounding difference	-	-	-	-	(1)	(1)
<b>Balance as at 31 December 2010</b>	<b>39 900</b>	<b>14 320</b>	<b>185 754</b>	<b>71 910</b>	<b>27 076</b>	<b>338 960</b>
<i>Other comprehensive income</i>						
Revaluation of property, plant and equipment - gross	-	-	938	-	-	938
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(141)	-	-	(141)
Disposal of revalued property, plant and equipment	-	-	(1 701)	-	1 701	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	255	-	(255)	-
<i>Total other comprehensive income</i>	-	-	(649)	-	1 446	797
Profit for the year	-	-	-	-	25 729	25 729
<b>Total comprehensive income for 2011</b>	<b>-</b>	<b>-</b>	<b>(649)</b>	<b>-</b>	<b>27 175</b>	<b>26 526</b>
<i>Transactions with owners</i>						
Transfers to reserves	-	-	-	4 972	(4 972)	-
Dividends for 2010	-	-	-	-	(19 950)	(19 950)
Rounding difference	-	-	-	1	-	1
<b>Balance as at 31 December 2011</b>	<b>39 900</b>	<b>14 320</b>	<b>185 105</b>	<b>76 883</b>	<b>29 329</b>	<b>345 537</b>

The notes on pages 19 to 59 are an integral part of these financial statements,



Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2011 (CONTINUED)**

	Share capital EUR'000	Share premium EUR'000	Revaluation reserve EUR'000	Other reserves EUR'000	Retained earnings EUR'000	Total EUR'000
<b>Balance as at 31 December 2009</b>	<b>56 773</b>	<b>20 376</b>	<b>265 167</b>	<b>98 947</b>	<b>26 948</b>	<b>468 211</b>
<i>Other comprehensive income</i>						
Revaluation of property, plant and equipment - gross	-	-	115	-	-	115
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(17)	-	-	(17)
Disposal of revalued property, plant and equipment	-	-	(1 130)	-	1 130	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	169	-	(169)	-
<i>Total other comprehensive income</i>	-	-	(863)	-	961	98
Profit for the year	-	-	-	-	36 699	36 699
<b>Total comprehensive income for 2010</b>	<b>-</b>	<b>-</b>	<b>(863)</b>	<b>-</b>	<b>37 659</b>	<b>36 796</b>
<i>Transactions with owners</i>						
Transfers to reserves	-	-	-	3 372	(3 372)	-
Dividends for 2009	-	-	-	-	(22 709)	(22 709)
Rounding difference	-	-	(1)	-	(1)	(2)
<b>Balance as at 31 December 2010</b>	<b>56 773</b>	<b>20 376</b>	<b>264 303</b>	<b>102 319</b>	<b>38 525</b>	<b>482 296</b>
<i>Other comprehensive income</i>						
Revaluation of property, plant and equipment - gross	-	-	1 335	-	-	1 335
Deferred income tax liability arising on the revaluation of property, plant and equipment	-	-	(200)	-	-	(200)
Disposal of revalued property, plant and equipment	-	-	(2 420)	-	2 420	-
Deferred income tax on disposal of revalued property, plant and equipment	-	-	363	-	(363)	-
<i>Total other comprehensive income</i>	-	-	(922)	-	2 057	1 135
Profit for the year	-	-	-	-	36 610	36 610
<b>Total comprehensive income for 2011</b>	<b>-</b>	<b>-</b>	<b>(922)</b>	<b>-</b>	<b>38 667</b>	<b>37 745</b>
<i>Transactions with owners</i>						
Transfers to reserves	-	-	-	7 075	(7 075)	-
Dividends for 2010	-	-	-	-	(28 386)	(28 386)
Rounding difference	-	-	-	1	(1)	-
<b>Balance as at 31 December 2011</b>	<b>56 773</b>	<b>20 376</b>	<b>263 381</b>	<b>109 395</b>	<b>41 730</b>	<b>491 655</b>

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

The notes on pages 19 to 59 are an integral part of these financial statements.

Translation from Latvian Original

**JOINT STOCK COMPANY "LATVIJAS GĀZE"**  
**FINANCIAL STATEMENTS**  
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**STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2011**

	Note	2011 LVL'000	2010 LVL'000	2011 EUR'000	2010 EUR'000
<b>Cash flows from operating activities</b>					
Cash generated from operations	24	39 993	41 518	56 902	59 075
Interest received		1 184	2 671	1 685	3 800
Income tax paid	21	(8 416)	(3 291)	(11 974)	(4 683)
<b>Net cash generated from operating activities</b>		<b>32 761</b>	<b>40 898</b>	<b>46 613</b>	<b>58 192</b>
<b>Cash flows used in investing activities</b>					
Purchases of property, plant and equipment		(19 075)	(22 690)	(27 141)	(32 284)
Proceeds from sale of property, plant and equipment		37	128	53	182
Purchases of intangible assets		(634)	(613)	(902)	(872)
Term deposits		(9 207)	-	(13 100)	-
<b>Net cash used in investing activities</b>		<b>(28 879)</b>	<b>(23 175)</b>	<b>(41 090)</b>	<b>(32 974)</b>
<b>Cash flows used in financing activities</b>					
EC funding received		3 552	-	5 054	-
Dividends paid		(19 950)	(15 960)	(28 386)	(22 709)
<b>Net cash used in from financing activities</b>		<b>(16 398)</b>	<b>(15 960)</b>	<b>(23 332)</b>	<b>(22 709)</b>
<b>Net increase / (decrease) in cash and cash equivalents during the year</b>		<b>(12 516)</b>	<b>1 763</b>	<b>(17 809)</b>	<b>2 509</b>
Cash and cash equivalents at the beginning of the year		37 573	35 810	53 462	50 953
<b>Cash and cash equivalents at the end of the year</b>	8	<b>25 057</b>	<b>37 573</b>	<b>35 653</b>	<b>53 462</b>

The notes on pages 19 to 59 are an integral part of these financial statements.

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**JOINT STOCK COMPANY "LATVIJAS GĀZE"  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011**

**NOTES TO THE FINANCIAL STATEMENTS**

**1 INCORPORATION AND ACTIVITIES**

The Company was re-organised on January 31, 1994 as a joint stock company wholly owned by the Government of the Republic of Latvia. The Company was formerly a state enterprise, which had its assets transferred to and obligations assumed by the joint stock company in accordance with the law. Since 15 February, 1999 the shares of the Company are quoted on NASDAQ OMX Riga Stock Exchange. The registered office of the Company is 20 Vagonu Street, Riga, Latvia.

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

The applied differential natural gas sale end tariffs consist of two parts: fixed tariffs for regulated services and the natural gas sale price, which changes with a step of 5 LVL/thous.m<sup>3</sup> depending on the actual natural gas purchase costs. The tariffs of gas sold to corporate and retail customers are set by the Public Utilities Commission (PUC) of the Republic of Latvia. Changes to tariffs are considered by PUC based on applications of the Company and in accordance with the methodology approved by PUC. The natural gas sale end tariff applied to users with the annual consumption volume over 25 thousand nm<sup>3</sup> changes every month, whereas to users with the annual consumption up to 25 thousand nm<sup>3</sup> – once in half year, on January 1 and July 1.

During 2011 the average number of persons employed by the Company was 1 270 (2010: 1 264).

These financial statements have been approved by the Board of Directors on April 27, 2012.

**2 ACCOUNTING POLICIES**

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

**(a) Basis of preparation**

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

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

The preparation of 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 Management's best knowledge of current events and actions, actual results ultimately may differ from those. Significant accounting estimates are described in Note 28.

*Certain new IFRSs became effective for the Company from 1 January 2011. Listed below are those new or amended standards or interpretations which are relevant to the Company's operations and the nature of their impact on the Company's accounting policies*

**Improvements to International Financial Reporting Standards** (issued in May 2010; most of the amendments are effective for annual periods beginning on or after 1 January 2011).

The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying value to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a

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

**2 ACCOUNTING POLICIES (CONTINUED)**

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

first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; IAS 1 was amended to clarify that the components of the statement of changes in equity include profit or loss, other comprehensive income, total comprehensive income and transactions with owners and that an analysis of other comprehensive income by item may be presented in the notes; IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits.

***Amendment to IAS 24, Related Party Disclosures***

The amendments did not have a material effect on these financial statements.

*The following new and amended IFRSs and interpretations became effective in 2011, but are not relevant for the Company's operations and did not have an impact on these financial statements.*

***Amendment to IAS 32 - Classification of Rights Issues***

***Amendment to IFRS 1*** Limited exemption from comparative IFRS 7 disclosures for first-time adopters

***Amendment to IFRIC 14***, Prepayments of a Minimum Funding Requirement

***IFRIC 19***, Extinguishing financial liabilities with equity instruments

*Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 January 2012 or later periods and which are not relevant to the Company or are not yet endorsed by the EU:*

***Disclosures—Transfers of Financial Assets – Amendments to IFRS 7***(effective for annual periods beginning on or after 1 July 2011).

***Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendment to IFRS 1.*** (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU).

***Deferred Tax: Recovery of Underlying Assets – Amendment to IAS 12*** (effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU).

***Employee benefits – Amendment to IAS 19*** (effective for annual periods beginning on or after 1 July 2012; not yet adopted by the EU).

***Financial statement presentation` regarding other comprehensive income – Amendment to IAS 1*** (effective for annual periods beginning on or after 1 July 2012; not yet adopted by the EU).

***Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32,*** (effective for annual periods beginning on or after 1 January 2014; not yet endorsed by the EU).

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

**2 ACCOUNTING POLICIES (CONTINUED)**

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

*Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7* (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU).

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

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

*IFRS 11, Joint arrangements* (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU).

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

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

*Separate financial statements - IAS 27 (revised 2011)*, (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU).

*Associates and joint ventures - IAS 28 (revised 2011)*, (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU).

*IFRIC 20, Stripping costs in the production phase of a surface mine*, (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU).

**(b) Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the board that makes strategic decisions. Board uses profit before tax as a profit measure of segments.

The Company has five operating segments: gas transmission (a type of power supply, which includes transportation of natural gas through high-pressure gas line to deliver it to respective distribution system or directly to a consumer, except sale of natural gas), gas storage (natural gas storage at the Inčukalns Underground Gas Storage Facility), gas distribution (a type of power supply, which includes transportation of natural gas through high-, moderate- and low-pressure gas line, except sale of natural gas), gas realization (a type of power supply, which includes purchasing of natural gas for realization and sale to natural gas to consumers) and other services. Division into segments corresponds to technological process of gas supply and is required for analysis of tariffs and expenses.

**(c) Foreign currency translation**

*Functional and presentation currency*

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates ('the functional currency'). The financial statements are presented in Latvian Lats (LVL), which is the Company's functional and presentation currency. In accordance with the requirements of the NASDAQ OMX RIGA all balances are also presented in Euro (EUR). For disclosure purposes the translation into EUR is based on the official exchange rate as set by the Bank of Latvia (determined by Bank of Latvia as of December 30, 2004 reposing to resolution of the Council of Bank of Latvia) during period from 1 January 2010 to 31 December 2011 – EUR/LVL (1 EUR = LVL 0.702804).

