elering

GENERATING OPPORTUNITIES

2017

Annual Report 2017

elering

GENERATING OPPORTUNITIES

Annual Report **2017**

MANAGEMENT REPORT – ELERING


elering

STATEMENT BY THE CHAIRMAN OF THE MANAGEMENT BOARD

TAAVI VESKIMÄGI

Digitalisation of the energy system

Future energy networks are characterised by the increasing amount of data. Value is created through balancing production and consumption in real time by making different energy carriers compete with one another on the energy market.

Opening the Estonian electricity market for competition has been a success story. It has not been accidental, but our choice, where Elering has performed a leading role. And as Albert Camus once said, "Life is the sum of all your choices". In Elering we have always believed that this is namely a functioning energy market that helps accomplish our mission to keep the lights on and rooms warm in our homes. And we have not done that alone, but with system operators that share identical values with us. After the completion of EstLink 2, Estonia will be a part of the Finnish electricity market. And this will be good. Thanks to that we will be participants in probably the best functioning Nordic-Baltic electricity market in global terms.

In the energy sector, Nordic countries are distinct from a lot of other regions due to their market confidence. Today, shared values are more important than anything else in the world. Actual economic efficiency can only arise on the basis of shared values. If there are none, even the best intentions are doomed to failure. Estonia should aim at establishing closer and closer Estonian-Finnish energy infrastructure as part of a wider regional infrastructure. And, needless to say, everything that is useful for Estonia is also useful for Finland.

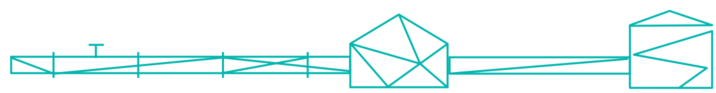
But we do not want to be only fellow passengers in creating the Nordic-Baltic energy market, but, instead, we want to provide our partners with the best that we have to share. The energy sector, just like many other industrial sectors, is undergoing a digital revolution, i.e. a large-scale growth in the share of ICT. In Estonia, we have created, under the leadership of Elering and in cooperation with our partners starting from Elektrilevi and ending with the Estonian Renewable Energy Association or vice versa, the Estfeed smart grid platform that is unique in Europe. The Estfeed energy smart grid platform creates value for parties to the energy market by linking and making available close to real time the data about the production and consumption of electricity, gas and district heating.

The logic according to which the energy system has been organised for years is that somewhere there is a central power plant from which electricity is transmitted over long distances through lines on big masts and, from there, it is distributed to consumers through lines on small masts. Those large power stations are operated according to consumption. When consumption increases, power stations 'put more steam on' and when consumption reduces, they 'put less steam on'. It has taken place in such a manner for a century. However, as a result of introducing new technologies and particularly thanks to digitalisation, the operation of the entire energy system is undergoing a fast change, just like many other industrial sectors. Energy systems are changing from the above-described centrally operating ones to consumer-centred dispersed ones. The consumer is not merely a consumer any more, but at the same time also a producer, storer and seller and, in addition, also a consumer all in one.

As a result of all of that, not so much energy should be transmitted from large power stations in the future any more, but, instead, much energy will be produced and consumed on the spot. The future energy system will lose borders between the transmission network and the distribution network; their roles and tasks will become quite similar. Network operators will, in essence, plan, construct, manage and administer the electricity network together and electricity moves from higher tension to lower tension and vice versa. It is important to ensure information management and processing at the central level across different networks and energy carriers.

Smart energy production and consumption equipment that exchanges information makes it possible to significantly improve the efficiency of the energy system and to eliminate wasting. Digitalisation of energy systems makes it possible to cut down on any unnecessary costs. For example, earlier excessive investments in power stations. We can make electricity and gas compete with each other. In the future we will not talk about the electricity or gas market any more, but about a cross-border energy market. This was one of the strategic reasons for why Elering acquired the gas transmission network. Both gas flowing in pipes and electricity moving in lines compete on the market on equal grounds. In the future, the energy market will be integrated by linking different energy sources. The ambition of Elering is to operate such a smart energy system. We have prerequisites for creating necessary competences in order to accomplish this task. Elering is ready for the new challenges that we will face in operating and developing the energy system.

OVERVIEW OF ELERING



885
km of gas pipelines

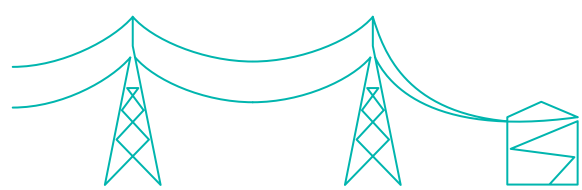
36
gas distribution stations

3
gas metering stations

Major projects in

2017

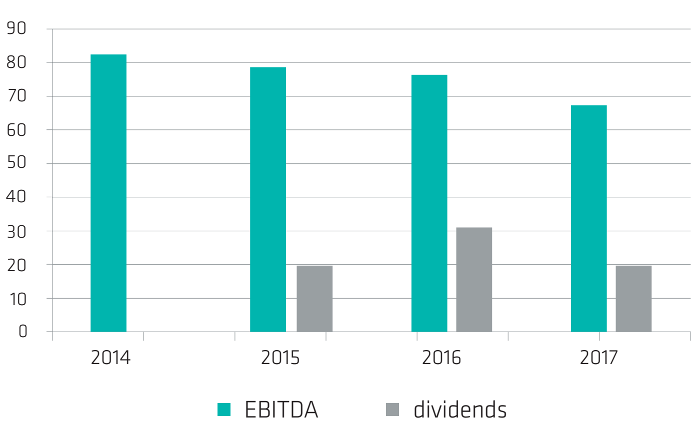
- Completion of renovation work of the Viru substation
- Launching of the Estfeed smart grid platform
- Completion of the Värska gas metering station
- Entry into the Harku-Lihula-Sindi building contract

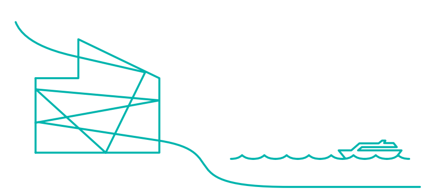


5 403
km of high voltage overhead and cable lines

148
substations

EBITDA and dividends

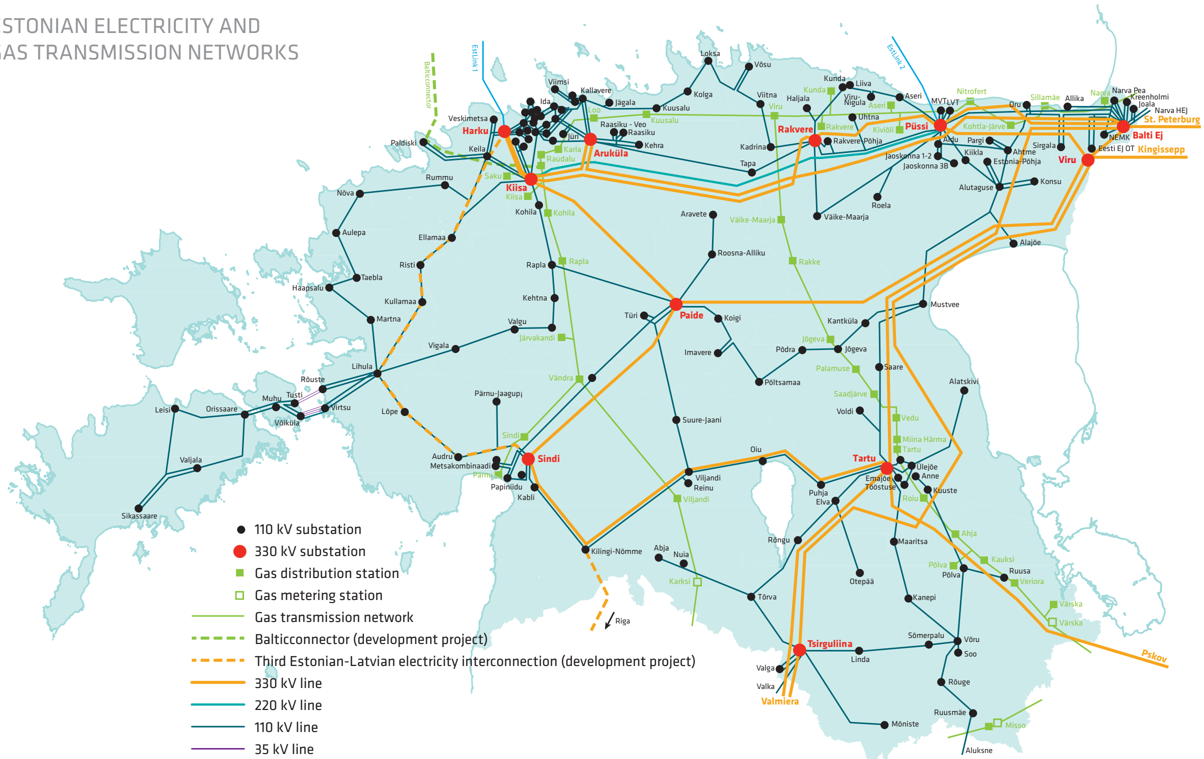




2
converter stations

139
km of DC cable lines

ESTONIAN ELECTRICITY AND
GAS TRANSMISSION NETWORKS



Financial figures (MEUR)

	2014	2015	2016	2017
Revenue	130.8	132.4	135.9	131.9
Operating expenses	80.0	90.9	98.1	98.8
Operating profit	50.8	41.6	37.8	33.1
Financial expenses	10.0	11.4	11.4	11.0
Income tax	0.0	5.0	7.8	5.0
Net profit	40.7	25.1	18.7	17.1
Borrowings	347.9	379.2	367.4	362.3
Equity	314.8	329.4	349.1	346.2
Assets	790.0	861.9	903.7	909.6
EBITDA	82.0	78.6	76.0	67.6
Investments	100.5	93.1	26.7	32.2
Dividends	0.0	20.0	31.0	20.0
Financial ratios				
ROE	13.8%	7.8%	5.5%	4.9%
Equity/Assets	40%	38%	39%	38%
Net borrowings/EBITDA	3.9	4.1	4.1	4.1

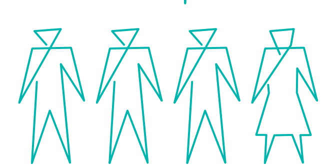
$$ROE = \frac{\textit{Net profit}}{\textit{Average equity for the year}}$$

Net borrowings = interest-bearing liabilities - cash and cash equivalents
EBITDA = Operating profit + depreciation

average age **44**

average length of employment **15**

voluntary turnover **4.7%**



214

people, of whom
25% are women

TEAM WORK

OVERVIEW OF PRINCIPAL ACTIVITIES

Elering is an independent electricity and gas system operator whose main duty is to guarantee high-quality energy supply to Estonian consumers. Elering connects the producers, various network operators and consumers who make up the system into a unified whole.

Alongside the physical electricity and gas networks, Elering develops the energy sector's IT infrastructure, which provides service providers with possibilities for developing and offering solutions of smart production and consumption of energy. The smart grid solutions allow energy producers and consumers to analyse the data generated and increase efficiency in energy production and consumption through data value. Services and applications of the Elering smart grid are available in the e-elering customer portal.

Key indicators of the Estonian energy system

Last year, the domestic electricity consumption of Estonia (including network losses) amounted to 8.5 TWh, which means a 1% increase compared to 2016. Electricity production increased by 8% year-on-year, forming 11.2 TWh. For the year, electricity production in Estonia exceeded electricity consumption by 32%, resulting in net exports of 2.7 TWh.