*Transactions and balances*

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

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

**2 ACCOUNTING POLICIES (CONTINUED)**

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

Buildings, gas transmission and distribution system and equipment are stated at fair value, based on periodic valuation less subsequent depreciation or impairment charge. Revaluation shall be made with sufficient regularity to ensure the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Revaluation is performed every 5 years using depreciated replacement cost method. All other property, plant and equipment (including land and buffer gas) are stated at historical cost, less accumulated depreciation and impairment charge. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

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

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

Land, buffer gas, advances for property, plant and equipment and assets under construction are not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

	<b>years</b>
Buildings	60 - 100
Gas transmission and distribution system	40 - 50
Machinery and equipment	5 - 20
Furniture and fittings	5 - 10
Computers and equipment	3.33

The Company's policy is to capitalize property, plant and equipment with cost exceeding LVL 150 (EUR 213) and useful life exceeding 1 year.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note (f)).

Costs of borrowing to finance assets under construction and other direct charges related to the particular asset under construction are capitalised, during the time that is required to complete and prepare the asset for its intended use, as part of the cost of the asset. Capitalisation of the borrowing costs is suspended during extended periods in which active developments are interrupted.

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

**(e) Intangible assets**

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

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

**2 ACCOUNTING POLICIES (CONTINUED)**

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

All Company's non-financial assets have a finite useful life (except land). Assets that are subject to amortization or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

**(g) Financial assets**

The Company classifies all its financial assets as Loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date. Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for assets with maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. Receivables are classified as 'trade receivables', 'other current assets' and 'cash and cash equivalents' in the balance sheet (Notes 2(i) and 2(j)).

**(h) Inventories**

The cost of natural gas in Inčukalns UGS and in gas transmission pipelines is determined separately using the first-in first-out (FIFO) method based on total natural gas movement. Materials, spare parts, gas meters and other inventories cost is determined using the weighted average method. The cost of natural gas comprises cost of gas purchased.

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

**(i) Trade receivables**

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

If, in subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as improvement of the debtor's credit rating), the reversal of the previously recognized impairment loss is recognized in the income statement.

**(j) Cash and cash equivalents**

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

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

Ordinary shares are classified as equity. Incremental external costs directly attributable to the issues of new shares, are shown in equity as a deduction, net of tax, from the proceeds. Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

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

**2 ACCOUNTING POLICIES (CONTINUED)**

**(l) Borrowings**

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

**(m) Deferred income tax**

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss, it is not accounted for.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the temporary differences will reverse.

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

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 assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis."

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

**(n) Income tax**

Income tax is assessed for the period in accordance with Latvian tax legislation. The tax rate stated by Latvian tax legislation is 15 percent.

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

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

**(p) Employee benefits**

*Bonus plans*

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



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

**2 ACCOUNTING POLICIES (CONTINUED)**

**(p) Employee benefits (continued)**

*Social security and pension contribution*

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

*Post employment and other employee benefits*

The Company provides defined benefits upon retirement and in the period of employment for employees whose employment conditions meet defined criteria according to the Employment contract. Amount of benefit liability is calculated based on current salary level and number of employees, which are entitled or may become entitled to receive those payments, as well as based on actuarial assumptions. Once a year an actuary evaluates these liabilities. Expected benefit expenses are accrued during the employment period.

**(q) Trade payables**

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

**(r) Revenue recognition**

The Company recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Company's activities as described below. The Company bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

*Sales of natural gas*

Sales are recognised upon delivery of gas, net of value added tax and discounts and the difference between the forecasted and actual purchase cost of natural gas, which is used for determination of applicable natural gas selling price for the following month. Sales of natural gas to residential customers are recorded on the basis of meter

readings reported by customers. Where relevant, this includes an estimate of the sales volume of gas supplied between the date of the last meter reading and the year-end. Natural gas sales to corporate customers are recognized based on invoice issued according to meter reading of customers.

*Income of transmission and storage on natural gas*

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

Applicable natural gas selling price is calculated based on latest available data. The exchange rate for EUR/USD set by ECB in the last day of the previous month, actual gross calorific value of gas in the previous month as well as planned volume of received and delivered gas are used in the calculation. Actual purchase costs of natural gas are calculated based on methodology approved by the PUC's Council, taking into account the exchange rate of EUR/USD at last day of the month when gas is delivered, actual gas gross calorific value as well as actual volume of gas purchased from suppliers.

*Interest income*

Interest income is recognized using the effective interest method. Interest income on term deposits is classified as Other income and interest on cash balances is classified as Finance income. Accrual of interest income is ceased, if it's recoverability is uncertain.

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**2 ACCOUNTING POLICIES (CONTINUED)**

**(p) Revenue recognition** (continued)

*Penalties income*

Based on prudence principle penalties, including fines for late payments for gas, are recognized when received.

*Income from contribution to financing of construction works*

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

*Income from EC funding*

EC funding related to property, plant and equipment is recognized as deferred income and is credited to the income statement systematically over the expected lives of the related assets.

*Other services*

Sales of services are recognised in the accounting period in which the services are rendered.

**(s) Earnings per share**

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

**(t) Related parties**

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

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**3 PROPERTY, PLANT AND EQUIPMENT**

	Land	Buffer gas	Buildings and gas transmission system	Equipment and machinery	Other assets	Advances	Assets under construction	Total
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000
<b>Cost or revaluation</b>								
<b>At December 31, 2009</b>	<b>1 785</b>	<b>6 590</b>	<b>600 277</b>	<b>82 232</b>	<b>10 954</b>	<b>14</b>	<b>5 111</b>	<b>706 963</b>
Additions	-	-	-	-	-	1 985	20 504	22 489
Reclassified	-	-	9 885	1 653	1 146	(1 974)	(10 710)	-
Revaluation	-	-	81	-	-	-	-	81
Disposals	-	-	(1 925)	(1 353)	(405)	-	(12)	(3 695)
Transferred to intangible assets	-	-	-	(2)	2	-	14	14
<b>At December 31, 2010</b>	<b>1 785</b>	<b>6 590</b>	<b>608 318</b>	<b>82 530</b>	<b>11 697</b>	<b>25</b>	<b>14 907</b>	<b>725 852</b>
<b>Depreciation</b>								
<b>At December 31, 2009</b>	<b>-</b>	<b>-</b>	<b>345 295</b>	<b>40 571</b>	<b>5 988</b>	<b>-</b>	<b>-</b>	<b>391 854</b>
Charged for 2010	-	-	14 467	4 686	1 098	-	-	20 251
Revaluation	-	-	(1 383)	(1 246)	(350)	-	-	(2 979)
Disposals	-	-	(242)	(22)	-	-	-	(264)
<b>At December 31, 2010</b>	<b>-</b>	<b>-</b>	<b>358 137</b>	<b>43 989</b>	<b>6 736</b>	<b>-</b>	<b>-</b>	<b>408 862</b>
<b>Net book value at December 31, 2010</b>	<b>1 785</b>	<b>6 590</b>	<b>250 181</b>	<b>38 541</b>	<b>4 961</b>	<b>25</b>	<b>14 907</b>	<b>316 990</b>
<b>Net book value at December 31, 2009</b>	<b>1 785</b>	<b>6 590</b>	<b>254 982</b>	<b>41 661</b>	<b>4 966</b>	<b>14</b>	<b>5 111</b>	<b>315 109</b>
	Land	Buffer gas	Buildings and gas transmission system	Equipment and machinery	Other assets	Advances	Assets under construction	Total
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000
<b>Cost or revaluation</b>								
<b>At December 31, 2010</b>	<b>1 785</b>	<b>6 590</b>	<b>608 318</b>	<b>82 530</b>	<b>11 697</b>	<b>25</b>	<b>14 907</b>	<b>725 852</b>
Additions	-	-	-	-	-	1 843	17 421	19 264
Reclassified	-	-	19 306	2 912	1 144	(1 783)	(21 579)	-
Revaluation	-	-	66	2	(15)	-	-	53
Correction*	-	-	4 657	28	-	-	-	4 685
Disposals	-	-	(5 935)	(879)	(254)	-	(4)	(7 072)
Transferred to inventories	-	-	-	-	-	-	(12)	(12)
Rounding	-	-	-	-	-	-	(1)	(1)
<b>At December 31, 2011</b>	<b>1 785</b>	<b>6 590</b>	<b>626 412</b>	<b>84 593</b>	<b>12 572</b>	<b>85</b>	<b>10 732</b>	<b>742 769</b>
<b>Depreciation</b>								
<b>At December 31, 2010</b>	<b>-</b>	<b>-</b>	<b>358 137</b>	<b>43 989</b>	<b>6 736</b>	<b>-</b>	<b>-</b>	<b>408 862</b>
Charged for 2011	-	-	14 904	4 323	1 194	-	-	20 420
Correction*	-	-	3 795	17	-	-	-	3 812
Reclassified	-	-	2	(45)	43	-	-	-
Disposals	-	-	(4 419)	(790)	(247)	-	-	(5 456)
<b>At December 31, 2011</b>	<b>-</b>	<b>-</b>	<b>372 419</b>	<b>47 494</b>	<b>7 726</b>	<b>-</b>	<b>-</b>	<b>427 639</b>
<b>Net book value at December 31, 2011</b>	<b>1 785</b>	<b>6 590</b>	<b>253 993</b>	<b>37 099</b>	<b>4 846</b>	<b>85</b>	<b>10 732</b>	<b>315 130</b>
<b>Net book value at December 31, 2010</b>	<b>1 785</b>	<b>6 590</b>	<b>250 181</b>	<b>38 541</b>	<b>4 961</b>	<b>25</b>	<b>14 907</b>	<b>316 990</b>

\* During the reporting year the management has identified assets which had no carrying value, proper correction of book values

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and depreciation are made in the financial statements.

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

**3 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

	Land	Buffer gas	Buildings and gas transmission system	Equipment and machinery	Other assets	Advances	Assets under construction	Total
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>Cost or revaluation</b>								
<b>At December 31, 2009</b>	<b>2 540</b>	<b>9 377</b>	<b>854 118</b>	<b>117 007</b>	<b>15 586</b>	<b>20</b>	<b>7 273</b>	<b>1 005 921</b>
Additions	-	-	-	-	-	2 824	29 175	31 999
Reclassified	-	-	14 065	2 352	1 631	(2 809)	(15 239)	-
Revaluation	-	-	115	-	-	-	-	115
Disposals	-	-	(2 739)	(1 925)	(576)	-	(17)	(5 257)
Transferred to intangible assets	-	-	-	(3)	3	-	20	20
<b>At December 31, 2010</b>	<b>2 540</b>	<b>9 377</b>	<b>865 559</b>	<b>117 431</b>	<b>16 644</b>	<b>35</b>	<b>21 212</b>	<b>1 032 798</b>
<b>Depreciation</b>								
<b>At December 31, 2009</b>	-	-	<b>491 311</b>	<b>57 729</b>	<b>8 521</b>	-	-	<b>557 561</b>
Charged for 2010	-	-	20 585	6 668	1 562	-	-	28 815
Revaluation	-	-	(1 968)	(1 773)	(498)	-	-	(4 239)
Disposals	-	-	(344)	(31)	-	-	-	(375)
<b>At December 31, 2010</b>	-	-	<b>509 584</b>	<b>62 593</b>	<b>9 585</b>	-	-	<b>581 762</b>
<b>Net book value at December 31, 2010</b>	<b>2 540</b>	<b>9 377</b>	<b>355 975</b>	<b>54 838</b>	<b>7 059</b>	<b>35</b>	<b>21 212</b>	<b>451 036</b>
<b>Net book value at December 31, 2009</b>	<b>2 540</b>	<b>9 377</b>	<b>362 807</b>	<b>59 278</b>	<b>7 065</b>	<b>20</b>	<b>7 273</b>	<b>448 360</b>
	Land	Buffer gas	Buildings and gas transmission system	Equipment and machinery	Other assets	Advances	Assets under construction	Total
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>Cost or revaluation</b>								
<b>At December 31, 2010</b>	<b>2 540</b>	<b>9 377</b>	<b>865 559</b>	<b>117 431</b>	<b>16 644</b>	<b>35</b>	<b>21 212</b>	<b>1 032 798</b>
Additions	-	-	-	-	-	2 622	24 788	27 410
Reclassified	-	-	27 470	4 143	1 628	(2 537)	(30 704)	-
Revaluation	-	-	94	3	(21)	-	-	76
Correction*	-	-	6 626	40	-	-	-	6 666
Disposals	-	-	(8 445)	(1 251)	(361)	-	(6)	(10 063)
Transferred to inventory	-	-	-	-	-	-	(17)	(17)
Rounding	-	-	-	-	-	-	(1)	(1)
<b>At December 31, 2011</b>	<b>2 540</b>	<b>9 377</b>	<b>891 304</b>	<b>120 366</b>	<b>17 890</b>	<b>120</b>	<b>15 272</b>	<b>1 056 869</b>
<b>Depreciation</b>								
<b>At December 31, 2010</b>	-	-	<b>509 584</b>	<b>62 593</b>	<b>9 585</b>	-	-	<b>581 762</b>
Charged for 2011	-	-	21 206	6 151	1 699	-	-	29 056
Correction*	-	-	5 400	24	-	-	-	5 424
Reclassified	-	-	3	(64)	61	-	-	-
Disposals	-	-	(6 288)	(1 124)	(351)	-	-	(7 763)
<b>At December 31, 2011</b>	-	-	<b>529 905</b>	<b>67 580</b>	<b>10 994</b>	-	-	<b>608 479</b>
<b>Net book value at December 31, 2011</b>	<b>2 540</b>	<b>9 377</b>	<b>361 399</b>	<b>52 786</b>	<b>6 896</b>	<b>120</b>	<b>15 272</b>	<b>448 390</b>
<b>Net book value at December 31, 2010</b>	<b>2 540</b>	<b>9 377</b>	<b>355 975</b>	<b>54 838</b>	<b>7 059</b>	<b>35</b>	<b>21 212</b>	<b>451 036</b>

\* During the reporting year the management has identified assets which had no carrying value, proper correction of book values and depreciation are made in the financial statements.

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

**3 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

During 2003 and 2004 buildings, gas transmission and distribution system and equipment were revalued using cost (amortised replacement) method. The amortised replacement cost was determined by a certified independent assessor JSC BDO "Invest Riga". During 2007 the Company performed subsequent revaluation of all asset groups mentioned above using amortised replacement cost method. The amortised replacement cost was determined by independent certified valuator JSC BDO "Invest Riga". During 2011 assets which were received for gratis or in exchange during the reporting year were revaluated.

Fixed assets include fully depreciated assets with a total cost of LVL 7 306 thousand or EUR 10 395 thousand (31.12.2010: LVL 24 669 thousand or EUR 35 101 thousand).

As at December 31, 2011 the carrying amount in case the revaluated property, plant and equipment would be carried under the cost model is LVL 158 619 thousand or EUR 225 695 thousand including buildings LVL 124 773 thousand (EUR 177 536 thousand) and equipment and machinery LVL 33 846 thousand (EUR 48 159 thousand) (31.12.2010: LVL 145 636 thousand or EUR 207 221 thousand including buildings LVL 111 081 thousand (EUR 158 054 thousand) and equipment and machinery LVL 34 555 thousand (EUR 49 167 thousand)).

During the reporting year the Company has capitalized depreciation in amount of LVL 7 thousand or EUR 10 thousand (2010: LVL 23 thousand or EUR 33 thousand).

Determination of a cadastral value of the land plots and buildings owned by the Company is in process. Assessed cadastral value on December 31, 2011 of the buildings is LVL 6 419 thousand or EUR 9 133 thousand (2010: LVL 7 275 thousand or EUR 10 351 thousand), cadastral value on December 31, 2011 of the land plots is LVL 3 361 thousand or EUR 4 782 thousand (31.12.2010: LVL 3 902 or EUR 5 552), LVL 50 thousand (EUR 72 thousand) for container equipment (31.12.2010: LVL 60 thousand (EUR 85 thousand)). Engineering buildings (distribution pipelines, drillings un reservoirs) cadastral value on December 31, 2011 is LVL 41 387 thousand or EUR 58 889 thousand (31.12.2010: LVL 55 696 thousand (EUR 79 248 thousand)).

Cadastral value is not determined for 8 buildings, 1 container equipment, 2 land plots and for 124 drillings.

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**4 INTANGIBLE ASSETS**

	<b>LVL'000</b>	<b>EUR'000</b>
<b><u>Cost</u></b>		
<b>As at December 31, 2009</b>	<b>6 145</b>	<b>8 743</b>
Additions	613	872
Disposals	(81)	(115)
Transferred to property, plant and equipment	(14)	(20)
<b>As at December 31, 2010</b>	<b>6 663</b>	<b>9 480</b>
<b><u>Depreciation</u></b>		
<b>As at December 31, 2009</b>	<b>3 715</b>	<b>5 285</b>
Charge for the year	800	1 138
On disposals	(81)	(115)
<b>As at December 31, 2010</b>	<b>4 434</b>	<b>6 308</b>
<b>Net Book Value as at December 31, 2010</b>	<b>2 229</b>	<b>3 172</b>
<b>Net Book Value as at December 31, 2009</b>	<b>2 430</b>	<b>3 458</b>
	<b>LVL'000</b>	<b>EUR'000</b>
<b><u>Cost</u></b>		
<b>As at December 31, 2010</b>	<b>6 663</b>	<b>9 480</b>
Additions	634	902
Disposals	(1)	(1)
<b>As at December 31, 2011</b>	<b>7 296</b>	<b>10 381</b>
<b><u>Depreciation</u></b>		
<b>As at December 31, 2010</b>	<b>4 434</b>	<b>6 308</b>
Charge for the year	787	1 120
On disposals	(1)	(1)
<b>As at December 31, 2011</b>	<b>5 220</b>	<b>7 427</b>
<b>Net Book Value as at December 31, 2011</b>	<b>2 076</b>	<b>2 954</b>
<b>Net Book Value as at December 31, 2010</b>	<b>2 229</b>	<b>3 172</b>

Intangible assets include fully amortised intangible assets with a total cost value of LVL 1 655 thousand or EUR 2 356 thousand (31.12.2010: LVL 1 387 thousand or EUR 1 974 thousand).

The major intangible assets are a geographic-informative system GIS and software for long-distance pipelines SCADA IT at a carrying amount of LVL 214 thousand (EUR 304 thousand) and LVL 193 thousand (EUR 274 thousand) respectively as at December 31, 2011 (31.12.2010: LVL 227 thousand (EUR 323 thousand) and LVL 221 thousand (EUR 314 thousand)).

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

**5 TRADE RECEIVABLES**

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
<i>Fair value of financial assets with revaluation in profit or loss</i>				
At the beginning of the reporting year	3	4	4	6
Revalued	1	(1)	1	(2)
<b>At the end of the reporting year</b>	<b>4</b>	<b>3</b>	<b>5</b>	<b>4</b>
<i>Non-current trade receivables</i>				
Gross value	7 731	4	11 001	6
Reclassified	4	-	6	-
Provisions for impairment of receivables	(5 837)	(4)	(8 305)	(6)
Reclassified provisions	(4)	-	(6)	-
	<b>1 894</b>	<b>-</b>	<b>2 696</b>	<b>-</b>
<i>Current trade receivables</i>				
Gross value	32 872	44 220	46 773	62 919
Provisions for impairment of receivables	(3 991)	(7 185)	(5 679)	(10 223)
	<b>28 881</b>	<b>37 035</b>	<b>41 094</b>	<b>52 696</b>
<b>Total trade receivables</b>	<b>30 779</b>	<b>37 038</b>	<b>43 795</b>	<b>52 700</b>

Provisions for impairment of bad and doubtful debts:

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
<b>Provisions at the beginning of the year</b>	<b>7 253</b>	<b>8 389</b>	<b>10 318</b>	<b>11 935</b>
Charged to income statement	6 247	1 135	8 889	1 615
Released to income statement	(3 445)	(2 087)	(4 902)	(2 970)
<b>Net charge to income statement (see Note 15)</b>	<b>2 802</b>	<b>(952)</b>	<b>3 987</b>	<b>(1 355)</b>
Written off	(133)	(184)	(189)	(262)
<b>Provisions at the year end</b>	<b>9 922</b>	<b>7 253</b>	<b>14 116</b>	<b>10 318</b>

Provisions as at December 31, 2011 of LVL 4 076 thousand (EUR 5 800 thousand) relate to current trade receivables, whereas as at 31 December 2010 they amounted to 7 185 thousand (EUR 10 234 thousand). Provisions as at December 31, 2011 of LVL 5 931 thousand (EUR 8 439 thousand) relate to other trade receivables (2010: LVL 63 thousand (EUR 90 thousand) (see Note 7). Provisions were created based on evaluation of the financial position and operations of separate groups of customers. The actual losses may differ from the current calculations, as the specific amounts required are regularly reviewed and changes are reflected in the income statement.

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

**6 INVENTORIES**

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Materials and spare parts (at net realisable value)	2 766	2 959	3 936	4 210
Gas and fuel (at cost)	35 825	8 016	50 974	11 406
	<b>38 591</b>	<b>10 975</b>	<b>54 910</b>	<b>15 616</b>

The cost of inventories recognized as expense and included in "Cost of sales" amounted to LVL 262 710 thousand or EUR 373 802 thousand (2010: LVL 270 242 thousand or EUR 384 520 thousand).

Provisions for impairment of obsolete and slow moving inventories:

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Provisions at the beginning of the year	673	443	957	629
Charged to income statement	67	420	95	598
Released to income statement	(107)	(59)	(152)	(84)
Written off	(18)	(131)	(26)	(186)
<b>Provisions at the year end</b>	<b>615</b>	<b>673</b>	<b>874</b>	<b>957</b>

Provisions have been created for slow moving materials and spare parts. During 2011 the Company sold inventories amounting to LVL 10 thousand or EUR 14 thousand (2010: LVL 37 thousand or EUR 53 thousand) and used in operations inventories amounting to LVL 50 thousand or EUR 71 thousand (2010: LVL 13 thousand or EUR 18 thousand) that had been written off in previous years.

**7 OTHER RECEIVABLES**

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Term deposits	9 207	-	13 100	-
Prepayments and deferred expense	415	431	589	613
Value added tax overpaid	40	110	57	157
Interest accrued on bank deposits	59	29	84	41
Receivable for services supplied	25	12	36	17
Prepayment for natural gas	37 950	24 216	53 998	34 456
Other debtors	2 106	311	2 997	443
	<b>49 802</b>	<b>25 109</b>	<b>70 861</b>	<b>35 727</b>
Provisions for impairment of bad and doubtful debts*	(90)	(63)	(128)	(90)
	<b>49 712</b>	<b>25 046</b>	<b>70 733</b>	<b>35 637</b>

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



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**8 CASH AND CASH EQUIVALENTS**

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Cash on hand	2	2	3	3
Current accounts with banks	2 808	6 273	3 995	8 926
Term deposits*	22 247	31 298	31 655	44 533
	<b>25 057</b>	<b>37 573</b>	<b>35 653</b>	<b>53 462</b>

\* As at December 31, 2011 deposits with initial maturity term over 90 days are LVL 9 207 thousand (EUR 13 100 thousand) and they are shown in Note 7, position "Term deposits". Term deposits fixed interest rate during 2011 is from 0.1% to 3.3% per annum (2010: from 0.37% to 12.7% per annum). As at December 31, 2010 there were no deposits with initial maturity term over 90 days.