Electricity balance, GWh	*2017*	*2016*	*Change %*
Electricity production in Estonia	**11,234**	**10,422**	**8%**
Domestic electricity production provided to Elering network	10,905	10,118	8%
Production of renewable energy in Estonia	1,620	1,412	15%
Electricity imports from cross-border power lines	**2,313**	**3,572**	**-35%**
• incl. physical transmission from Finland	1,679	3,052	-45%
• incl. physical transmission from Latvia and Russia	634	520	22%
Total electricity provided to network	**13,547**	**13,994**	**-3%**
Electricity consumption in Estonia	**8,500**	**8,385**	**1%**
Elering's domestic transmission service for consumption	7,865	7,672	3%
Elering network losses	326	408	-20%
Electricity exports through cross-border power lines	**5,047**	**5,609**	**-10%**
• incl. physical transmission to Finland	872	685	27%
• incl. physical transmission to Latvia and Russia	4,175	4,924	-15%
Total electricity taken from network	**13,547**	**13,994**	**-3%**
Balance	**2,734**	**2,037**	**34%**

In 2017, the quantity of gas transmitted through the Elering gas transmission network for domestic consumption reduced by five percent and the total volume of the domestic gas consumption was 5.2 TWh.

Gas balance, GWh	*2017*	*2016*	*Change %*
Transit flows (Misso)	**12,983**	**18,939**	**-31%**
Total gas provided to the transmission pipeline	**5,234**	**5,530**	**-5%**
Domestic transmission service for consumption	**5,219**	**5,499**	**-5%**
Network losses, incl. self-consumption	**16**	**15**	**7%**
Change in the transmission pipeline reserve capacity	**-3**	**16**	**-119%**

In technical terms, both the electricity and gas network functioned well in 2017. The trend line in respect of indicators characterising reliability of the electricity network, such as the total number of failures and the energy that could not be transmitted to customers as a result of failures, continues to be clearly on a decline. Cross-border connections functioned very well and did not cause any noticeable restrictions for transnational trade.

Reliability Indicators	*2017*	*10-year average*
Number of failures of electricity network devices	117	194
Undelivered energy	44 MWh	150 MWh

There were no more dangerous incidents and outages for gas consumers in the gas network either, despite the fact that the maintenance and investment work performed by Elering during the years before the acquisition of the gas network was not sufficient for ensuring sustainable functioning of the network. More important activities for ensuring the ongoing safety of the gas infrastructure include maintenance and repair work based on diagnostics and cleaning routes from flora.

Our stable, highly educated and experienced staff form the foundation of Elering's sustainable economic growth.

The highest value of Elering – employees

Our stable, highly educated and experienced staff form the foundation of Elering's sustainable economic growth.

At the end of 2017, Elering employed 214 people. The average length of employment is a little over 15 years and the average age of employees is 44. About three-quarters of the workforce are men.

Elering is characterised by low employee turnover, being just 4.7% (voluntary turnover) last year. This is a strategically important indicator for the company due to the high level of competence required for its core business. The overwhelming majority of our employees have higher education, and almost half of the employees of Elering have a Master's degree or PhD.

Activities of Elering in the field of personnel management and in other issues concerning the personnel are performed in accordance with the personnel management policy that was drawn up in 2016. The policy establishes focuses for the development in the following years: unitary enterprise and established reputation as an employer, involving management culture and systematic talent management.

Within the next five years approximately one-fifth of Elering's current employees will reach pensionable age, while fewer students are being accepted into specialities in the field of energy. To promote energy education and assist young people in entering the labour market, Elering cooperates with universities through organising an annual traineeship programme in the field of energy and announcing a grant competition. In 2017, we also carried out a survey on the image of the employer among students of the field of energy, on the basis of which Elering proved to be among the first three most preferred employers. Consistent conduct of the survey and implementation of development activities based on the students' feedback ensure that a sufficient number of young people are interested in working for Elering.

In order to develop employees, we have prepared, in addition to various professional training events and training programmes of general competences, the Elering Academy development programme aimed at specialists of high development potential, where eight young people started in 2017. We have also described the career path of a specialist of Elering as a tool for managers in order to assist them in supporting the development of their team members. In order to develop the management quality, all managers have passed the Elering management development programme and have taken part in preparing uniform management principles, to whose implementation we will commit ourselves during the next year. In 2017, we also carried out a survey of employees' satisfaction and commitment. Based on the feedback from employees we prepared an action plan "Our Elering", which will be executed in cooperation with Elering leaders in the next two years.


KETTLER


OPEN
NESS

DEVELOPMENT OF ENERGY SYSTEMS

Upon development of energy networks, the main focus in 2017 continued to be on three most important strategic projects: construction of the Balticconnector gas pipeline between Estonia and Latvia, construction of the third electricity connection between Estonia and Latvia and desynchronising the Baltic electricity network from the Russian electricity network.

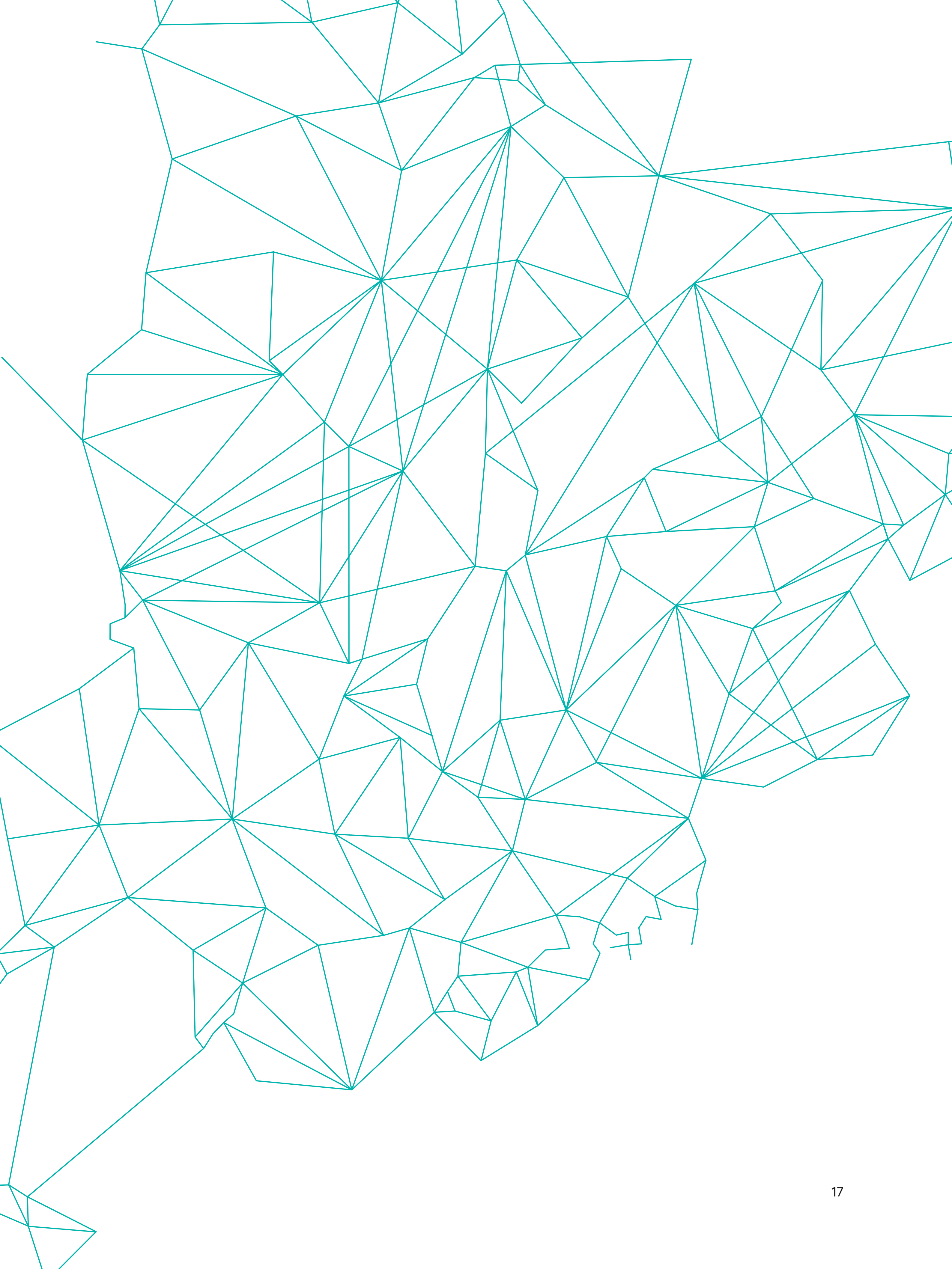
In order to construct the Balticconnector gas connection, in 2017 procurements were launched for the construction of both the submarine part and ground-based facilities. The procurement for purchasing submarine pipes resulted in selecting a successful tenderer and tenders for the procurement of mounting submarine pipes will be submitted in Q1 of 2018. As regards procurements for building contracts concerning the mainland part of the Estonian side, the round for the qualification of tenderers was completed by the end of 2017 and tenders will also be submitted in Q1 of 2018. The Balticconnector connection as a whole should be at the disposal of the gas market by 2020.

An important milestone reached within the framework of the Estonian-Latvian new electricity connection project is the building contract concerning the Harku-Sindi line section, which forms the largest share of the activities concerning the Estonian side of the entire project. The contractual partner is Empower AS and Leonhard Weiss Energy AS jointly, who will complete a line of the length of approximately 175 km by the end of 2020. The contract was entered into on 21 August and its financial volume is approximately 60 million euros. In order to implement the entire project, it is necessary, in addition to this work, to complete the line section from the Kilingi-Nõmme substation to the Latvian border and also build connections of the lines in substations.

In addition to strategic projects, a lot of activities concerned clients' connections in 2017. New supply points were completed in their entirety for clients in the Tööstuse and Mustamäe substations and the supply point of the Nuia substation reached the stage where the client could start consuming electricity through the connection.

Within the framework of renovating the existing network of Elering, the major work completed in 2017 was the second stage of reconstructing the Viru 330-kV substation, whose cost was approximately 9.1 million euros. Replacement of the overhead transmission line between the Veskimetsa and Järve substations with underground cable lines and reconstruction of the Saare 110-kV substation were also completed.

Major work in the gas network was reconstruction of the Värska gas metering station with the value of the work being 2.9 million euros.



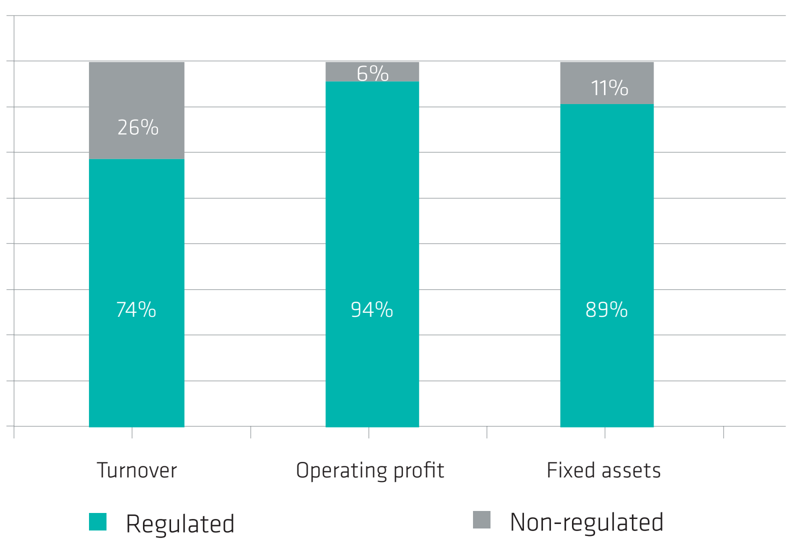

COMMIT
MENT

OVERVIEW OF ECONOMIC ACTIVITIES

Nature of economic activities

The economic activities of Elering may be divided into two – regulated electricity and gas network activities and non-regulated areas of activity.

Regulated network activities consist in the transmission of electricity and gas through the electricity and gas transmission networks in the ownership of the company. Network activities are overwhelmingly more important than the other areas of activity in terms of turnover, profitability and assets.



The regulation of network activities consists in the determination of the maximum permitted revenue in the case of both electricity and gas (the so-called Revenue Cap principle), which comprises operating expenses and operating profit. Operating profit is received by multiplying the regulatory asset base by the weighted average cost of capital (WACC). Since network activities are regulated, network charges are approved by the regulator, i.e. the Estonian Competition Authority. The regulator assesses thereby whether the expenses set out in the application for network charges are justified and provides the rate of return that has been calculated on the basis of the Capital Asset Pricing Model.