**9 SHARE CAPITAL**

(a) Authorised, subscribed and paid-up share capital as at December 31, 2011 consists of 39 900 000 ordinary shares of LVL 1 each. All shares have equal voting rights and rights to dividend.

	<b>31.12.2011.</b>		<b>31.12.2010.</b>	
	<b>% from total</b>	<b>Number of</b>	<b>% from total</b>	<b>Number of</b>
	<b>share capital</b>	<b>shares</b>	<b>share capital</b>	<b>shares</b>
Registered (closed issues) shares	36.52	14 571 480	36.52	14 571 480
Bearer (public issues) shares	63.48	25 328 520	63.48	25 328 520
	<b>100.00</b>	<b>39 900 000</b>	<b>100.00</b>	<b>39 900 000</b>

(b) Shareholders

	<b>31.12.2011.</b>		<b>31.12.2010.</b>	
	<b>% from</b>	<b>Number of</b>	<b>% from</b>	<b>Number of</b>
	<b>total share</b>	<b>shares</b>	<b>total share</b>	<b>shares</b>
	<b>capital</b>		<b>capital</b>	
E.ON Ruhrgas International GmbH <i>(including registered shares of closed issues 7 285 740)</i>	47.23	18 846 385	47.23	18 846 385
Itera Latvija LLC	16.00	6 384 001	16.00	6 384 001
JSC Gazprom <i>(including registered shares of closed issues 7 285 740)</i>	34.00	13 566 701	34.00	13 566 701
Shares owned by the State	0.00	117	0.00	117
Bearer (public issues) shares	2.77	1 102 796	2.77	1 102 796
	<b>100.00</b>	<b>39 900 000</b>	<b>100.00</b>	<b>39 900 000</b>

State owned shares are given for holding to the Ministry of Economies of the Republic of Latvia.

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

**10 BORROWINGS**

During 2011 the Company did not have borrowings. On 17 September, 2010 an overdraft agreement concluded between the Company and SEB Banka which granted an overdraft facility of EUR 50 000 thousand (LVL 35 140 thousand) for the Company expired. The agreement was concluded on 18 September, 2008 for one year with a variable interest rate with the purpose of providing financial resources for settlements with the suppliers of the natural gas in cases when customers' payments were delayed.

**11 DEFERRED INCOME**

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

	<b>31.12.2011.</b> <b>LVL'000</b>	<b>31.12.2010.</b> <b>LVL'000</b>	<b>31.12.2011.</b> <b>EUR'000</b>	<b>31.12.2010.</b> <b>EUR'000</b>
Non-current portion of borrowings	13 754	13 855	19 570	19 714
Current portion of borrowings	586	569	834	810
	<b>14 340</b>	<b>14 424</b>	<b>20 404</b>	<b>20 524</b>

Deferred income movement:

	<b>2011</b> <b>LVL'000</b>	<b>2010</b> <b>LVL'000</b>	<b>2011</b> <b>EUR'000</b>	<b>2010</b> <b>EUR'000</b>
At the beginning of the year	14 424	14 373	20 524	20 451
Received from residents and enterprises during the reporting year	489	605	695	861
Written down to income statement in the reporting year (see Note 16)	(573)	(554)	(815)	(788)
<b>Deferred to the following periods</b>	<b>14 340</b>	<b>14 424</b>	<b>20 404</b>	<b>20 524</b>

(b) difference between the actual and forecasted purchase cost of natural gas:

- current portion	<b>4 669</b>	<b>6 996</b>	<b>6 644</b>	<b>9 954</b>
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Deferred income movement:

	<b>2011</b> <b>LVL'000</b>	<b>2010</b> <b>LVL'000</b>	<b>2011</b> <b>EUR'000</b>	<b>2010</b> <b>EUR'000</b>
At the beginning of the year	6 996	275	9 954	391
Difference between the actual and forecasted purchase cost of natural gas invoiced to customers in the reporting year	1 461	6 721	2 080	9 563
Written down to income statement in the reporting year	(3 788)	-	(5 390)	-
<b>Deferred to the following periods</b>	<b>4 669</b>	<b>6 996</b>	<b>6 644</b>	<b>9 954</b>

(c) EC funding recognised

Non-current portion	6 587	-	9 372	-
Current portion	183	-	260	-
	<b>6 770</b>	<b>-</b>	<b>9 632</b>	<b>-</b>

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**11 DEFERRED INCOME (CONTINUED)**

Deferred income movement:

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
At the beginning of the year	-	-	-	-
Recognised deferred income from EC grants in the reporting year	6 814	-	9 695	-
Written down to income statement in the reporting year	(44)	-	(63)	-
<b>Deferred to the following periods</b>	<b>6 770</b>	<b>-</b>	<b>9 632</b>	<b>-</b>
<b>Total deferred to the following periods</b>	<b>25 779</b>	<b>21 420</b>	<b>36 680</b>	<b>30 478</b>

In accordance with the European Commission resolution No.C(2010) 5554 dated August 13, 2008 on the award of a financial grant under the EC Regulation (EC) No.663/2009 on gas and electricity interconnections, the Company has received funding of 50%, but not more than LVL 7 million (EUR 10 million) for realization of Actions No.EEPR-2009-INTg-RF-LV-LT-I2.566527 "Modernization of 15 wells at the Inčukalns UGS" and SI2.566531 "Construction of a gas passage below the River Daugava and a pig receiver". The objects were put into operation in 2011. The unused portion of funds is granted for reconstruction of two other wells. The final payment from EC will be received in 2014.

See also Accounting policies Note (r).

**12 OTHER PAYABLES**

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>LVL'000</b>	<b>LVL'000</b>
Prepayments received	7 795	5 385	11 091	7 662
Social insurance contributions	631	620	897	882
Personal income tax	394	446	560	635
Value added tax	8 503	10 250	12 098	14 585
Excise tax	1 919	-	2 730	-
Real estate tax	1	-	1	-
Salaries	486	493	692	701
Accrued expenses for unused annual leave	893	920	1 271	1 309
Accrued expenses for bonuses	4 904	4 920	6 978	7 001
Accrued other expenses	415	306	591	435
Accrued post-employment benefit liabilities and other obligations to employees *	192	311	273	443
Other current liabilities	142	137	203	195
	<b>26 275</b>	<b>23 788</b>	<b>37 385</b>	<b>33 848</b>

\* Accrued post-employment benefit liabilities and other obligations to employees in Note 22.

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

**13 REVENUE**

Sales per customers` groups are as follows:

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Income from natural gas sales to industrial customers	298 733	299 678	425 059	426 403
Income from natural gas sales to residential customers	38 839	40 722	55 263	57 942
Income from transmission and storage of natural gas	15 165	12 290	21 578	17 488
Income from natural gas sales to vehicles	-	9	-	13
Other services	601	646	855	919
	<b>353 338</b>	<b>353 345</b>	<b>502 755</b>	<b>502 765</b>

If income from natural gas as per leveraged payment (residential customers) increased or decreased by 5%, then income from natural gas sales to residential customers would increase or decrease by 5%.

**14 COST OF SALES**

Purchase of natural gas	262 348	265 622	373 288	377 946
Salaries	11 623	13 186	16 538	18 762
Social insurance contributions	2 843	3 015	4 045	4 290
Life, health and pension insurance	853	866	1 214	1 232
Materials and spare parts	7 542	6 086	10 731	8 660
Depreciation and amortisation	20 598	20 396	29 308	29 021
Other expenses	5 769	5 502	8 209	7 829
	<b>311 576</b>	<b>314 673</b>	<b>443 333</b>	<b>447 740</b>

**15 ADMINISTRATIVE EXPENSES**

Salaries	3 307	3 553	4 705	5 055
Social insurance contributions	746	774	1 061	1 101
Life, health and pension insurance	176	183	250	261
Maintenance and utilities	765	957	1 088	1 362
Real estate tax	767	755	1 091	1 074
Depreciation and amortisation	502	528	714	751
Bank charges	82	76	117	108
Provisions for impairment of bad and doubtful debts, net (see Note 5)	2 802	(952)	3 987	(1 355)
Other expenses	1 628	1 199	2 316	1 707
	<b>10 775</b>	<b>7 073</b>	<b>15 329</b>	<b>10 064</b>

**16 OTHER INCOME**

Penalties from customers	952	698	1 355	994
Income from contribution to financing of construction works (see Note 11)	573	554	815	788
Income from change in provisions of slow moving and obsolete inventories	40	-	57	-
Other income	398	595	566	847
Interest income	818	930	1 164	1 323
	<b>2 781</b>	<b>2 777</b>	<b>3 957</b>	<b>3 952</b>

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

**17 OTHER EXPENSES**

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Materials	26	37	37	53
Salaries	193	175	275	249
Social insurance contributions	25	24	36	34
Depreciation and amortisation	114	104	162	148
Sponsorship	2 194	2 332	3 122	3 318
Loss from sale of fixed assets	981	121	1 396	172
Provisions for slow moving and obsolete inventories impairment	-	361	-	514
Loss from increase in exchange rates, net	1 108	2 573	1 577	3 661
Other expense	239	243	340	346
	<b>4 880</b>	<b>5 970</b>	<b>6 945</b>	<b>8 495</b>

**18 EXPENSES BY NATURE**

Purchase of natural gas	262 348	265 622	373 288	377 946
Depreciation and amortisation	21 214	21 028	30 184	29 920
Employee benefit expense (see Note 26)	19 766	21 776	28 124	30 984
Material and spare parts	7 568	6 123	10 768	8 713
Net provisions for impaired receivables	2 802	(952)	3 987	(1 355)
Other expenses	13 533	14 119	19 256	20 091
	<b>327 231</b>	<b>327 716</b>	<b>465 607</b>	<b>466 299</b>

**19 FINANCE INCOME**

**Finance income**

- Interest income	331	1 493	471	2 124
	<b>331</b>	<b>1 493</b>	<b>471</b>	<b>2 124</b>

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

The exchange net differences are credited to the income statement under Other income and Other expenses (see Notes 16 and 17).

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

Other income (see Note 16)	818	930	1 164	1 323
Finance income (see Note 19)	331	1 493	471	2 124
	<b>1 149</b>	<b>2 423</b>	<b>1 635</b>	<b>3 447</b>

**21 INCOME TAX EXPENSE**

Current income tax	4 754	5 878	6 764	8 364
Deferred income tax	(1 264)	(1 771)	(1 798)	(2 520)
	<b>3 490</b>	<b>4 107</b>	<b>4 966</b>	<b>5 844</b>

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**21 INCOME TAX EXPENSE (CONTINUED)**

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

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
<b>Profit before income tax</b>	<b>29 219</b>	<b>29 899</b>	<b>41 576</b>	<b>42 542</b>
<b>Theoretically calculated tax at tax rate of 15%</b>	<b>4 383</b>	<b>4 485</b>	<b>6 236</b>	<b>6 381</b>
<i>Tax effect of:</i>				
Tax non-deductible expenses, net	113	754	161	1 074
Tax relief on donations	(1 006)	(1 132)	(1 431)	(1 611)
<b>Tax charge</b>	<b>3 490</b>	<b>4 107</b>	<b>4 966</b>	<b>5 844</b>

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

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

Receivable/ (liability) as at 1 January	1 230	(1 357)	1 750	(1 931)
Charge for the year	4 754	5 878	6 764	8 364
Paid during the year	(8 416)	(3 291)	(11 974)	(4 683)
<b>Liability / (receivable) as at 31 December</b>	<b>(2 432)</b>	<b>1 230</b>	<b>(3 460)</b>	<b>1 750</b>

**Calculation of deferred income tax:**

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
<b>Deferred income tax liabilities at the beginning of the reporting year</b>	<b>27 822</b>	<b>29 700</b>	<b>39 587</b>	<b>42 259</b>
Increase in deferred income tax liabilities that results from revaluation of property, plant and equipment (charged to other comprehensive income)	141	12	200	17
Decrease in deferred income tax liabilities (charged to income statement)	(1 264)	(1 771)	(1 798)	(2 520)
Deferred income tax that results from disposal of revalued property, plant and equipment (credited to equity)	(255)	(119)	(363)	(169)
<b>Deferred income tax liabilities at the end of the reporting year</b>	<b>26 444</b>	<b>27 822</b>	<b>37 626</b>	<b>39 587</b>

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**21 INCOME TAX EXPENSE (CONTINUED)**

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

	31.12.2011. LVL'000	31.12.2010. LVL'000	31.12.2011. EUR'000	31.12.2010. EUR'000
Difference on depreciation of property, plant and equipment (to be settled within 12 months)	1 448	1 248	2 060	1 776
Difference on depreciation of property, plant and equipment (to be settled after more than 12 months)	28 692	29 694	40 824	42 251
Impairment of bad and doubtful debts (to be settled within 12 months) *	(1 336)	(269)	(1 901)	(383)
Accrued expenses for unused annual leave and bonuses (to be settled within 12 months)	(864)	(874)	(1 229)	(1 244)
Accruals for post employment benefits and other employee benefits (to be settled after more than 12 month)	(641)	(781)	(912)	(1 111)
Accruals for other liabilities (to be settled within 12 months)	(763)	(1 095)	(1 085)	(1 558)
Impairment of inventories (to be settled within 12 months)	(92)	(101)	(131)	(144)
<b>Deferred income tax liability, net</b>	<b>26 444</b>	<b>27 822</b>	<b>37 626</b>	<b>39 587</b>

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

**22 ACCRUALS FOR EMPLOYMENT AND POST EMPLOYMENT BENEFITS**

	31.12.2011. LVL'000	31.12.2010. LVL'000	31.12.2011. EUR'000	31.12.2010. EUR'000
At the beginning of reporting year	5 207	4 416	7 409	6 283
Current service costs	(317)	(209)	(451)	(297)
Interest (expenses) / income	(970)	955	(1 380)	1 359
Post employment benefits paid	(183)	(175)	(260)	(249)
Losses as a result of changes in assumptions of actuary	537	220	764	313
<b>Provisions at the end of the reporting year</b>	<b>4 274</b>	<b>5 207</b>	<b>6 082</b>	<b>7 409</b>
Non-current portion of provisions	4 082	4 896	5 809	6 966
Current portion of provisions (see Note 12)	192	311	273	443
<b>Provisions at the end of the reporting year</b>	<b>4 274</b>	<b>5 207</b>	<b>6 082</b>	<b>7 409</b>

Post employment benefits are unique or monthly (in limited time period) benefits, which are paid to an employee, whose employment conditions meet defined criteria according to the Employment contract. Accruals for benefits are calculated based on the current level of the salaries and the number of those employees, who might be entitled to such benefits, if they terminated employment with the Company, as well as previously applied benefit rates and

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actuarial assumptions.

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

**22 ACCRUALS FOR EMPLOYMENT AND POST EMPLOYMENT BENEFITS (CONTINUED)**

For calculation of provisions following assumptions have been used:

	<b>2011</b>	<b>2010</b>
Discount rate (considering profitability of government bonds at the balance sheet date), %	4,232	4,35
Employee rotation ratio	5,35	1,32
Pension age of employees, years	62	62
Mortality, years	***	***
Change in payroll, %:		
2011	3,00	5,00
2012	4,00	5,00
2013	6,00	6,00
2014	6,00	7,00
2015	8,00	8,00
2016	5,00	9,00
2017	6,00	-
Contributions in private pension funds, % of total gross income of employees	5,00	5,00
SSC	*	**
PIT	*	**

\* according to the Cabinet of Ministers rules in force during 2011.

\*\* according to the Cabinet of Ministers rules in force during 2010.

\*\*\* according to provision calculation methodology.

Sensitivity of total employment and post-employment allowance depending on the assumption changes:

	<b>Change in assumptions</b>	<b>Impact on the total liabilities</b>
Discount rate	Increase/decrease of 0.5%	Decrease of 3.75% / increase of 3.80%
Employee rotation ratio	Increase/decrease of 0.5	Decrease of 3.18% / increase of 2.78%
Pension age	Increase/decrease of 1 year	Decrease of 5.96% / increase of 4.87%
Life period	Increase/decrease of 1 year	Increase of 2.06% / decrease of 2.06%
Payroll growth ratio	Increase/decrease of 0.5%	Increase of 3.65% / decrease of 3.64%
Contribution to the private pension funds	Increase/decrease of 0.5%	Increase of 0.34% / decrease of 0.35%
SSC	Increase/decrease of 0.5%	Increase of 0.34% / decrease of 0.35%
PIT	Increase/decrease of 0.5%	Increase of 0.01% / decrease of 0.01%

**23 EARNINGS AND DIVIDENDS PER SHARE**

**(a) EARNINGS PER SHARE**

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

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



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

**(a) EARNINGS PER SHARE (CONTINUED)**

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Net profit attributable to shareholders (a)	25 729	25 792	36 610	36 698
	<b>number, th.</b>	<b>number, th.</b>	<b>number, th.</b>	<b>number, th.</b>
Ordinary shares as at 1 January	39 900	39 900	39 900	39 900
Ordinary shares as at 31 December	39 900	39 900	39 900	39 900
Weighted average number of ordinary shares outstanding during the year (b)	39 900	39 900	39 900	39 900
<b>Basic earnings per share during the year (a/b) in LVL or EUR</b>	<b>0.645</b>	<b>0.646</b>	<b>0.918</b>	<b>0.920</b>

**(b) DIVIDENDS PER SHARE**

Dividends payable are not accounted for until they are declared at the Annual General Meeting. At the meeting, a dividend in respect to 2011 of LVL 0,50 (EUR 0,711) per share will be proposed by the management. These financial statements do not reflect these dividends payable, which will be accounted for in the shareholders' equity as an appropriation of retained earnings for 2011.

The dividends paid in 2011 for 2010 were LVL 19 950 thousand (LVL 0.50 per share) or EUR 28 386 thousand (EUR 0.71 per share). The dividends paid in 2010 for 2009 were LVL 15 960 thousand (LVL 0.40 per share) or EUR 22 709 thousand (EUR 0.569 per share).

**24 CASH GENERATED FROM OPERATIONS**

Reconciliation of profit before tax to cash generated from operations:

	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Profit before income tax	29 219	29 899	41 576	42 542
<i>Adjustments for:</i>				
Depreciation (Note 3)	24 233	20 251	34 480	28 815
Amortisation (Note 4)	787	800	1 120	1 138
Deviations of actual and predictable purchases of natural gas and income from participation fees (see Note 11)	(2 944)	6 167	(4 189)	8 776
Provision for impairment of slow moving inventories (Note 6)	(40)	361	(57)	514
Change in accrued expenses for bonuses	(16)	(278)	(23)	(395)
Change in accrued expenses for unused annual leave	(27)	96	(38)	137
Change in accruals for other liabilities	110	36	157	51
Change in accrued expenses for post employment benefits and other employee benefits (Note 22)	(933)	791	(1 327)	1 126
Interest income (Note 20)	(1 149)	(2 423)	(1 635)	(3 447)
Loss on sale of property, plant and equipment (Note 17)	981	121	1 396	172
<i>Changes in working capital</i>				
- trade and other receivables	1 902	(38 456)	2 704	(54 719)
- inventories	(27 615)	72 558	(39 293)	103 240
- trade and other payables	15 485	(48 405)	22 031	(68 875)

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39 993	41 518	56 902	59 075
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**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

**25 RELATED PARTY TRANSACTIONS**

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

**(a) Sale of services**

	2011 LVL'000	2010 LVL'000	2011 EUR'000	2010 EUR'000
JSC "Gazprom"	13 333	9 877	18 971	14 053
Companies controlled JSC "Gazprom"	-	8	-	11
	<b>13 333</b>	<b>9 885</b>	<b>18 971</b>	<b>14 064</b>

**(b) Purchase of natural gas**

JSC "Gazprom"	192 065	131 324	273 283	186 858
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**(c) Accounts payable for natural gas and services**

	31.12.2011. LVL'000	31.12.2010. LVL'000	31.12.2011. EUR'000	31.12.2010. EUR'000
JSC "Gazprom"	-	515	-	733
E.ON Ruhrgas AG	17	-	24	-
	<b>17</b>	<b>515</b>	<b>24</b>	<b>733</b>

Payables are payable in cash and are not secured by a pledge or otherwise.

**(d) Accounts receivable for natural gas in transit**

JSC "Gazprom"	1 359	1 483	1 934	2 110
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Receivables are receivable in cash and are not secured by a pledge or otherwise.

**(e) Advance payment for natural gas to related company**

JSC "Gazprom" for natural gas	37 950	24 216	53 998	34 456
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Advance payments for natural gas injected into the Inčukalns UGS for the needs of Latvia.

**(f) Expenses for services from companies controlled by related party**

	2011 LVL'000	2010 LVL'000	2011 EUR'000	2010 EUR'000
E.ON Ruhrgas AG	28	-	40	-
OPEN GRID EUROPE GmbH	150	29	213	41
Companies controlled by JSC "Gazprom"	5 577	3 280	7 935	4 667
	<b>5 755</b>	<b>3 309</b>	<b>8 188</b>	<b>4 708</b>

**(g) Accounts payable for services from companies controlled by related party**

	31.12.2011. LVL'000	31.12.2010. LVL'000	31.12.2011. EUR'000	31.12.2010. EUR'000
OPEN GRID EUROPE GmbH	-	29	-	41
Companies controlled by JSC "Gazprom"	-	602	-	857
	-	602	-	857

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-	<b>631</b>	-	<b>898</b>
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**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

**25 RELATED PARTY TRANSACTIONS (CONTINUED)**

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

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

	2011 LVL'000	2010 LVL'000	2011 EUR'000	2010 EUR'000
Salaries	1 363	1 332	1 939	1 895
Social insurance contributions	278	274	396	390
Change in accruals for post employment benefits and other employee benefits	(17)	-	(24)	-
Health and life insurance	3	2	4	3
Contributions to pension funds	45	43	64	61
	<b>1 672</b>	<b>1 651</b>	<b>2 379</b>	<b>2 349</b>

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

**26 EMPLOYEE BENEFIT COSTS**

Wages and salaries	14 932	15 641	21 246	22 255
Expenses for accruals for post employment benefits and other employee benefits	191	1 273	272	1 811
Social insurance contributions	3 559	3 589	5 064	5 106
Social insurance contributions for accruals for post employment benefits and other employee benefits	55	224	78	319
Life, health and pension insurance	1 029	1 049	1 464	1 493
	<b>19 766</b>	<b>21 776</b>	<b>28 124</b>	<b>30 984</b>

In accordance with the Rules of the Cabinet of Ministers of Latvia 72.84% (2010: 65.46%) of the social insurance contributions are used to fund the state defined contribution pension system.