The company has in total 27 electricity network service clients and 9 gas network service clients. Most of the network service revenue (92%) comes from clients who are regulated distribution network operators acting as natural monopolies. The largest client by far is Elektrilevi OÜ (82% of the network service revenue), a distribution network operator belonging to the Eesti Energia AS group, which is owned by the Republic of Estonia.

Non-regulated areas of activity mostly consist in the provision of electricity and gas balancing service.

In order to ensure stable frequency in the electricity system, it is necessary to keep the system balanced, i.e. production must equal consumption at all times. This means, however, that all market participants must also be balanced and most of them purchase their electricity balancing service from balance providers. Elering itself provides balance providers (in total 8) with the service of balancing their energy balance.

The principles of balancing the gas system are generally the same. The only difference is that the gas system does not have to be balanced at all times. If the consumption of gas exceeds inflow, the pressure in the system starts to drop, and vice versa. The task of Elering as a gas transmission system operator is to maintain pressure within the permitted range. For this purpose, Elering buys and sells balancing gas to gas balance providers (in total 9).

The balancing service has no significant impact on the profit of Elering because balancing service fees are calculated so that the revenue earned covers the expenses of providing the service.

Financial results

Income statement

The total revenue of the company amounted to 131.9 million euros in 2017 (2016: 135.9 million euros). The most important source of revenue was the sale of network services, which amounted to 98.9 million euros (2016: 106.5 million euros). This consisted of electricity network services (91%) and gas network services (9%). However, 97% of the network service revenue came from network tariffs.

Revenue from balancing and regulation services amounted to 27.2 million euros (2016: 23.4 million euros).

The main reason behind the decline in the revenue was the reduction of the so-called ITC revenue due to a smaller transit of electricity passing through Estonia (a reduction of 5.3 million euros). ITC, i.e. Inter TSO Compensation, is a contract entered into between European electricity transmission network operators on the basis of the legislation of the European Union (EU), pursuant to which the operators compensate one another for expenses caused by the transit of electricity. If in previous years the entire import of electricity of the Baltic States came from the Nordic countries to the Baltic States through Estonia, since the commencement of operation in full power of the NordBalt electrical connection connecting Lithuania and Sweden there has been a significant decline in the transit of electricity of the Nordic countries passing through Estonia. In the long term, the reduction in the ITC revenue does not reduce the profitability of Elering since the revenue received on the basis of the ITC contract must be given back to the network clients through lowering the tariff.

Operating expenses totalled 98.8 million euros (2016: 98.1 million euros) and financial expenses amounted to 11.0 million euros (2016: 11.4 million euros), both of them remaining more or less at the same level as in 2016.

Cash flow statement

Cash flow from operating activities amounted to 58.5 million euros (2016: 56.6 million euros).

Cash flow used in investing activities amounted to 3.8 million euros (2016: 52.7 million euros). Purchases of fixed assets totalled 31.1 million euros (2016: 25.9 million euros). Proceeds from cross-border transmission capacity auctions were 5.2 million euros (2016: 12.6 million euros). The EU assistance received in 2016 for financing cross-border gas investments in an amount of 21.8 million euros was reclassified as cash.

Cash flow used in financing activities amounted to 25.7 million euros (2016: 11.4 million euros), which consisted of dividends paid in an amount of 20.0 million euros (2016: 31.0 million euros) and repayments of long-term loans in an amount of 5.7 million euros (2016: 12.4 million euros).

The cash balance increased in total by 29.0 million euros.

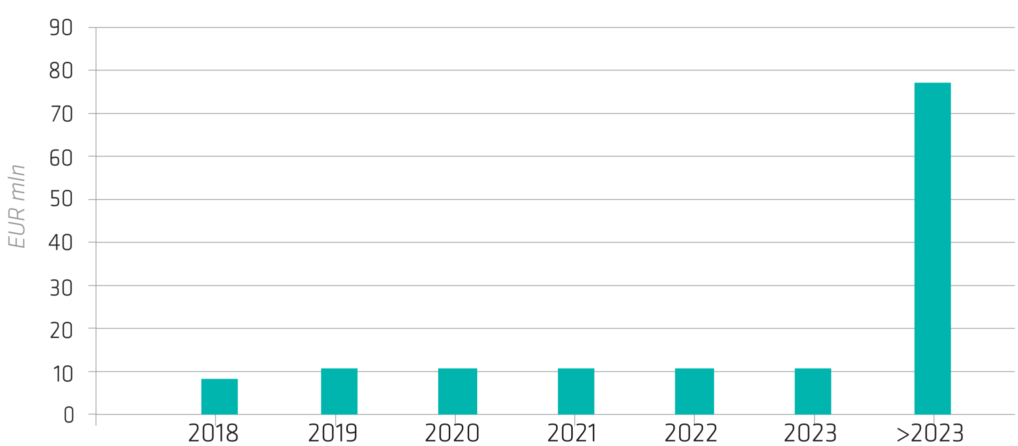
Financing

The interest-bearing liabilities of the company as of the balance sheet date are presented in the table below:

EUR mln	*31.12.2017*
Bonds	225
Depreciable portion of long-term bank loans	8
Total current interest-bearing liabilities	**233**
Long-term bank loans	129
Total interest-bearing liabilities	**362**

Elering has eurobonds in an amount of 225 million euros listed on the London Stock Exchange since 2011. Their redemption deadline is 12 July 2018 and the company plans to refinance these with new eurobonds in the period from April to July 2018. In order to hedge the risk of refinancing the bonds, in December 2017 Elering entered into two loan agreements in a total volume of 200 million euros with the repayment deadline being in March 2019. The company has the right to take out the loans until the redemption deadline of the bonds and the company will do that only if there are unfavourable conditions on capital markets during the planned refinancing period.

The bank loans have been taken from the European Investment Bank and the Nordic Investment Bank. The loans are depreciable and the last repayment will be made in 2033. The schedule for repayment of the bank loans is as follows:



In addition to the interest-bearing liabilities, Elering also finances investments from sources that do not involve any interest expenses. The main source is the non-refundable assistance received from the European Union. The company has entered into financing agreements with the EU INEA agency for financing the following projects:

a. the third electricity connection between Estonia and Latvia;
b. Balticconnector, i.e. the submarine gas pipeline connecting the gas networks of Estonia and Finland along with the related infrastructure;
c. strengthening the connection between the gas networks of Estonia and Latvia.

The following table provides an overview of financing major cross-border investments:

EUR mln	*Investment*	*EU assistance*	*Construction*
The third electricity connection between Estonia and Latvia	79	49	2018-2020
Balticconnector	135	98	2018-2019
Estonian-Latvian gas connection	43	19	2018-2020
Total	**257**	**166**	

The second financing source that does not involve any interest expenses is congestion income. It arises in situations where price differences occur between different price regions (countries) of the power exchange and the power exchange transfers the money received due to the price differences to the transmission network operators of respective countries. In accordance with the EU regulation, money received in this manner must be used, first and foremost, for increasing cross-border transmission capacities. As of the end of 2017, Elering has in this manner already collected 68.0 million euros.

The assets built both on the account of the EU assistance and the congestion income are not accounted for as the regulatory asset base; thus, the capital expenditure thereof is not included in the network tariffs.

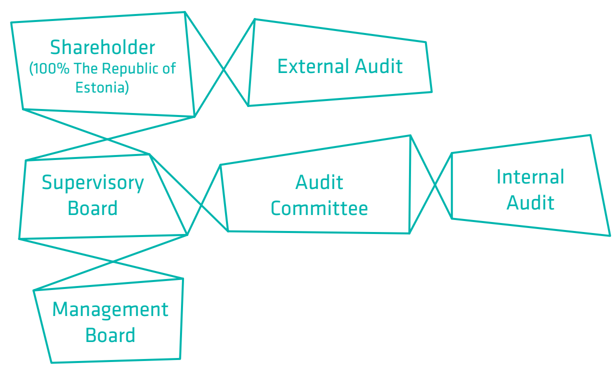
Summary

2017 was an economically successful year for Elering. The net profit was 17.1 million euros (2016: 18.7 million euros), the cash balance along with short-term bank deposits at the end of the year was 122.0 million euros (2016: 74.8 million euros) and this strong financial position enables the company to pay dividends to its owner in an amount of 20.0 million euros in 2018 (2017: 20.0 million euros). The requirements provided for in loan agreements have been fulfilled with a surplus and the company is ready for future investments.


EQUAL
TREATMENT

CORPORATE GOVERNANCE

Corporate governance structure



Corporate governance of Elering is based on the Commercial Code, the State Assets Act, the articles of associa-tion of Elering and the Corporate Governance Code prepared by the Financial Supervision Authority and the OMX Tallinn Stock Exchange.

Elering has committed itself to following the Corporate Governance Code and wishes to grow further in this ar-ea. We consider this a prerequisite for achieving our strategic goals and shaping our organisational culture. A more detailed report on compliance with the Corporate Governance Code in 2017 is set out on the website of Elering: https://elering.ee/en/investors#tab2

General meeting of shareholders

The General Meeting is the highest managing body of Elering. The General Meeting is competent to amend the articles of association; increase and decrease the share capital; elect and remove members of the Supervisory Board; elect auditors; designate a special audit; approve the annual report and distribute profit; and decide on merger, division, transformation and/or dissolution of the company. In addition to the Commercial Code, the General Meeting also follows in its activities (calling a meeting, information to be disclosed, etc.) the State As-sets Act.

The owner is represented at the General Meeting by the Minister of Economic Affairs and Infrastructure, who was Kadri Simson in 2017.

During the year, one General Meeting was held on 18 April 2017, which approved the 2016 annual report and dis-tribution of profit.

With the resolution of the sole shareholder of 30 August 2017, a new wording of the articles of association of Elering AS was approved, AS PricewaterhouseCoopers was appointed the auditor for the financial years of 2017 to 2021 and a new work procedure of the Supervisory Board was approved.

Supervisory board

The owner's interests in the company are guaranteed by members of the Supervisory Board. The Supervisory Board provides the Management Board with guidelines for organising the management of the company and ex-ercises supervision over the activities of the Management Board of the company. The Supervisory Board regular-ly reviews and assesses the company's strategy, principal activities, risk assessments, annual report and budg-ets.

In accordance with the articles of association of the company, regular meetings of the Supervisory Board are held as and when necessary, but no less frequently than once every three months.

Composition and remuneration of the Supervisory Board

The Supervisory Board consists of three to five members. The number of members of the Supervisory Board is decided and the members of the Supervisory Board are elected and removed by the representative of the owner, i.e. the Minister of Economic Affairs and Infrastructure, on the basis of recommendations made by an independ-ent Appointments Committee. The work of the Supervisory Board is organised by the Chairman of the Supervi-sory Board, who sets the agenda for Supervisory Board meetings, chairs the meetings, observes the efficiency of the work of the Supervisory Board, organises operational communication of data to members of the Supervisory Board, ensures that the Supervisory Board has enough time for drafting resolutions and examining the data and represents the Supervisory Board in communicating with the Management Board of Elering. In order to organise the work of the Supervisory Board, the General Meeting has established a work procedure for the Supervisory Board.

In 2017, the Supervisory Board held four ordinary meetings and one extraordinary meeting and one electronic meeting:

- 11 April: Approval of the annual report, approval of the Supervisory Board report, overview of perfor-mance of principal activities, approval of the work procedure of the Supervisory Board, transactions in-volving registered assets, overview of the desynchronising project, overview of administration of the electricity network;

- 14 June: Overview of four-month financial results, overview of financial activities of Elering, budget of business activities of Elering for 2018 and approval of the principles of establishment of the capital expenditure budget for 2018 to 2022, overview of the ordinary General Meeting, transactions involving registered assets, election of the Chairman of Supervisory Board, change in members of the Audit Committee, approval of amendment to the work procedure of the Supervisory Board;

- 31 July: Establishment of the personal right of use, establishment of servitude of way;

- 27 September: Overview of six-month financial results, approval of entry into loan agreements, ap-proval of refinancing a bond, approval of assuming a long-term debt obligation in connection with the GIPL project, overview of the strategy of Elering until 2027, transactions involving registered assets, change in members of the Audit Committee;

- 27 November: Approval of the strategy of Elering for 2018 to 2027, overview of the process of ordering back-up loans, specification and approval of refinancing of bonds;

- 14 December: Approval of operating budget and capital expenditure budget, overview of ten-month fi-nancial results, transactions involving registered assets.