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**27 SEGMENT REPORTING**

**31.12.2011.**

	<b>Gas transmission LVL'000</b>	<b>Gas storage LVL'000</b>	<b>Gas distribution LVL'000</b>	<b>Gas realization LVL'000</b>	<b>Other services LVL'000</b>	<b>TOTAL LVL'000</b>
Segment revenue from external customers	3 647	11 486	-	337 605	600	353 338
Inter-segment revenue	17 718	12 182	36 520	324	122	66 866
Inter-segment costs	(33)	(243)	(555)	(66 034)	(1)	(66 866)
Interest income	-	-	-	-	331	331
Profit before tax	6 973	6 217	7 507	14 192	(5 670)	29 219
Corporate income tax	918	899	944	458	271	3 490
Assets	100 111	90 180	158 067	110 299	5 120	463 777
Liabilities	13 030	12 282	36 556	56 067	305	118 240
Other information on segment						
<i>Depreciation and amortisation</i>	7 665	3 760	9 402	252	135	21 214
<i>Additions of non-current assets</i>	5 888	7 736	5 181	901	3	19 709

**31.12.2011.**

	<b>Gas transmission EUR'000</b>	<b>Gas storage EUR'000</b>	<b>Gas distribution EUR'000</b>	<b>Gas realization EUR'000</b>	<b>Other services EUR'000</b>	<b>TOTAL EUR'000</b>
Segment revenue from external customers	5 189	16 343	-	480 369	854	502 755
Inter-segment revenue	25 211	17 333	51 963	461	174	95 142
Inter-segment costs	(47)	(346)	(790)	(93 958)	(1)	(95 142)
Interest income	-	-	-	-	471	471
Profit before tax	9 922	8 846	10 682	20 193	(8 067)	41 576
Corporate income tax	1 306	1 279	1 343	652	386	4 966
Assets	142 444	128 315	224 909	156 942	7 285	659 895
Liabilities	18 540	17 476	52 014	79 776	434	168 240
Other information on segment						
<i>Depreciation and amortisation</i>	10 906	5 350	13 377	359	192	30 184
<i>Additions of non-current assets</i>	8 378	11 007	7 372	1 282	4	28 043

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**27 SEGMENT REPORTING (CONTINUED)**

**31.12.2010.**

	<b>Gas transmission LVL'000</b>	<b>Gas storage LVL'000</b>	<b>Gas distribution LVL'000</b>	<b>Gas realization LVL'000</b>	<b>Other services LVL'000</b>	<b>TOTAL LVL'000</b>
Segment revenue from external customers	2 753	9 501	-	340 445	646	353 345
Inter-segment revenue	20 295	14 010	40 574	8 356	137	83 372
Inter-segment costs	(1 200)	(5 925)	(1 881)	(74 366)	-	(83 372)
Interest income	-	-	-	-	1 493	1 493
Profit before tax	7 793	3 320	11 001	6 343	1 442	29 899
Corporate income tax	1 065	357	1 615	649	421	4 107
Assets	99 347	86 371	161 633	72 056	10 444	429 851
Liabilities	11 933	7 813	38 894	31 808	443	90 891
Other information on segment						
<i>Depreciation and amortisation</i>	<i>7 529</i>	<i>4 124</i>	<i>8 979</i>	<i>273</i>	<i>123</i>	<i>21 028</i>
<i>Additions of non-current assets</i>	<i>7 172</i>	<i>10 863</i>	<i>4 991</i>	<i>275</i>	<i>2</i>	<i>23 303</i>

**31.12.2010.**

	<b>Gas transmission EUR'000</b>	<b>Gas storage EUR'000</b>	<b>Gas distribution EUR'000</b>	<b>Gas realization EUR'000</b>	<b>Other services EUR'000</b>	<b>TOTAL EUR'000</b>
Segment revenue from external customers	3 917	13 519	-	484 410	919	502 765
Inter-segment revenue	28 877	19 935	57 732	11 890	194	118 628
Inter-segment costs	(1 708)	(8 431)	(2 676)	(105 813)	-	(118 628)
Interest income	-	-	-	-	2 124	2 124
Profit before tax	11 088	4 724	15 653	9 025	2 052	42 542
Corporate income tax	1 515	507	2 298	924	600	5 844
Assets	141 358	122 895	229 983	102 526	14 861	611 623
Liabilities	16 979	11 117	55 341	45 259	631	129 327
Other information on segment						
<i>Depreciation and amortisation</i>	<i>10 713</i>	<i>5 868</i>	<i>12 776</i>	<i>388</i>	<i>175</i>	<i>29 920</i>
<i>Additions of non-current assets</i>	<i>10 204</i>	<i>15 457</i>	<i>7 101</i>	<i>391</i>	<i>3</i>	<i>33 156</i>

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**27 SEGMENT REPORTING (CONTINUED)**

*The largest customers:*

Five of the Company's customers comprise up to 50.0% (in 2010 – 51.2%) of income. Income generated by the largest customer as of December 31, 2011 was 35.3% (in 2010 – 32.2%), the second and the third largest customers constituted 7.4% and 2.1% respectively (in 2010 – 7.7% and 6.2%) of the total income amount. This income is related to the natural gas realization segment.

No geographical segment information is provided as all principal operations are carried out in Latvia.

**28 CRITICAL ESTIMATES AND JUDGEMENTS**

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

IFRS requires that in preparing the financial statements, management of the Company make estimates and assumptions that affect the reported amounts of assets and liabilities and required disclosure at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The areas involving a higher degree of judgement and thus having significant risk of causing a material adjustments to the carrying amounts of assets and liabilities within the next financial year are revaluation of property, plant and equipment, determination of frequency of revaluations, the management assumptions and estimates in determination of useful lives of property, plant and equipment, recoverable amount of accounts receivable and inventories, post employment benefits and other employee benefits as described in respective notes.

*Revaluation of fixed assets*

The management determines fair value and the remaining useful life of buildings, gas transmission and distribution system and equipment based on valuations performed by independent certified valutors in accordance with real estate valuation standards and based on the average construction costs relevant for the reporting year. The Company's internal policy is to perform the revaluations when there are indications that average construction costs and/or purchase prices related to the buildings, gas transmission and distribution system and equipment have changed significantly. On 1 February 2007 the Company performed revaluation of the buildings, gas transmission and distribution system and equipment that increased the carrying amount of these assets by LVL 80.2 million (EUR 114.1 million). The amortised replacement cost was determined by an independent certified valuator JSC BDO 'Invest Rīga'.

*Recoverable amount of trade receivables*

The estimated collectibility of accounts receivable is assessed on an individual basis for each customer. In case individual assessment is not possible due to the large number of individual balances, only the significant debtors are assessed individually. Receivables that are not individually assessed for impairment are classified into groups of receivables with similar credit risk characteristics and are collectively assessed for impairment, using historical loss experience. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

*Inventory valuation*

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

*Evaluation of post employment and other employee benefits*

Liabilities for the employee benefits are presented in the balance sheet at their present value. Employee benefit liabilities are calculated for each year using the Projected Unit Credit method. Both actuary defined and publicly available assumptions are used in calculations regarding changes in demographic and financial variables.

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

**28 CRITICAL ESTIMATES AND JUDGEMENTS (CONTINUED)**

*Recognition of revenues using the leveraged consumption payment scheme*

Customers, who settle payments using the leveraged consumption payment scheme, when paying bills (commercial users and private persons, who perform an operating activity), perform the readings of meters twice a year and determine the leveraged consumption for the winter season (November to April) and summer season. Customers are invoiced on the monthly bases.

Customers who are residents (household customers) settle accounts using the leveraged consumption payment scheme in the self-service order. Customers perform the readings of meters (depending on consumption) once a year or when tariffs are changed. All customers of the households are invoiced on a monthly basis by summing the leveraged consumption for which a seasonal rate is applied.

**29 FINANCIAL RISK MANAGEMENT**

**29.1. Financial risk factors**

The Company's overall risk management program is based on "JSC "Latvijas Gāze" risk management guidelines and procedures" developed by SIA Marsh in 2005, as well as "The Rules of "JSC "Latvijas Gāze" on management of financial resources" (hereafter – Rules) developed in 2012.

The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance. An approach of assessment of the financial stability of Latvian commercial **banks** and foreign credit institutions' **branches** by evaluating various criteria (both quantitative and qualitative) with the added assessment scales is described in the Rules.

Financial instruments owned by the Company (according to IFRS 7):

- financial assets: current debtors, long term debtors, cash in bank accounts, cash in bank deposits;
- financial liabilities: creditors.

**Financial instruments by categories**

All financial assets are included in category Loans and Receivables and all financial liabilities are measured at amortised cost.

**Company's activities are exposed to following risks:**

- Credit risk
- Liquidity risk
- Market risk, incl.
  - Interest rate risk
  - Currency exchange rate risk

**Credit risk**

The Company is exposed to credit risk, which is a risk of material losses arising in a case when a counterparty is not able to fulfill its contractual obligations to the Company. The credit risk is critical to the operations of the Company, so it is important to manage this risk effectively.

The credit risk arises from cash and cash equivalents, deposits with banks and financial institutions, as well as credit exposure to customers, including outstanding receivables and committed transactions.

*Sources of credit risk*

Credit risk mainly relates to few largest customers of the Company. Largest part 55.0% (2010: 56.7%) of trade receivables natural gas comprises of debts of 5 largest customers of the Company, one of these customers debt comprised 21.8% (2010: 22.1%), second and third largest customer debt comprised 6.9% and 6.7% respectively (2010: 7.5% and 5.8%) of total trade receivables as at December 31, 2011. The Company has introduced and observes such a credit policy that envisages selling goods on credit only to customers with a good credit history,

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controlling the amount of credit set for each customer. Debts of 5 largest customers are not impaired as at December 31, 2011.

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

**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

*Credit risk management*

Control over debtors is performed by Individual customer transaction department (hereinafter - Individual CTD), Industrial customers transaction department (hereinafter - Industrial CTD), Contact center (hereinafter - CC) and Financial accounting department (hereinafter – FAD) of the Company.

A debtors aging analysis is prepared on a monthly basis. Debtors are analysed in the following groups:

- households, which use natural gas for heating purposes or for heating purposes and for other purposes simultaneously;
- households, which use natural gas for other purposes than heating;
- companies with gas consumption less than 25 thousand m<sup>3</sup> a year;
- companies with gas consumption more than 25 thousand m<sup>3</sup> a year.

*Debt monitoring process of households, which use natural gas for heating purposes or for heating purposes and for other purposes in parallel*

1. When the payment due date, specified in the settlement procedures, for the natural gas received during the settlement period, is reached (according to leveraged consumption payment scheme), Individual CTD arranges dispatching of a reminder about debts overdue to Debtors.
2. If the debt is not repaid within a time limit set in the reminder, a warning of natural gas supply's termination is sent to the household.
3. If the payment is not repaid within a specified date, a debtor for heating is included in a natural gas supply's termination list and the supply of natural gas is terminated.
4. After receiving of the natural gas supply's termination deed, Individual CTD or a respective Department performs a final debt calculation and sends a claim for a debt to the debtor with a notice of debt recovery procedures.
5. If the debt amount exceeds LVL 200 and the payment deadline set in the claim falls due, Individual CTD or a respective Department evaluates possibilities of collecting the debt from the debtor under compulsory, by legal proceedings.
6. If the Debtor is declared insolvent, Individual CTD or a respective Department organises a termination of natural gas supply for the gasified object of the Debtor at the earliest possible time, as well as prepares required documentation and transfers the documents to the Legal department for submission of creditors' claim.

*Debt monitoring process of households, which use natural gas for other purposes than heating*

1. When the payment due date, specified in the settlement procedures for the natural gas received during the settlement period is reached (according to leveraged consumption payment scheme), Individual CTD arranges dispatching of a reminder about debts overdue to Debtors.
2. If the debt is not repaid within a time limit set in the reminder, a warning of natural gas supply's termination is sent to the household.
3. If the debt is not paid during the term indicated in the warning letter, Individual CTD initiates a repeated warning letter of natural gas termination sent out to the Debtor, at the same time informing Debtors about submitting their personal data to the debt collection companies and the possibility that their personal data may be included in the public data bases.
4. If a Debt collection company could not collect the debt of the Debtor, or the debt for natural gas supplied based on leveraged consumption payment scheme exceeds LVL 100, or the Debtor has not paid for supplied natural gas



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for the last 5 (five) years, the debtor is included in the natural gas supply's termination list and the supply of natural gas is terminated.

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

**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

5. After receiving of the natural gas supply's termination deed Individual CTD or a respective Department performs a final debt calculation and sends a claim for a debt to the debtor with a notice of debt recovery procedures.

6. If the debt amount exceeds LVL 200 and the payment deadline set in the claim falls due, Individual CTD or a respective Department evaluates possibilities of collecting the debt from the debtor under compulsory, by legal proceedings.

7. If the Debtor is declared insolvent, Individual CTD or a respective Department organises the termination of natural gas supply for the gasified object of the Debtor at the earliest possible time, as well as prepares required documentation and transfers the documents to the Legal department for submission of creditors' claim.

*Debt monitoring process of companies with gas consumption less than 25 thousand m<sup>3</sup> a year*

1. When the payment due date, specified in the settlement procedures, for the natural gas received during settlement period, is reached (according to leveraged consumption payment scheme), Individual CTD arranges dispatching of reminder to Debtors about overdue.

2. If the payment for the natural gas received during the settlement period is not received after the date specified in the settlement procedures, Individual CTD and Departments send a warning letter to Debtors about termination of natural gas supply.

3. If a payment is not received during the term indicated in the warning letter, respective departments of the Company issue an order for termination of the supply of natural gas to the gasified object of the Debtor.

4. If a termination of the natural gas supply or reading the Counter data is not possible at the gasified object of the Debtor, Individual CTD or a respective Department sends to the Debtor, as well as to the gasified object owner (if the Debtor is not an owner of the gasified object) a repeated warning letter about the gas supply's termination, at the same time informing about administrative responsibility.

5. After receiving of the natural gas supply's termination deed, Individual CTD or a respective Department performs a final debt calculation and sends a claim for a debt to the debtor with a notice of debt recovery procedures.

6. If the debt amount exceeds LVL 200 and the payment deadline set in the claim falls due, Individual CTD or a respective Department evaluates possibilities of collecting the debt from the debtor under compulsory, by legal proceedings.

7. If the Debtor is declared insolvent, Individual CTD or a respective Department organises termination of natural gas supply for the gasified object of the Debtor at the earliest possible time, as well as prepares required documentation and transfers the documents to Legal department for submission of creditors' claim.

*Debt monitoring process of companies with gas consumption more than 25 thousand m<sup>3</sup> a year*

1. When the payment due date specified in the settlement procedures for the natural gas received during the settlement period is reached, Industrial CTD, as well as Departments (agreed in advance with Individual CTD) arranges a dispatching of a warning letter to Debtors about natural gas supply's termination.

2. Agreeing with the head of Gas accounting and payment department, Industrial CTD and Departments prepare and send warning letters to the Debtors also if the payment for supplied natural gas during any of the current month decades has not been received.

3. Every month CC or a respective Department contacts debtors included in the list via phone and reminds about the payment due date. If a debt due from a debtor is accumulated for natural gas supplied to an apartment type

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house' heating, Industrial CTD or a respective Department may inform residents of the apartment type house by means of placing a corresponding announcement about the termination of gas supply.

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

**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

4. If a payment is not received after the actions mentioned above, the Company shall decide before the expiration of the term indicated in the warning letter on either the termination of gas supply or the delay of gas supply termination.

5. If a payment is not received during the term indicated in the warning letter and the decision to terminate gas supply to the client has been made, an order is given to terminate gas supply to the debtor during a corresponding day.

6. If the debt amount exceeds LVL 200 and the payment deadline set in the claim falls due, Industrial CTD evaluates possibilities of collecting the debt from the debtor under compulsory, by legal proceedings.

7. If a client has been declared insolvent or is subject to legal protection process, Industrial CTD may organize gas supply with a prepayment.

December 31, 2011 (LVL'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Natural gas	27 275	23 994	3 281	-
<i>incl. renegotiated receivables</i>	114	114	-	-
Other services	1 606	1 606	-	-
<b>Total current trade receivables</b>	<b>28 881</b>	<b>25 600</b>	<b>3 281</b>	<b>-</b>

December 31, 2011 (EUR'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Natural gas	38 809	34 140	4 669	-
<i>incl. renegotiated receivables</i>	162	162	-	-
Other services	2 285	2 285	-	-
<b>Total current trade receivables</b>	<b>41 094</b>	<b>36 425</b>	<b>4 669</b>	<b>-</b>

December 31, 2010 (LVL'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Natural gas	35 508	33 924	1 584	-
<i>incl. renegotiated receivables</i>	471	471	-	-
Other services	1 527	1 527	-	-
<b>Total current trade receivables</b>	<b>37 035</b>	<b>35 451</b>	<b>1 584</b>	<b>-</b>

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

**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

December 31, 2010 (EUR'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Natural gas	50 523	48 269	2 254	-
<i>incl. renegotiated receivables</i>	670	670	-	-
Other services	2 173	2 173	-	-
<b>Total current trade receivables</b>	<b>52 696</b>	<b>50 442</b>	<b>2 254</b>	<b>-</b>

\* 100% provisions are created for doubtful debtors (see Note 5).

December 31, 2011 (LVL'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Advance payments for materials	87	87	-	-
Advance payments to employees	5	2	3	-
Tax receivables	421	421	-	-
Other receivables	1 503	1 459	44	-
<b>Total other receivables</b>	<b>2 016</b>	<b>1 969</b>	<b>47</b>	<b>-</b>

December 31, 2011 (EUR'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Advance payments for materials	124	124	-	-
Advance payments to employees	7	3	4	-
Tax receivables	599	599	-	-
Other receivables	2 139	2 076	63	-
<b>Total other receivables</b>	<b>2 869</b>	<b>2 802</b>	<b>67</b>	<b>-</b>

December 31, 2010 (LVL'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Advance payments for materials	11	11	-	-
Advance payments to employees	7	3	4	-
Tax receivables	1	1	-	-
Other receivables	228	133	95	-

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<b>Total other receivables</b>	<b>247</b>	<b>148</b>	<b>99</b>	<b>-</b>
<b>NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)</b>				

**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

December 31, 2010 (EUR'000):

	<b>TOTAL</b>	<b>Neither <i>past due</i> nor impaired (incl. renegotiated receivables)</b>	<b>Past due, not impaired</b>	<b>Impaired, net*</b>
Advance payments for materials	17	17	-	-
Advance payments to employees	10	4	6	-
Tax receivables	1	1	-	-
Other receivables	324	189	135	-
<b>Total other receivables</b>	<b>352</b>	<b>211</b>	<b>141</b>	<b>-</b>

\* 100% provisions are created for doubtful debtors (see Note 7).

*Quality of the debtors*

Fully performing debtors having no overdue debts are mainly comprised by heat supply companies. The shareholders of major part of the heat supply companies are local municipalities, which guarantee timely settlement of the debts or make advance payments for natural gas.

Past due not impaired and impaired debtors are not secured (with mortgage or commercial pledge).

Aging analysis of trade receivables past due, but not impaired is following:

	<b>31.12.2011. LVL'000</b>	<b>31.12.2010. LVL'000</b>	<b>31.12.2011. EUR'000</b>	<b>31.12.2010. EUR'000</b>
Up to 3 months	2 764	1 537	3 933	2 187
	<b>2 764</b>	<b>1 537</b>	<b>3 933</b>	<b>2 187</b>

Aging analysis of other trade receivables past due, but not impaired is following:

	<b>31.12.2011. LVL'000</b>	<b>31.12.2010. LVL'000</b>	<b>31.12.2011. EUR'000</b>	<b>31.12.2010. EUR'000</b>
Up to 3 months	-	31	-	44
3 to 6 months	44	12	63	17
More than 6 months	3	56	4	80
	<b>47</b>	<b>99</b>	<b>67</b>	<b>141</b>

***Term deposits and cash at bank***

Before placing a term deposit the Board of the Company evaluates credit ratings, financial performance as well as offered interest rates of the banks.

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**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

Moody's Investors Services credit ratings of banks (or its owners) are used by the Company (as at 16 February 2012):

Bank	Long term rating	Short term rating	Rating of financial security	Rating forecast
Nordea Bank Finland	Aa2	P-1	C	-*
GE Money Bank (General Electric Co)	Aa2	P-1	-*	Stable
DnB ASA	Aa3	P-1	C	Stable
SEB group	A1	P-1	C-	Stable
Swedbank AB	A2	P-1	C-	Stable
Danske Bank AB	A2	P-1	C-	Negative
Latvijas Hipotēku un Zemes banka	Baa3	P-3	E+	-*
SMP bank (Russia)	Baa3	-*	E+	Stable
Citadele bank	-*	-*	-*	-*

\* Data on credit rating is not available

	31.12.2011. LVL'000	31.12.2010. LVL'000	31.12.2011. EUR'000	31.12.2010. EUR'000
Citadele bank	183	16 977	261	24 156
Swedbank	1 669	2 884	2 375	4 104
Latvijas Krājbanka	-	6 576	-	9 357
SEB bank	14 405	1 746	20 496	2 484
DnB bank	8 002	6 151	11 386	8 752
GE Money Bank	12	81	17	115
Nordea Bank Finland Latvia branch	727	31	1 034	44
Danske Bank Latvia branch	12	-	17	-
SMP Bank	44	80	63	114
Latvijas Hipotēku un Zemes banka	1	3 045	1	4 333
<b>Total accounts with banks</b>	<b>25 055</b>	<b>37 571</b>	<b>35 650</b>	<b>53 459</b>

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**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Credit risk (continued)**

Credit quality of cash and cash equivalents (Moody's Investors Service)

	<b>31.12.2011.</b> <b>LVL'000</b>	<b>31.12.2010.</b> <b>LVL'000</b>	<b>31.12.2011.</b> <b>EUR'000</b>	<b>31.12.2010.</b> <b>EUR'000</b>
Aa2	739	112	1 051	159
Aa3	8 002	6 151	11 386	8 752
A1	14 405	1 746	20 496	2 484
A2	1 681	2 884	2 392	4 104
Baa3	45	3 045	64	4 333
Ba3	-	16 977	-	24 156
B3	-	80	-	114
Data on credit rating is not available	183	6 576	261	9 357
<b>Total accounts with banks</b>	<b>25 055</b>	<b>37 571</b>	<b>35 650</b>	<b>53 459</b>

**Liquidity risk**

Liquidity risk is associated with the Company's ability to settle its liabilities within agreed due dates.