In 2017, the following persons were members of the Supervisory Board of Elering:

- Timo Tatar (Head of the Energy Department, Ministry of Economic Affairs and Communications) – Chairman of the Supervisory Board until 14 June 2017: attended five meetings and one electronic vot-ing;

- Thomas Auväärt (Head of the Financial Markets Policy Department, Ministry of Finance), until 22 May 2017: attended one meeting;

- Indrek Kasela (entrepreneur), from 21 August 2016: attended five meetings and one electronic voting;

- Ando Leppiman (Deputy Secretary-General for Energy, Ministry of Economic Affairs and Communica-tions), until 22 May 2017: attended one meeting;

- Timo Rajala (entrepreneur), Chairman of the Supervisory Board from 14 June 2017: attended four meet-ings and one electronic voting;

- Tarmo Porgand (Deputy Head of the State Assets Department, Ministry of Finance), from 22 May 2017: attended four meetings and one electronic voting;

- Toomas Põld (entrepreneur), from 22 May 2017: attended four meetings and one electronic voting.

The remuneration paid to members of the Supervisory Board of Elering AS in 2017 was 63.7 thousand euros (incl. taxes). There is no provision for the payment of severance benefits or other benefits to members of the Supervi-sory Board.

Members of the Supervisory Board must meet the requirements set for members of the Supervisory Board in the Commercial Code, as well as in the State Assets Act, and they must meet all of their obligations.

Management board

The Management Board is a managing body of Elering that represents and manages the everyday activities of the company in accordance with the requirements of law and the articles of association of the company and or-ganises the accounting of the company. The Management Board of Elering has complete freedom of deci-sion: everyday management choices are made independently, without interference from the owner and the Supervi-sory Board. The Management Board needs the consent of the Supervisory Board for transactions and operations that are beyond the everyday economic activities of the company. The Management Board ensures that mem-bers of the Supervisory Board have sufficient information regarding the economic situation of the company, as well as important circumstances related to economic activities, and informs the Supervisory Board of the most important circumstances related to economic activities as and when necessary.

Composition and remuneration of the Management Board

In accordance with the articles of association, the Management Board may consist of one to three members. Members of the Management Board are elected by the Supervisory Board for a term of up to five years. Pur-su-ant to the articles of association of Elering, the company may be represented in all legal acts by two members of the Management Board jointly or by the Chairman of the Management Board alone.

A person authorised by the Supervisory Board enters into contracts with members of the Management Board that determine in more detail the rights and obligations of members of the Management Board in respect of the company and their remuneration.

Throughout 2017, the Management Board of Elering consisted of three members:

- Taavi Veskimägi – Chairman of the Management Board. His responsibilities include day-to-day duties of the Chief Executive Officer of Elering, i.e. managing and representing the company, ensuring com-pliance with contracts and legislation, organising the work of the Management Board, coordinating the development of the strategy of the company and performing a leadership role in the implementa-tion of this strategy;

- Peep Soone – Member of the Management Board. His responsibilities include the role of the Chief Fi-nancial Officer, managing the financial activities, administration and information technology field in Elering;

- Kalle Kilk – Member of the Management Board. His responsibilities include day-to-day duties as the Head of Asset Management.

Based on the articles of association, a member of the Management Board may only be paid remuneration under a contract entered into with them. A member of the Management Board may also be paid additional remunera-tion based on their performance in the amount of up to four months' remuneration. Bonuses may be paid on the basis of annual results or on any other grounds according to a resolution of the Supervisory Board. The remuner-ation of members of the Management Board is fixed and provided for in the Management Board member's con-tract. Elering has not established any long-term bonus systems. A member of the Management Board may only be paid severance benefits upon their removal at the initiative of the Supervisory Board before the term of their authority has expired in the amount of up to three months' remuneration.

The remuneration paid to members of the Management Board of Elering AS in 2017 was 439.3 thousand euros (incl. taxes).

Avoiding conflicts of interest

Members of the Management Board do not adopt resolutions based on their own interests, nor do they use commercial offers made to Elering to their own gain. A member of the Management Board must declare any conflict of interest to the Supervisory Board and other members of the Management Board before entering into their contract of service, or as soon as such a conflict arises. A member of the Management Board must prompt-ly notify other members of the Management Board and the Chairman of the Supervisory Board about any com-mercial offers related to the company's economic activities made to them, their family members or anyone else associated with them.

The requirement for avoiding conflicts of interest of members of the Management Board has been provided for in the contracts entered into with them.

A member of the Management Board avoids conflicts between their own interests and the interests of the company. He or she declares any direct or indirect interest in the transactions made by the company to the Super-vi-sory Board of Elering, informing them of any conflict as soon as it arises or of any situation that could lead to such a conflict. The Supervisory Board decides on concluding transactions with members of the Management Board or any transactions that could involve personal interests of members of the Management Board. They al-so decide on the terms and conditions of the transactions.

Members of the Management Board declare the parties related to them and the amounts of the transactions concluded with such parties are set out in the annual report. Elering did not enter into any transactions with members of the Management Board or related parties in 2017.

Audit committee

The Supervisory Board elects the Audit Committee, consisting of up to five members. The Committee is responsible for exercising supervision over risk management, internal control and financial reporting. The Committee advises the Supervisory Board in the area of accounting, checking the independence of the sworn auditor, risk management, internal control and audit, exercising supervision and preparation of the budget as well as the le-gality of activities.

Members of the Committee are elected for a term of three years. They elect from among themselves a chairman to organise the activities of the Audit Committee. The Chairman of the Supervisory Board may not hold the po-sition of the chairman of the Audit Committee. Members of the Audit Committee are paid remuneration for par-ticipating in the activities of the Committee. In 2017, the total amount paid to them was 6.6 thousand euros (incl. taxes). Members of the Audit Committee are members of the Supervisory Board of Elering.

In 2017, the Audit Committee met four times: on 11 April, 14 June, 27 September and 14 December. The Audit Committee addressed the following internal audits that had been carried out: audit on ensuring the security of supply of gas; IT development audit; audit of providing the electricity network service; audit of the EGLE infor-mation system (client view of connections).

Cooperation between management and supervisory boards

The Management Board and the Supervisory Board cooperate closely for the purpose of the best protection of interests of Elering. They work together to develop the strategy of the company. The Management Board makes its management decisions according to the strategic guidelines issued by the Supervisory Board.

The Management Board regularly informs the Supervisory Board of any important matters that concern plan-ning the activities of the company as well as its business activities and draws particular attention to important changes in the business activities of Elering. The Management Board forwards data, incl. financial reports, to the Supervisory Board in sufficient time prior to Supervisory Board meetings. If the Supervisory Board requires more information about the activities of the Management Board and the company, a member of the Manage-ment Board provides the necessary information either verbally or in writing. They also ensure the Supervisory Board's access to any data relevant to the activities of the Management Board and the company.

The management principles of the company are based on legislation, the articles of association and resolutions made and objectives set at General Meetings and meetings of the Supervisory Board.

Disclosure of information

The website of Elering (www.elering.ee) presents a separate list of data that is subject to disclosure pursuant to legislation. The website presents annual reports, financial results, performance indicators, an overview of prin-ci-pal activities, structure of Elering, a summary of its strategy, news and notices as well as other information nec-essary for investors and the public. The website is also available in English. The information (incl. news and no-tices) on the website is constantly updated.

Financial reporting and auditing

The Management Board of Elering publishes an annual report once a year and mid-term reviews during the fi-nancial year. The annual report is compiled in accordance with the International Financial Reporting Standards (IFRS) and is audited according to International Standards on Auditing (ISA). At the invitation of the Supervisory Board, the auditor of the company also participates in the meeting of the Supervisory Board to review the annu-al report. The annual report signed by members of the Management Board is submitted to the General Meeting for approval. Along with the annual report, the Supervisory Board's opinion on the annual report is submitted to the General Meeting.

Elering elects an external auditor following the procurement procedure and ensuring the best possible value for money for the auditing services. Only internationally recognised, high-quality service providers are asked to submit a tender.

An external auditor is appointed upon a resolution of the General Meeting, while the contract for auditing services is entered into by the Management Board. In the contract entered into with the auditor, his or her tasks, timeframe and remuneration are set out. This contract can in no way hinder the auditor's work in assessing the activities of the company.

A new procurement for finding an auditor for the period from 2017 to 2021 was carried out in spring 2017. The procurement was won by AS PricewaterhouseCoopers. When performing external audits, the company is guided by the legislation of the Republic of Estonia, the ISA and auditor risk management regulation, including the Regulation of the European Union related to the field of audit that came into force in 2016.

During 2017, the auditor of the Company has provided to the Company an assurance engagement on Activities report in accordance with Electricity Market Act § 17, report on audit findings to the National Audit Office of Estonia, tax advice and some other advisory services that are permissible in accordance with the Auditors Activities Act of the Republic of Estonia.

The Audit Committee monitors the activities of the external auditor in accordance with the Auditors Activities Act.

Risk management and internal control system

The risk management of Elering is in compliance with the ERM (Enterprise Risk Management) principles. The risk management objectives in Elering are as follows:

- to manage and describe risk management processes in the company;
- to define the roles and responsibilities of the parties to the risk management process;
- to ensure that all risks are identifiable, assessable and able to be responded to; and
- to help managers better understand and manage risks

The principles of the risk management policy in Elering must ensure that:

- the culture, processes and structure of the company encourage the fulfilment of the strategic objectives of the company and at the same time the identification, management, monitoring and, if possible, hedging of risks;
- the monitoring and management of the risks of the company and the internal control system are based on the internationally accepted Enterprise Risk Management (ERM) Model developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), a voluntary organisation that promotes good corporate governance;
- all relevant legislation, standards, regulations and contractual obligations as well as requirements and ex-pectations arising from the society are taken into account in managing risks of the company; and
- we continuously improve our risk management activities in the company.

The Management Board is responsible for the functioning of the internal control system of the company. To ensure the functioning of the system, the internal auditor service is outsourced to an audit company. The internal auditor reports to the Audit Committee.

From 2017 to 2019, the internal audit service will be provided to the company by KPMG Baltics OÜ. In performing the internal audit function, the company is guided by the legislation of the Republic of Estonia and internal au-dit guidance issued by the Institute of Internal Auditors (IIA), including the Regulation of the European Union re-lated to the field of audit that came into force in 2016.

The internal audit represents an independent and objective action that is designed to provide security and ad-vice, add value to and improve the activities of the company. This helps the company achieve its goals by using a systematic and orderly approach to assessing and improving risk management and the effectiveness of control and management processes. The function of the internal audit, which is independent from the areas being as-sessed, is to report to the Audit Committee of the company.

Equal treatment

As a system operator, Elering bears responsibility for the system in accordance with the Electricity Market Act. This means the obligation to ensure, at all times, the security of supply and the balance of the electricity system. The system operator exercises its rights and performs its obligations in compliance with the principles of equal treatment.

In order to ensure equal treatment, Elering has established internal procedures and, based on the legislation of the Republic of Estonia and of the European Union (including network codes), has compiled various standard conditions, methodologies and other rules that have been published on the website of the company and ap-proved by the Estonian Competition Authority.


RESPONSI
BILITY

ELERING AND THE ENVIRONMENT

Elering is an infrastructure enterprise with strategic importance and our core business – to ensure the security of supply of electricity in Estonia – is directly related to the environment and has a significant impact on it.

In addition to building new lines, maintenance of the existing lines is also important. In 2017, 346 metres of oil-filled cables were disassembled, 38 masts and stands were utilised and 3,000 metres of lightning protection cable were disassembled and utilised.