Main guidelines applied by the Company – do not permit delay of payments to creditors and prioritise payments to suppliers for the delivered gas. If the Company does not have sufficient amount of cash, a credit line is used.

An operating cash flow plan is prepared to manage liquidity risk on a monthly basis after actual data of the previous month is received, or in cases which may significantly affect financial performance (significant changes in heavy fuel global market price / or natural gas purchase prices) of the Company.

Contractual maturity of liabilities as at 31 December, 2011 (LVL'000):

	<b>&lt; 1 month</b>	<b>1-3 months</b>	<b>3 months- 1 year</b>	<b>Total</b>
Trade payables	1 603	33 981	76	35 660
Other liabilities, incl.	62	-	415	477
<i>Accrued expenses for other expenses</i>	-	-	415	415
<i>Other short term liabilities</i>	62	-	-	62
	<b>1 665</b>	<b>33 981</b>	<b>491</b>	<b>36 137</b>

Contractual maturity of liabilities as at 31 December, 2011 (EUR'000):

	<b>&lt; 1 month</b>	<b>1-3 months</b>	<b>3 months- 1 year</b>	<b>Total</b>
Trade payables	2 281	48 351	108	50 740
Other liabilities, incl.	88	-	590	678
<i>Accrued expenses for other expenses</i>	-	-	590	590
<i>Other short term liabilities</i>	88	-	-	88
	<b>2 369</b>	<b>48 351</b>	<b>698</b>	<b>51 418</b>

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**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Liquidity risk (continued)**

Contractual maturity of liabilities as at 31 December, 2010 (LVL'000):

	<b>&lt; 1 month</b>	<b>1-3 months</b>	<b>3 months- 1 year</b>	<b>Total</b>
Trade payables	5 548	121	6 065	11 734
Other liabilities, incl.	89	-	306	395
<i>Accrued expenses for other expenses</i>	-	-	306	306
<i>Other short term liabilities</i>	89	-	-	89
	<b>5 637</b>	<b>121</b>	<b>6 371</b>	<b>12 129</b>

Contractual maturity of liabilities as at 31 December, 2010 (EUR'000):

	<b>&lt; 1 month</b>	<b>1-3 months</b>	<b>3 months- 1 year</b>	<b>Total</b>
Trade payables	7 894	172	8 630	16 695
Other liabilities, incl,	127	-	435	562
<i>Accrued expenses for other expenses</i>	-	-	435	435
<i>Other short term liabilities</i>	127	-	-	127
	<b>8 021</b>	<b>172</b>	<b>9 065</b>	<b>17 257</b>

**Market risk**

*Interest rate risk*

The Company is not exposed to cash flow interest rate risk, as it has no borrowings as at December 31, 2011 (see Note 10). Other financial assets and liabilities bear no interest, or interest rate is fixed. As all financial assets and liabilities are accounted for at amortised cost, the Company is not exposed to the fair value interest rate risk.

*Foreign currency exchange risk*

Foreign currency exchange risk is a probability, that foreign currency exchange fluctuations will affect the financial position and cash flows of the Company. The Company is not directly subject to the risk of fluctuation of foreign currency rates as the gas purchase price is set in USD and afterwards recalculated in EUR, whereas the gas sales tariffs are set in LVL. Settlements for the supplied gas are made in EUR. As since January 1, 2005 the LVL rate is pegged to the euro rate, the fluctuations of the LVL/EUR rate are limited and are not expected to have a significant influence on further financial results. The changes in gas purchase prices in USD depending on the quotation of oil products are covered by the PUC-approved natural gas sales tariffs, which to a certain extent cover the fluctuations of both the LVL/EUR and the EUR/USD rate. The risk of fluctuations of foreign currency rates related to debts to suppliers is under control by keeping a significant share of financial resources in deposits of the respective currency.



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**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Market risk (continued)**

Open foreign currencies positions:

	<b>31.12.2011.</b>			
	<b>USD'000</b>	<b>EUR'000</b>	<b>GBP'000</b>	<b>Other'000</b>
Financial assets	93	144 354	1	55
Financial liabilities	-	(48 480)	-	-
Balance sheet position in original currency	93	95 874	1	55
Balance sheet position in LVL'000	50	67 381	1	4
Balance sheet position in EUR'000	72	95 875	1	5

Open foreign currencies positions:

	<b>31.12.2010.</b>			
	<b>USD'000</b>	<b>EUR'000</b>	<b>GBP'000</b>	<b>Other'000</b>
Financial assets	20	87 561	-	3 587
Financial liabilities	-	(14 829)	-	-
Balance sheet position in original currency	20	72 732	-	3 587
Balance sheet position in LVL'000	11	51 116	-	66
Balance sheet position in EUR'000	15	72 732	-	94

Exchange rate fluctuations sensitivity analysis

In determination of future fluctuations of exchange rates, assumption is made based on prior year USD currency exchange rate fluctuations, which were in the range of 7% (2010: 9%), GBP currency exchange rate fluctuations, which were in the range of 3% (2010: 5%), and for other currencies in range of 1% (2010: 1%) (net of tax effect).

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**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.1. Financial risk factors (continued)**

**Market risk (continued)**

**December 31, 2011**

	Currency	Book value	Impact to	Impact to	Book value	Impact to	Impact to
			current year profit	current year profit		current year profit	current year profit
			+7% (USD)	-7% (USD)		+7% (USD)	-7% (USD)
			+3% (GBP)	-3% (GBP)		+3% (GBP)	-3% (GBP)
			+1% (other currencies)	-1% (other currencies)		+1% (other currencies)	-1% (other currencies)
		LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000
<b>Assets</b>							
Cash	EUR	20 142	171	(171)	28 659	243	(243)
	USD	6	0	0	9	0	0
	Other	4	0	0	6	0	0
Accounts receivable	EUR	81 311	691	(691)	115 695	983	(983)
	USD	44	3	(3)	63		
	GBP	1	0	0	1	0	0
		<b>101 508</b>	<b>865</b>	<b>(865)</b>	<b>144 433</b>	<b>1 226</b>	<b>(1 226)</b>
<b>Liabilities</b>							
Accounts payable	EUR	34 072	289	(289)	48 480	411	(411)
		<b>34 072</b>	<b>289</b>	<b>(289)</b>	<b>48 480</b>	<b>411</b>	<b>(411)</b>
<b>Net impact</b>		<b>67 436</b>	<b>576</b>	<b>(576)</b>	<b>95 953</b>	<b>815</b>	<b>(815)</b>

**December 31, 2010**

	Currency	Book value	Impact to	Impact to	Book value	Impact to	Impact to
			current year profit	current year profit		current year profit	current year profit
			+9% (USD)	-9% (USD)		+9% (USD)	-9% (USD)
			+1% (other currencies)	-1% (other currencies)		+1% (other currencies)	-1% (other currencies)
		LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000
<b>Assets</b>							
Cash	EUR	31 680	269	(269)	45 077	383	(383)
	USD	11	1	(1)	16	1	(1)
	Other	4	-	-	6	-	-
Accounts receivable	EUR	29 858	254	(254)	42 484	361	(361)
	RUB	62	6	(6)	88	9	(9)
		<b>61 615</b>	<b>530</b>	<b>(530)</b>	<b>87 671</b>	<b>754</b>	<b>(754)</b>
<b>Liabilities</b>							
Accounts payable	EUR	10 422	89	(89)	14 829	127	(127)
		<b>10 422</b>	<b>89</b>	<b>(89)</b>	<b>14 829</b>	<b>127</b>	<b>(127)</b>
<b>Net impact</b>		<b>51 193</b>	<b>441</b>	<b>(441)</b>	<b>72 842</b>	<b>627</b>	<b>(627)</b>

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**29 FINANCIAL RISK MANAGEMENT (CONTINUED)**

**29.2. Capital risk management**

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal structure to reduce the cost of capital.

The Company manages capital, based on a proportion of borrowed capital against the total capital. This ratio is calculated as proportion of total liabilities to the total capital of the Company, except cash and cash equivalents. Liabilities include all current and non-current liabilities, but total capital includes all liabilities of the Company and equity. This ratio is used to evaluate the structure of the capital of the Company, as well as its solvency. The strategy of the Company is to ensure that the ratio is not lower than 2% and not higher than 50%.

In 2011 and 2010 proportion of borrowed capital to total capital was as follows:

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Total liabilities	118 240	90 891	168 240	129 327
(Cash and cash equivalents)	(25 057)	(37 573)	(35 653)	(53 462)
Net total liabilities	93 183	53 318	132 587	75 865
Total liabilities and equity	463 777	429 851	659 895	611 623
<b>Borrowed capital proportion to total capital</b>	<b>20.09%</b>	<b>12.40%</b>	<b>20.09%</b>	<b>12.40%</b>

**29.3. Fair value**

Carrying amount of financial assets and liabilities of the Company does not significantly differ from their fair value, because almost all financial assets and liabilities are short term, so influence of discounting factor is minor.

**30 CAPITAL COMMITMENTS**

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

	<b>31.12.2011.</b>	<b>31.12.2010.</b>	<b>31.12.2011.</b>	<b>31.12.2010.</b>
	<b>LVL'000</b>	<b>LVL'000</b>	<b>EUR'000</b>	<b>EUR'000</b>
Contracted for, but not delivered	2 146	5 819	3 053	8 280
Authorised, but not yet contracted for	23 371	14 023	33 254	19 953
	<b>25 517</b>	<b>19 842</b>	<b>36 307</b>	<b>28 233</b>

**31 TAX CONTINGENT LIABILITIES**

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

**32 LITIGATION**

On September 2011 the Company was investigated in accordance with the European Council Regulation No.1/2003 part 4 of Article 20 (Case COMP/39.816) in connection with the alleged abuse by the related company "Gazprom" of a dominant position in the gas sector, which would be contrary to Article 102 of LESD and Article 54 of the Agreement on the European Economic Area and suspected participation of JSC "Latvijas Gāze" in the agreements, which would be directed against competition and would be contrary to Article 101 of LESD and Article 53 of the Agreement on the European Economic area.

The Company has signed an agreement with a law firm that has international experience in the competition

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proceedings and has prepared an assessment of potential risks as well as defence strategy.

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

**32 LITIGATION (CONTINUED)**

The management of the Company considers it to be impossible at the moment to estimate when the examination will be finished and its results.

**33 SUBSEQUENT EVENTS**

There are no subsequent events since the last date of the reporting year that would have a significant effect on the financial position of the Company as at December 31, 2011.

On January 17, 2012 the Company received a letter from the Competition Council to provide information and explanation about a case, which was initiated by the Competition Council in regard of part 3 of section 1 in Article 13 of the competition law's (abuse of dominant position) stated prohibition's violation. The Competition Council has acted aggressively against the Company through media, by requesting consumers to report refusals of signing natural gas delivery agreements by the Company in gasified objects which have debts for previously received natural gas.

On January 23, 2012 the Board of the Company agreed to sign an agreement with JSC „BDO” on revaluation of the Company's property, plant and equipment as at February 1, 2012, by using the amortised replacement cost method.

On 10 February, 2012 the Company together with OJSC "Lietuvos Dujos" has sent a technical report to EC on the accomplishment of the subprogram to Action No.EEPR-2009-INTg-RF-LV-LT SI2.566527 "Modernization of 15 wells at the Inčukalns UGS" and SI2.566531 "Construction of a gas passage below the River Daugava and a pig receiver" and financial statements on attributable costs over the period from January 16, 2011 till January 15, 2012. In April 2012, LVL 1 367 thousand (EUR 1 945 thousand) were received in bank account of the Company.