The biggest environmental hazards where Elering's substations are concerned are oil that can leak from transformers, chemicals and hazardous waste (mainly batteries).

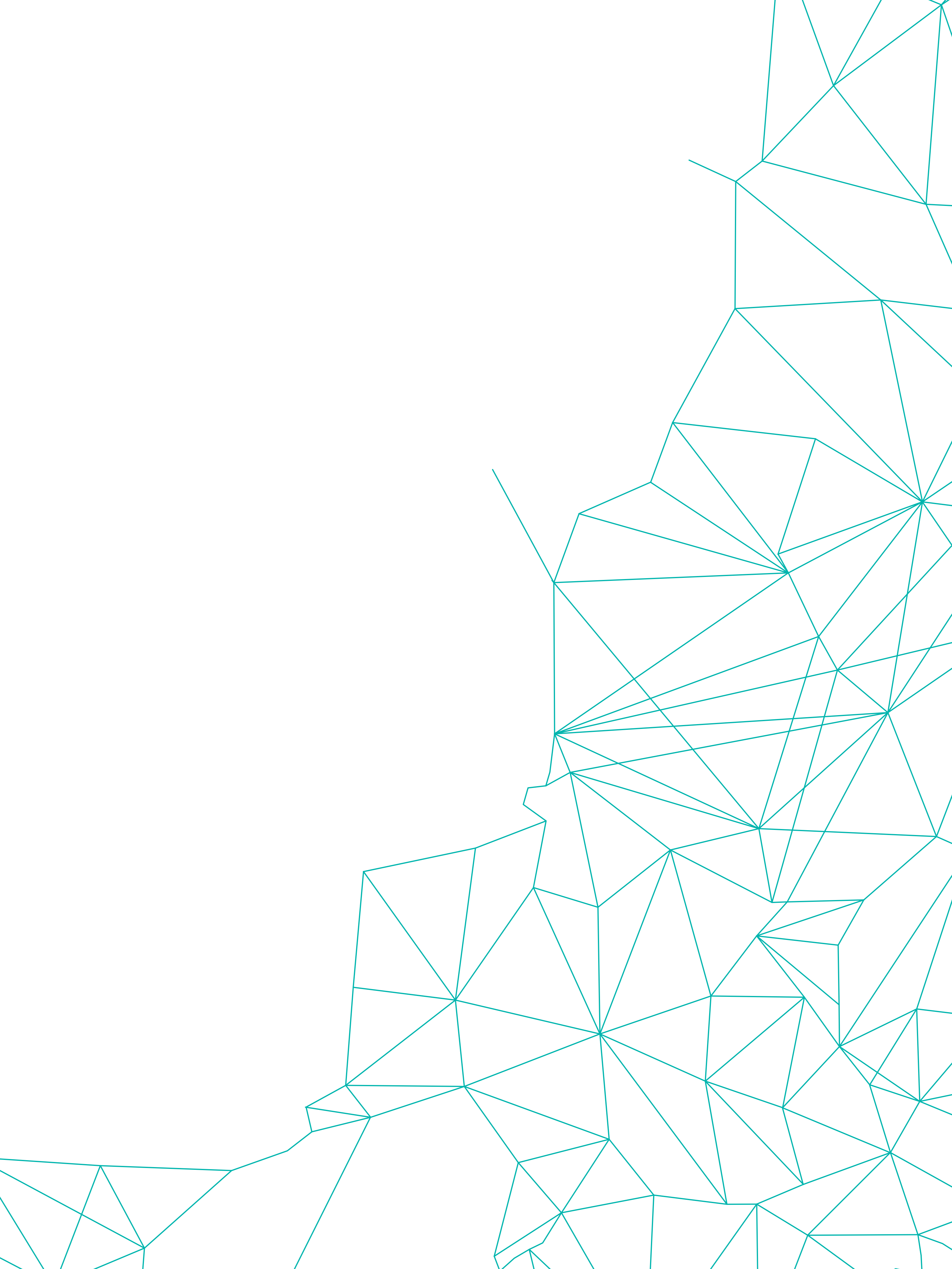
In connection with reconstructing substations, in 2017 the following work reducing the possible environmental impact was performed:

- in the Ida, Kopli and Saare substations, the oil collection systems of the existing transformers were renovated;
- in the Abja, Linda, Lõpe, Suure-Jaani, Tapa and Jüri substations, outdated transformers were replaced with new ones whose noise level is lower;
- in the Aruküla, Jüri and Viru substations, measurements of electric and magnetic fields were performed, which showed that limit values had not been exceeded. According to the data of the World Health Organization (WHO), electric and magnetic fields do not have any adverse impact on human health if the indicators remain within the permitted limits.

In 2017, several investments were made in the gas network of Elering, which increase the safety of the gas network and improve the overall status of the environment. The investments made include the following work:

- the electrically powered diesel generators of the Sillamäe and Kunda gas stations were replaced with generators working on natural gas, which are characterised by more environmentally friendly emission levels and a lower noise level;
- boilers of the heating systems of the Sillamäe, Kunda, Rakvere and Värska gas stations were replaced with more economical natural gas boilers working on the principle of condensation;
- in the Tartu and Kohila gas stations, the freely breathable natural gas scenting (odourising) devices were replaced with new ones – a closed system device (the contact and thus also the pollution of the ambient air has been eliminated);
- noise barrier walls were built for the regulator building of the Värska gas metering station.

In order to prevent the possible adverse environmental impact of Elering facilities, the company has entered into a contract for the provision of environmental management advisory services with the consultation company Skepast&Puhkim OÜ.



Annual report

Statement of financial position

in thousands of euros	*Note*	*31.12.2017*	*31.12.2016*
ASSETS			
Current assets			
Cash and cash equivalents	7	81,997	52,997
Short term deposits	7	40,000	0
Restricted cash	7	0	21,778
Trade and other receivables	8	27,715	26,682
Inventories	9	3,727	3,543
Total current assets		**153,439**	**105,001**
Non-current assets			
Available-for-sale financial assets	2	1,946	1,946
Long term deposits	7	0	40,000
Property, plant and equipment	10	746,503	751,621
Intangible assets	11	7,755	5,153
Total non-current assets		**756,204**	**798,721**
TOTAL ASSETS		**909,643**	**903,722**
LIABILITIES			
Current liabilities			
Borrowings	12	232,824	5,704
Trade and other payables	13	36,000	27,963
Total current liabilities		**268,824**	**33,667**
Non-current liabilities			
Borrowings	12	129,439	361,685
Deferred income	14	165,191	159,296
Total non-current liabilities		**294,630**	**520,982**
TOTAL LIABILITIES		**563,454**	**554,649**
EQUITY			
Share capital	15	189,890	189,890
Statutory reserve capital	15	12,898	11,962
Retained earnings	15	143,402	147,220
TOTAL EQUITY		**346,190**	**349,072**
TOTAL LIABILITIES AND EQUITY		**909,643**	**903,722**

The notes on pages 44 to 81 are an integral part of these financial statements.

Statement of comprehensive income

in thousands of euros	*Note*	*2017*	*2016*
Revenue	16	130,349	134,012
Other income	17	1,586	1,879
Goods, raw materials and services	18	-49,905	-46,662
Other operating expenses	19	-6,374	-5,457
Staff costs	20	-8,049	-7,807
Depreciation and amortization	10; 11	-34,486	-38,128
Operating profit		**33,121**	**37,841**
Financial income	21	71	18
Financial costs	21	-11,074	-11,395
Profit before income tax		**22,118**	**26,463**
Income tax expense	15	-5,000	-7,750
Profit for the year		**17,118**	**18,713**
Total comprehensive income for the year		**17,118**	**18,713**

The notes on pages 44 to 81 are an integral part of these financial statements.

Cash flow statement

in thousands of euros	*Note*	*2017*	*2016*
Cash flows from operating activities			
Profit before income tax		22,118	26,463
Adjustments for:			
· Profit from sale of property, plant and equipment	17	-53	-32
· Depreciation, amortisation and impairment	10, 11	34,486	38,128
· Dividends received from long-term financial investments	17	-118	-59
· Government grants expended and amortised	17	-1,174	-1,174
· Interest expenses	21	11,068	11,390
· Interest income	21	-71	-17
· Changes in inventories	9	-184	-182
· Changes in receivables and prepayments related to operating activities	8	-1,825	-70
· Changes in liabilities and prepayments related to operating activities	13	8,709	1,972
· Changes in deferred income from connection and other service fees	14	1,401	-895
Cash generated from operations		**74,355**	**75,525**
Income tax paid	15	-5,000	-7,750
Interest paid	13, 21	-10,929	-11,200
Interest received	21	65	18
Net cash from operating activities		**58,492**	**56,593**
Cash flows from investing activities			
Purchases of property, plant and equipment and intangible assets	10, 11, 13	-31,118	-25,872
Grants to acquire non-current assets	7, 14	21,117	0
Proceeds from sale of property, plant and equipment	10, 17	271	510
Placing long term deposits	7	0	-40,000
Dividends received from long-term financial investments	17	118	59
Congestion fees received	8, 13, 14	5,238	12,600
Net cash used in investing activities		**-3,773**	**-52,703**
Cash flows from financing activities			
Repayments of bank loans	12	-5,719	-12,381
Proceeds from contributions to equity	15	0	32,000
Dividends paid to company´s shareholders	15	-20,000	-31,000
Net cash used in financing activities		**-25,719**	**-11,381**
Net increase/decrease in cash and cash equivalents		**29,000**	**-7,491**
Cash and cash equivalents at the beginning of the year	**7**	**52,997**	**60,489**
Cash and cash equivalents at the end of the year	**7**	**81,997**	**52,997**

The notes 44 to 81 are an integral part of these financial statements.

Statement of changes in equity

in thousands of euros	*Share capital*	*Unregistered share capitall*	*Statutory reserve capital*	*Retained earnings*	*Total*
Balance as of 1.01.2016	**149,890**	**8,000**	**10,743**	**160,725**	**329,359**
Comprehensive income for financial year	0	0	0	18,713	18,713
Total comprehensive income for the period	**0**	**0**	**0**	**18,713**	**18,713**
Transactions with owners:					
Contributions to equity	40,000	-8,000	0	0	32,000
Transfers to statutory reserve capital	0	0	1,219	-1,219	0
Dividends paid	0	0	0	-31,000	-31,000
Total transactions with owners	**40,000**	**-8,000**	**1,219**	**-32,219**	**1,000**
Balance as of 31.12.2016	**189,890**	**0**	**11,962**	**147,220**	**349,072**
Comprehensive income for financial year	0	0	0	17,118	17,118
Total comprehensive income for the period	**0**	**0**	**0**	**17,118**	**17,118**
Transactions with owners:					
Transfers to statutory reserve capital	0	0	936	-936	0
Dividends paid	0	0	0	-20,000	-20,000
Total transactions with owners	**0**	**0**	**936**	**-20,936**	**-20,000**
Balance as of 31.12.2017	**189,890**	**0**	**12,898**	**143,402**	**346,190**

More detailed information on share capital and other equity items is set out in Note 15.

The notes on pages 44 to 81 are an integral part of these financial statements.


lering
AME ENERGIAD

Notes to the Financial Statements

Note 1

ELERING AS AND ITS OPERATIONS

The financial statements of Elering AS ("Elering") for the year ended 31 December 2017 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union. Elering is incorporated in the Republic of Estonia and its registered address is Kadaka tee 42, 12915 Tallinn, Estonia. Elering is engaged in electricity and natural gas transmission in the Republic of Estonia.

As at 31 December 2017 and during 2017, Elering had no subsidiaries. Up until 28 February 2016, Elering had the subsidiary AS Võrguteenus Valdus, which had, in turn, the subsidiary Elering Gaas AS. In 2016, the subsidiaries merged with the parent company. The merger did not have any impact on the consolidated figures of Elering and in separate financial statements the merger was accounted for using the predecessor method, therefore, following the merger, the consolidated and separate financial statements of Elering were identical during the comparative period presented in these financial statements.

The business of Elering is subject to laws of the Republic of Estonia and European Union. Elering's transmission business and balancing service business are regulated by the Estonian Competition Authority, including the approval of network tariffs and standard terms and conditions of such services.

The sole shareholder of Elering AS is the Republic of Estonia.

The Management Board approved these financial statements on 5 March 2018. Pursuant to the Commercial Code of the Republic of Estonia, the annual report shall be presented for approval to Elering's Supervisory Board and the General Meeting of Shareholders.

Note 2

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bases of preparation
These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union under the historical cost convention. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Segment reporting
Business segment disclosures are provided in a manner that operating results are regularly reviewed by Elering's chief operating decision maker. The chief operating decision maker responsible for the allocation of resources for business segments and the results of their operations is Elering's management board.

Functional and presentation currency
The financial statements of Elering are presented in thousands of euros which is Elering´s functional and presentation currency.

Foreign currency translation
Foreign currency transactions are translated into the functional currency using the exchange rates of the European Central Bank prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year-end exchange rates are recognised in profit or loss.

Financial assets
The purchases and sales of financial assets are recognised on the trade date – the date on which Elering commits to purchase or sell a certain financial asset. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and Elering has transferred substantially all risks and rewards of ownership.

Depending on the purpose for which financial assets were acquired as well as management's intentions, financial assets are classified into the following categories at initial recognition according to IAS 39:

- financial assets at fair value through profit or loss;
- loans and receivables;
- available-for-sale financial assets.

As at 31 December 2017, Elering had no other classes of financial assets than those classified under the category of 'loans and receivables' and 'available-for-sale financial assets' (as at 31 December 2016, 'loans and receivables' and 'available-for-sale financial assets').

Loans and receivables
are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These assets are initially recognised at fair value plus transaction costs. After initial recognition, loans and receivables are accounted for at amortised cost using the effective interest rate method.

Elering assesses at the end of each reporting period whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The criteria that Elering uses to determine that there is objective evidence of an impairment loss include: significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and a breach of contract, such as a default or delinquency in payments for more than 90 days.

The amount of the loss is the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the impairment loss is recognised in profit or loss.

Uncollectible loans and receivables are written off against the related allowance account.

Elering recognises the following financial assets in the category of 'loans and receivables': "Cash and cash equivalents", "Trade and other receivables", "Restricted cash" and "Term deposits".

Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or that are not classified in any of the others categories above. Available-for-sale financial assets are carried as non-current financial investments except when the financial asset expires or Elering intends to sell it during 12 months after the end of the reporting period. Available-for-sale financial assets are initially recognised at fair value, including transaction costs. Available-for-sale financial assets are subsequently carried at fair value; gains and losses arising from changes in fair value of available-for-sale financial assets are included in the statement of comprehensive income. Generally, the basis to determine the fair value is considered to be the market price in the active market or if that is not available, then the value established by using commonly accepted valuation techniques. If the fair value of a financial asset cannot be measured reliably, they are measured at cost less any impairment losses. Dividend income is recognised when the right to receive payment is established.

Available-for-sale financial assets entirely comprise of shares of Nord Pool AS (until 2016 AS Nord Pool Spot). The principal business activity of Nord Pool AS Group, registered in Norway, is the organisation of electricity exchanges in the Nordic countries, Great Britain and the Baltic States. The investment was made with a long-term strategic goal of taking part in the decision-making process concerning the development of electricity market in the Nordic-Baltic region.

As at the balance sheet date, Elering does not have any current financial information on AS Nord Pool; nor are its shares traded in the financial markets. It is also unlikely that those shares will be actively traded in the future or that the company will start publishing periodic information on future forecasts. Therefore, the fair value of those shares cannot be reliably measured. AS Nord Pool shares are carried at their cost.

Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

Prepayments
Prepayments are carried at cost less a provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which itself will be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once Elering has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to Elering. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying amount of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

Inventories
Inventories are initially recorded at cost, consisting of the purchase costs, production costs and other costs incurred in bringing the inventories to their present location and condition.

The purchase costs of inventories include the purchase price, customs duties and other non-refundable taxes and direct transportation costs related to the purchase, less discounts and subsidies. Inventories are expensed using the FIFO method.

Inventories are measured in the balance sheet at the lower of acquisition cost and net realisable value. Net realisable value is calculated by deducting estimated expenses that are necessary for preparing the product for sale and for completing the sale from the estimated sales price used in the ordinary course of business.

Property, plant and equipment

Property, plant and equipment are tangible assets that are used in business activities and the useful life of which is longer than one year. Property, plant and equipment are carried using the cost method, i.e. at historical cost less any accumulated depreciation and any impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Other than the purchase price, cost of the acquired property, plant and equipment includes transportation and installation expenses, as well as other expenses directly related to acquisition and putting such assets into operation. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets. Borrowing costs are capitalised if the borrowing costs and expenditures for the asset have been incurred and the construction of the asset has commenced. Capitalisation of borrowing costs is ceased when the construction of the asset is completed or when the construction has been suspended for an extended period of time.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only if they meet respective criteria for property, plant and equipment. The carrying amount of the replaced part is derecognised. All other repairs and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

If property, plant and equipment consist of components with significantly different useful lives, the components are recognised as separate items of property, plant and equipment.

Land is not depreciated. Depreciation of other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives in years
Buildings	25-40
Facilities – electricity transmission lines, gas pipelines	30-60
Machinery and equipment – electricity and natural gas transmission equipment until 1 December 2017	7-25
Machinery and equipment – electricity and natural gas transmission equipment since 1 December 2017	7-40
Other property, plant and equipment	3-20

The expected useful lives of items of property, plant and equipment are reviewed during the annual stocktaking, when subsequent expenditures are recognised and in the case of significant changes in development plans. When the estimated useful life of an asset differs significantly from the previous estimate, it is treated as a change in the accoun¬ting estimate, and the remaining useful life of the asset is changed, as a result of which the depreciation charge of the following periods also changes.

The residual value of an asset is the estimated amount that Elering would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, on each balance sheet date.

Gains and losses on disposals and write-offs determined by comparing proceeds with the carrying amount are recognised in profit or loss under “Other income” or “Other operating expenses” respectively.

Intangible assets
Intangible assets are recognised in the statement of financial position only if the following conditions are met:

- the asset is controlled by Elering;
- it is probable that the future economic benefits that are attributable to the asset will flow to Elering;
- the cost of the asset can be measured reliably.

An intangible asset is initially recognised at its cost, comprising its purchase price, any directly attributable expenditure on preparing the asset for its intended use and borrowing costs that relate to assets that take a substantial period of time to get ready for use. After initial recognition, an intangible asset is carried at its acquisition cost less any accumulated amortisation and impairment losses.

Acquired software licences are capitalised on the basis of the costs incurred to acquire and bring them to use.

Personal right of use
Payments made for rights of superficies and servitudes meeting the criteria for recognition as intangible assets are recognised as intangible assets. The costs related to rights of use of land are depreciated according to the contract period, not exceeding 100 years.

Intangible assets and personal of use are amortised using the straight-line method over their useful lives:

	Useful lives in years
Software licences	3-5 years
Personal rights of use	50-100 years

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less costs of disposal.

Impairment of non-financial assets
Land and assets that are subject to depreciation/amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset’s fair value less costs of disposal and value in use. For the purposes 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 loss are reviewed for possible reversal of impairment on each reporting date.

Leases
Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made or received under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

Financial liabilities

Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Elering has financial liabilities only in the category of 'other financial liabilities'.

Other financial liabilities are initially recognised at fair value, net of transaction costs incurred and are subsequently carried at amortised cost. The amortised cost of current liabilities normally equals their nominal value; therefore current liabilities are stated in the statement of financial position in their redemption value. Non-current liabilities are subsequently carried at amortised cost. The difference between the amortised cost and the redemption value is recognised as an interest expense in profit or loss over duration of the contract using the effective interest rate method. The borrowing costs associated with the qualifying assets meeting respective requirements are capitalised as part of cost of the assets.

A financial liability is classified as current when it is due within 12 months after the balance sheet date or Elering does not have an unconditional right to defer the payment for longer than 12 months after the balance sheet date. Borrowings with a due date of 12 months or less after the balance sheet date that are refinanced into non-current borrowings after the balance sheet date but before the approval of the annual report, are classified as current. Borrowings that the lender has the right to recall due to the violation of terms specified in the contract if such right is established by the balance sheet date are also classified as current liabilities.

Provisions and contingent liabilities

Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when Elering has a present legal or constructive obligation as a result of past events and, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Other possible or present obligations arising from past events but whose settlement is not probable or the amount of which cannot be measured with sufficient reliability are disclosed as contingent liabilities in the notes to the financial statements.

Development costs

Development costs are costs that are incurred in applying research findings for the development of specific new products or processes. Development costs are capitalised if all of the criteria for recognition specified in IAS 38 have been met. Capitalised development costs are amortised over the period during which the products are expected to be used. Expenses related to research carried out for collecting new scientific or technical information and training costs are not capitalised.

Share capital

Elering does not have any preference shares. Incremental costs directly attributable to the issue of new shares are recognised as a reduction of equity. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Dividends

Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the notes to the financial statements.

Statutory reserve capital
Statutory reserve capital is formed to comply with the requirements of the Commercial Code. Reserve capital is formed from annual net profit allocations. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

Revenue recognition
Revenue is measured at the fair value of the consideration received or receivable, net of VAT and discounts.

Revenue from sales of goods is recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped.

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

Electricity transmission service
Elering measures the quantity of electricity transmission by remotely read metres in customers' connection points. The transmission service fees are calculated on the basis of the volumes of electricity transmitted in these points and regulated transmission tariffs.

Natural gas transmission service
Elering measures the quantity of natural gas transmission by remotely read metres in customers' connection points. The transmission service fees are calculated on the basis of the volumes of natural gas transmitted in these points and regulated transmission tariffs.

Electricity balancing service
Elering prepares on an hourly basis the energy balance in kilowatt-hours of the Estonian electricity system that consists of the energy balances of Elering itself and balance providers that have entered into a balance agreement with Elering. Energy balances are prepared by comparing the measurement data of Elering and that received from distribution network operators with balancing plans of balance providers. In a trading period when the real consumption of electricity, based on the measurement data, is bigger than electricity volume presented in the energy balance, Elering sells the balance providers electricity to the extent of shortage. In a trading period when the situation is opposite, Elering buys electricity from the balance providers to the extent of surplus. The sale and purchase prices are calculated by Elering for each trading period using methodology approved by the Estonian Competition Authority. Elering has considered that it is a principal in selling electricity as part of providing the balancing service as Elering is ultimately responsible for keeping the system in balance.

Gas balancing service
Elering prepares on a daily basis the gas balance in cubic meters of the Estonian gas system that consists of the gas balances of Elering itself and balance providers that have entered into a balance agreement with Elering. Gas balances are prepared by comparing the measurement data of Elering and that received from distribution network operators with balancing plans of balance providers. In a trading period when the real consumption of natural gas, based on the measurement data, is bigger than natural gas volume presented in the gas balance, Elering sells the balance providers gas to the extent of shortage. In a trading period when the situation is opposite, Elering buys gas from the balance providers to the extent of surplus. The sale and purchase prices are calculated by Elering for each trading period using methodology approved by the Estonian Competition Authority. Elering has considered that it is a principal in selling gas as part of providing the balancing service as Elering is ultimately responsible for keeping the system in balance.

Congestion income
In situations where market participants place more requests for cross-border transmission of electricity than is technically possible, transmission rights for cross-border electricity are sold at special auctions (see below). Under the principle used in these auctions, 50% of auction proceeds belongs to the transmission system operator of either country. Types of the auctions:

1. Proceeds from the day-ahead market auction are essentially the difference between the exchange prices of Estonia and neighbouring price regions of the Nord Pool power exchange every hour. The power exchange collects the aforementioned price difference through its trading mechanism and transfers it to respective transmission system operators.

2. At auctions of long-term transmission capacity, i.e. at Limited Physical Transmission Rights (PTR-Limited) auctions, Elering offers, in cooperation with the Latvian transmission system operator Augstsprieguma tīkls AS, those market participants that have bought transmission capacity the right to the hourly auction proceeds of the day-ahead market for the same volume. Elering distributes to market participants the hourly auction proceeds received from the power exchange in proportion to the PTR-Limited volume acquired by the market participant.

Net proceeds from the day-ahead market and PTR-Limited auctions are recognised in compliance with the requirements of Article 16 of Regulation (EC) No. 714/2009 of the European Parliament and of the Council, pursuant to which congestion income should be used in particular for the construction of new interconnection capacities between countries and for guaranteeing the actual availability of the allocated transmission capacity; if the proceeds cannot be used for these purposes, the proceeds will be taken into account when reducing the network service tariff.

If congestion proceeds are used for the construction of new interconnection capacities, then they are recognized in the financial statements similarly to the government grants. Initially, they are recognized as deferred income, and then are credited to income over the estimated useful life of the asset. If congestion proceeds are used for the reduction of tariffs, then proceeds are recognised in profit or loss during the period when Elering's right to receive proceeds from the day-ahead market and PTR auctions is established. Beginning from 1 July 2014 Elering has been using auctions proceeds for the construction of new interconnection capacities. See also Note 3.

Recognition of connection fees
When connecting to the electricity network, the clients must pay a connection fee based on the actual costs of infrastructure to be built in order to connect to the network. The revenue from connection fees is deferred and recognised as income evenly over the estimated customer relationship period. The amortisation period of connection fees is 25 years. Deferred connection fees are carried in the statement of financial position as long-term deferred income.

Interest income
is recognised when it is probable that the interest will be received and the amount of revenue can be measured reliably. Interest income is recognized on an accrual basis using the effective interest method.

Accounting for government grants
Government grants are recognised at fair value when there is a reasonable assurance that Elering will comply with all the conditions attached to government grants and that the grant will be received. The government grants are recognised in profit or loss on a systematic basis over the periods in which Elering incurs the related costs which the grants are intended to compensate.

Government grants are presented in the statement of financial position using the gross method, according to which the government grant is recognised at its cost, and if the government grant is received in the form of a transfer of a non-monetary asset, it is recognised at its fair value. The amount of the government grant received for the purpose of acquisition of assets is recognised as deferred income from government grants. The acquired asset is depreciated and the grant is credited to income over the estimated useful life of the asset.

Electricity inter-transmission system operator compensation mechanism (ITC)
ITC is a mechanism for the compensation of cross-border energy flows, as designated by the EU regulation No 838/2010, in which transmission system operators of over 30 countries participate. The mechanism works under the principle that a transmission system operator of a country compensates, through the ITC fund, the other transmission network operators for additional expenses caused by cross-border energy flows in case if that country has exported or imported electricity during the reporting period, and a transmission system operator receives compensation from the fund if a transit flow caused by market participants of other countries has crossed the country. Such accounting is kept by specifically authorised administrators in Switzerland, who submit to the members of the mechanism the data in the form of net amounts to be paid each month. Elering recognises the net amounts in the statement of comprehensive income depending whether it is net income or net expense under “Revenue” within ‘Revenue from other network services’ or under “Goods, raw materials and services” within ‘Other costs’ respectively.

Subsidies to electricity producers
The law obliges Elering to participate in supporting mechanism for eligible electricity producers (first and foremost power plants using renewable sources of energy). Elering collects subsidies from consumers and distribution network operators and pays it out to those electricity producers who meet the criteria.

In accordance with current principles, Elering prepares an estimate of the amount of subsidies for the following calendar year, based on estimates on the amount of electricity produced by these producers, and the amount of network services to be provided to the end users in Estonia. Elering uses these estimates to determine the charge of subsidy for the following calendar year per kWh (kilowatt-hour) of network services, taking into account any difference between estimated and actual amounts of subsidies paid during the previous period (from November to October), interest earned on over collected amounts or interest paid on under collected amounts and justified expenses incurred for management of subsidies.

The customers are charged according to the estimated charge per kWh. For different reasons the actual amounts paid out and received as subsidies always differ from the estimated amounts. Over or under collected subsidies are shown in the statement of financial position as either Trade and other payables (in case of surplus) or Trade and other receivables (in case of deficit). These balances are taken into account when determining the charge for the next period as described above. Collecting and paying of subsidies has no material impact on profit or loss of Elering. See also Note 8 and 13.

Subsidies to biogas producers
In accordance with law, Elering must participate in the mechanism for subsidising biogas producers that are in compliance with the requirements provided for by law. Elering AS is compensated for biogas subsidies by the Ministry of Economic Affairs and Communications. Elering AS as a system operator organises entry into contracts with biogas producers, supervision of use of the subsidies and payment of the subsidies.

Activities necessary for the implementation of the contract are financed as a prepayment on the basis of a quarterly expenditure forecast submitted by Elering AS. For different reasons the actual amounts paid out and received as subsidies always differ from the estimated amounts. Over or under collected subsidies are shown in the statement of financial position as either Trade and other payables (in case of surplus) or Trade and other receivables (in case of deficit). Collecting and paying of subsidies has no material impact on profit or loss of Elering. See also Note 8 and 13.

Employee benefits
Employee short-term benefits include wages, salaries and social taxes, benefits related to temporary suspension of employment contracts (holiday or other similar pay). These benefits are recognised in profit or loss in the year in which the associated services are rendered by the employees of Elering. Any amounts unpaid by the balance sheet date are recognised as a liability.

If during the reporting period, an employee has provided services for which payment of compensation is to be expected, Elering will recognise a liability (accrued expense) in the amount of forecasted compensation, from which all amounts already paid, will be deducted.

Income tax
According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. The tax rate on the net dividends paid out of retained earnings is 20/80. From 2019, tax rate of 14/86 can be applied to dividend payments. The more beneficial tax rate can be used for dividend payments in the amount of up to the average dividend payment during the three preceding years that were taxed with the tax rate of 20/80. When calculating the average dividend payment of three preceding years, 2018 will be the first year to be taken into account. The corporate income tax arising from the payment of dividends is recognised as a liability and an income tax expense in the period in which dividends are declared, regardless of the period for which the dividends are paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

Due to the nature of the taxation system, the companies registered in Estonia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise. A contingent income tax liability which would arise upon the payment of dividends is not recognised in the statement of financial position. The maximum income tax liability which would accompany the distribution of retained earnings is disclosed in the notes to the financial statements.

Tax rates in Estonia
The following tax rates have been valid through 2017:

Tax	*Tax rate*
Social security tax	33% of the paid payroll to employees and fringe benefits
Unemployment insurance tax	0.8% of the payroll paid to employees
Fringe benefit income tax	20/80 of fringe benefits paid to employees
Land tax	0.5-2.5% on taxable value of land per annum
Excise tax on electricity	4.47 euros per MWh of electricity
Excise tax on gas	40.52 per thousand cubic meters
Corporate income tax on non-business related expenses	20/80 on non-business related expenses

Note 3

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

Elering makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Useful lives of property, plant and equipment
The estimated useful lives of items of property, plant and equipment (Note 10) are based on management's estimates regarding the period during which the asset will be used. The estimation of useful lives is based on historical experience and takes into consideration production capacity and physical condition of the assets. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. Therefore, the management changed their estimation regarding the useful lives of certain electricity transmission equipment by extending the useful lives as of 1 December 2017, which will reduce the depreciation of property, plant and equipment in 2018 by approximately EUR 1,200 thousand a year. In the reporting period, depreciation amounted to EUR 33,711 thousand (2016: EUR 37,327 thousand). If depreciation rates were increased/decreased by 10%, the depreciation charge for the year would increase/decrease by EUR 3,371 thousand (2016: EUR 3,733 thousand).

Congestion income
According to the accounting principles described in Note 2, timing of recognition of congestion income depends on the purposes for which the proceeds is used – for constructions of new interconnection capacities or reduction of current network tariffs. The purposes are outlined in the Article 16 of European Parliament and Council Regulation (EC) No 714/2009. Since 1 July 2014 congestion income has been used for constructions of new interconnection capacities. In 2017 Elering recognised deferred congestion income in the amount EUR 5,668 thousand (2016: EUR 12,933 thousand); see also Note 14. Amounts accrued since 1 July 2014 are used to finance investments in network that will increase the cross border interconnection capacity, i.e. the construction of the third electricity transmission line between Estonia and Latvia.

Note 4

NEW ACCOUNTING PRONOUNCEMENTS

Adoption of new or revised standards and interpretations
The following new or revised standards and interpretations became effective for Elering from 1 January 2017:

Disclosure Initiative - Amendments to IAS 7
(effective for annual periods beginning on or after 1 January 2017). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities.

Elering disclosed a reconciliation of movements in liabilities arising from financing activities in the notes to the financial statement.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2017 that would be expected to have a material impact to Elering.

New or revised standards and interpretations
Certain new or revised standards and interpretations have been issued that are mandatory for Elering's annual periods beginning on or after 1 January 2018, and which Elering has not early adopted.

IFRS 9, Financial Instruments: Classification and Measurement
(effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

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

Elering assessed that IFRS 9 did not have a material impact to Elering as at 1 January 2018 because impairment of receivables has been historically not material and cash and deposits are held in credit institutions of minimum of Aa3 rating; therefore applying the expected loss model, including assessment of forward-looking information, did not cause material impairment losses. All the financial assets (except for the investment in Nord Pool shares) meet SPPI requirement and are held to collect, thus will continue to be measured using the amortised cost method. The carrying amount of Nord Pool shares is not significantly different from their fair value; the management has not yet determined whether the fair value changes will be recognised through profit or loss or other comprehensive income, the decision will be made during the first quarter of 2018.

IFRS 15, Revenue from Contracts with Customers
(effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

Amendments to IFRS 15, Revenue from Contracts with Customers
(effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard.

Elering has assessed that the new revenue standard does not have a material impact to different revenue sources of Elering. The management has concluded that the connection fees do not represent a separate performance obligation from providing network service; therefore Elering will continue to defer the revenue from connection fees. Also, the management has assessed that the conclusions on whether Elering is acting as an agent or principal, has not changed under the new revenue standard.

IFRS 16, Leases
(effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in profit or loss. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

Elering has assessed that the new leasing standard is not expected to have a material impact to Elering as the lease payments are immaterial (refer to Note 22). Elering is in process of assessing whether certain agreements that are currently not accounted for as lease agreements, would be in the scope of the new standard, and if so, whether to apply the transition exemption in respect of reassessment of such agreements.

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

Note 5

FINANCIAL RISK MANAGEMENT

The risk management function is performed at Elering in accordance with internationally approved Enterprise Risk Management Mode methodology, which has been developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Elering's risks are assessed in four categories: strategic, operational, financial and external risks. Financial risk comprises market risk (including electricity and natural gas price risk, currency risk, interest rate risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then to ensure that exposure to risks stays within these limits. Risk management is monitored at the Management Board level and the results are reported to the Audit Committee. Elering's financial risks are managed at Elering's Finance Department.

The following table provides reconciliation of classes of financial assets and financial liabilities of Elering in accordance with the measurement categories of IAS 39:

Financial assets

in thousands of euros	*31.12.2017*	*31.12.2016*
Cash and cash equivalents (Note 7)	81,997	52,997
Restricted cash (Note 7)	0	21,778
Short term deposits (Note 7)	40,000	0
Long term deposits (Note 7)	0	40,000
Trade and other receivables (Note 8)	27,521	26,438
Available-for-sale financial assets (Note 2)	1,946	1,946
Total financial assets	**151,463**	**143,160**

Financial liabilities

in thousands of euros	*31.12.2017*	*31.12.2016*
Trade and other payables (Note 13)	32,378	24,127
Borrowings (Note 12)	362,263	367,389
Total financial liabilities	**394,641**	**391,516**

Credit risk
Elering takes on exposure to credit risk, which is the risk that one party of a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of Elering's sales on credit terms and other transactions with counterparties giving rise to financial assets. In accordance with Elering's risk management principles, Elering's short-term available cash resources can be deposited in the following domestic

financial instruments: overnight deposits at acceptable credit institutions or term deposits at credit institutions. The following principles are followed when depositing short-term available cash resources: ensuring of liquidity, capital preservation, interest income generation.

Elering's assets exposed to credit risk as of balance sheet days were as follows:

in thousands of euros	*31.12.2017*	*31.12.2016*
Cash and cash equivalents (Note 7)	81,997	52,997
Restricted cash (Note 7)	0	21,778
Short term deposits (Note 7)	40,000	0
Long term deposits (Note 7)	0	40,000
Trade and other receivables (Note 8)	27,521	26,438
Total exposure of assets to credit risk in the statement of financial position	**149,517**	**141,214**

Elering structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties or groups of counterparties or by applying additional instruments for credit risk management. Elering established criteria for holding financial assets at credit institutions. According to the given criteria maximum permitted limits depend on the credit rating and equity of the credit institution. Limits on the level of credit risk are approved regularly by management. Such risks are monitored on an ongoing basis and they are subject to an annual review.

Elering's Accounting Department reviews ageing analysis of outstanding trade receivables and follows up on past due balances each week. The results are reported to the CFO of Elering. Elering has identified circumstances under which the collection of debt is passed over to a collection agency. Information about credit risk is disclosed in Note 8.

Credit risk concentration

Elering is exposed to concentrations of credit risk. Management monitors and discloses concentrations of credit risk by reports, which list exposures to counterparty with aggregated balances in excess of 5% of Elering's equity. On 31.12.2017, Elering had one counterparty (31.12.2016: one counterparty) with an aggregated receivables balance of EUR 18,487 thousand (31.12.2016: EUR 18,942 thousand) or 67% of the total amount of accounts receivable (31.12.2016: 79%).

In 2017 as well as in 2016 the major part of receivables was to the wholly state owned company who is monopolist in distribution network. Therefore Management believes that the credit risk arising from the concentration of receivables is not significant.

Cash in bank is deposited in five banks. The credit ratings of the banks are described in Note 7.

Market risk

Elering is exposed to market risk. Market risk arises mainly from changes in the electricity price, as well as from open positions in foreign currencies and interest bearing assets and liabilities. Management sets limits on the value of exposed positions that may be accepted, which is monitored on a daily basis. However, the use of this approach does not completely prevent losses outside of these limits, but limits their maximum amounts.

Sensitivities to market risks shown below are based on a change in one factor while holding all other factors constant. In practice, this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in the interest rate and changes in foreign currency rates.

Electricity price risk
For compensating network losses, Elering buys electricity primarily in the electricity exchange. The average electricity exchange price of the last period is used for calculation of network tariffs. In a situation where the exchange price differs from the one used for calculation of tariffs, the difference is not compensated in the next tariff period. Elering does not expect the risk of potential loss to be high and therefore it does not use any financial instruments to mitigate this risk.

Price risk of natural gas
Elering purchases natural gas for compensating network losses. In a situation where the price of gas estimated for the calculation of network tariffs differs from its actual price, the difference is not compensated in the next tariff period. This results in a situation where Elering may generate a profit or sustain a loss on the purchased gas in the short-term as the price of gas changes. Elering does not expect the risk of potential loss to be high and therefore it does not employ any financial instruments to mitigate this risk.

Currency risk
Currency risk is the risk that in the future fair value of financial instruments of cash flow will fluctuate due to changes in currency rates. As virtually all of Elering's transactions and balances are denominated in euros, Elering is not exposed to significant currency risk. Elering established separate limits for open currency positions depending on the currency and duration. Transactions in other currencies are insignificant; there were no financial instruments denominated in other currencies as of 31.12.2017 and 31.12.2016.

Interest rate risk
The financial instruments with floating interest rate expose Elering to cash flow interest rate risk, i.e. the risk that an increase in market interest rates will cause an increase in Elering's interest expense. At the same time, in case of short-term deposits, a change in market interest rates has effect on Elering's interest income arising from investment of available resources into new deposits. Elering established the minimum limit for fixed interest-bearing liabilities at 50% of all liabilities. To some extent, Elering is protected against interest rate risk, because according to tariff regulations, the average interest rate of the last five years is included in the calculation of network tariffs. Since Elering does not carry interest-bearing financial instruments at fair value, change in market interest rates does not have effect on balance value of available assets or liabilities, nor interest income or expense arising from them.

As of 31.12.2017 borrowings with fixed interest rate constituted 62% (as of 31.12.2016 62%) of all borrowings carried at amortised cost; the remaining 38% (as of 31.12.2016 38%) of the abovementioned liabilities were long-term bank loans with a floating interest rate carried at amortised cost. Long-term bonds were issued on 12.07.2011 with the maturity of seven years and the nominal value of EUR 225 million. The bonds' coupon is fixed at 4.625% p.a. and interest payments are made once a year. The floating interest rate of bank loans is based on the 6-month Euribor and it is fixed twice a year.

As at 31.12.2017 borrowings with a floating interest rate totalled EUR 137,577 thousand (as at 31.12.2016: EUR 143,274 thousand).

As at 31.12. 2017, if the interest rates of Elering's borrowings, that are exposed to the cash flow interest rate risk, had been 50 basis points (31.12.2016: 50 basis points) higher with all other variables held constant, profit for the year would have been EUR 688 thousand (2016: EUR 716 thousand) lower.

Elering's interest-bearing financial assets are overnight deposits and term deposits. The rate for overnight deposits is being fixed once a day and term deposits have a fixed interest rate for the whole term of the deposit. Therefore Elering is not exposed to cash flow interest rate risk from financial assets.

Elering did not have other financial instruments exposed to risk of change in interest rate.

Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. Elering is exposed to daily calls on its available cash resources. Liquidity risk is managed by the Finance Department of Elering. Elering's objective is to obtain a stable funding base primarily consisting of amounts due to banks and bonds. The liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Finance Department.

The table below shows liabilities on 31.12.2017 and 31.12.2016 by their remaining contractual maturity. The amounts disclosed in the maturity table are contractual undiscounted cash flows. The cash flows for borrowings subsequent periods are calculated on the basis of loan interest rates effective at balance sheet date.

The maturity analysis of financial liabilities on 31.12.2017 is as follows:

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Over 5 years*	*Total*
Liabilities*					
Trade and other payables (Note 13)	18,373	7,756	0	0	26,129
Borrowings (Note 12)	0	243,892	43,021	88,229	375,141
Total future payments	**18,373**	**251,648**	**43,021**	**88,229**	**401,270**

** including interest expenses*

Elering has Eurobonds in a nominal value of EUR 225,000 thousand listed on the London Stock Exchange. The redemption deadline thereof is 12 July 2018. Due to the deadline of the bonds, the working capital of Elering is negative. According to the management, the negative working capital does not cause any financial difficulties since Elering plans to refinance these bonds with new Eurobonds in spring 2018. In order to reduce the refinancing risk of the bonds against possible unfavourable conditions on capital markets, in December 2017 Elering entered into two loan agreements in a total volume of EUR 200,000 thousand and with a term until January 2019. In accordance with the agreements, Elering has the right to take out the loans if, for any reason, refinancing the bonds does not prove to be possible or rational at the planned time. For further information see the terms and conditions of the loan in Note 12. These loans have not been taken out as of 31 December 2017.

The maturity analysis of financial liabilities on 31.12.2016 is as follows:

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Over 5 years*	*Total*
Liabilities*					
Trade and other payables (Note 13)	15,869	3,157	0	0	19,026
Borrowings (Note 12)	0	16,754	276,896	99,906	393,569
Total future payments	**15,869**	**19,921**	**276,896**	**99,909**	**412,595**

** including interest expenses*

Elering holds its money in bank deposits. As of 31.12.2017, Elering had cash and cash equivalents EUR 81,997 thousand (as of 31.12.2016: EUR 52,997 thousand) and short-term bank deposits EUR 40,000 thousand (as of 31.12.2016 restricted cash EUR 21,778 thousand and long-term bank deposits EUR 40,000 thousand). See further information in Note 7.

Capital Management

Elering's main goal in capital risk management is to ensure Elering's sustainability of operations in order to generate return for its shareholder and provide a sense of security to creditors and thereby, preserve an optimal capital structure and lower the cost of capital. In order to preserve or improve the capital structure, Elering can regulate the dividends payable to the shareholders, buy back shares from shareholders, issue new shares or bonds and take new loans.

According to the widespread industry practice, Elering uses the equity to asset ratio for monitoring Elering's capital structure, arrived at by dividing total equity by total assets as of the balance sheet date. Elering's target has been to preserve the ratio of equity to assets at 35% - 45%. The equity to asset ratio is presented in the table below:

in thousands of euros	*31.12.2017*	*31.12.2016*
Equity	346,190	349,072
Total assets	909,643	903,722
Equity to asset ratio	**38%**	**39%**

Fair Value of Financial Instruments
Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best expressed by an active quoted market price.

The tables below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1
quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2
inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly;
Level 3
inputs for the asset or liability that are not based on observable market data.

Estimated fair values of financial instruments have been determined by Elering using available market information, where it exists, and appropriate valuation methodologies. The additional estimations are used for interpreting market data to determine the fair value.

Financial assets carried at amortised cost
Carrying amounts of trade and other financial receivables approximate their fair values (level 3).

Liabilities carried at amortised cost
Carrying amounts of trade and other payables approximate their fair values (level 3).

The estimated fair value of bonds rate is determined using their quoted price (level 1). The estimated fair value of non-current borrowings with a floating interest rate (level 3) is determined using valuation techniques, based on expected cash flows discounted at current interest rates (0.31%) for new instruments with similar credit risk and remaining maturity.

Elering had the following borrowings as of 31.12.2017: bonds, the market value was EUR 230,437 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 137,577 thousand (nominal value EUR 137,577 thousand). The following borrowings as of 31.12.2016 consisted of bonds the market value of which was EUR 241,290 thousand (nominal value EUR 225,000 thousand) and bank loans, the market value of which was EUR 143,429 thousand (nominal value EUR 143,429 thousand).

Note 6

SEGMENT REPORTING

The Management Board is the chief operating decision maker. During the financial year, the internal reporting used by the Management Board for the purposes of monitoring Elering's performance and making management decisions, has changed to a product-based reporting. This is a change from 2016, when Management Board monitored the business by electricity and gas activities. From 2017, Elering has determined main products and services that generate external revenues and profit, and has built up a methodology of allocation of revenues and expenses, and assets to the products.

Elering has distinguished three reportable segments of its business representing its main products and services; a number of minor products and services are presented together as "Other segments":

1. Regulated electricity network services that consist in the transmission of electricity through the electricity transmission networks based on tariffs approved by the regulator, i.e. the Estonian Competition Authority;
2. Regulated gas network services that consist in the transmission of gas through the gas transmission networks based on tariffs approved by the regulator, i.e. the Estonian Competition Authority;
3. Balancing services of electricity and gas (while the Management Board receives separate reporting for electricity and gas balancing services, the two have been aggregated into one reportable segment as they have common business processes and similar characteristics, clients and regulatory environment);
4. Other segments.

Other segments include minor products and services (e.g. connection fees, government grant, congestion income, lease income, etc.) which individual share of Elering's revenue and EBITDA is immaterial and which is not taken into account by the Estonian Competition Authority for calculating network tariffs and determining principles of charging for balancing services. None of these products and services meet the quantitative thresholds that would require reporting separate information.

The comparative information has been restated.

The internal reporting provided to the Management Board has been prepared using the accounting policies and presentation consistent with those used in preparation of the financial statements. The income taxes are allocated to electricity segment only.

The Management Board assesses the performance of the operating segments based on revenue, EBITDA (net profit plus income taxes, net finance cost, and depreciation and amortization) and net profit.

Elering is domiciled in Estonia. Non-current assets of Elering are located in Estonia. In the reporting period, Elering had one counterparty with an aggregated revenue more than 10% of Elering´s revenue totalling EUR 80,254 thousand (2016: EUR 81,180 thousand). The largest customer´s revenue is attributable to the electricity transmission segment.

The breakdown of the major component of the total of revenue from external customers is disclosed below.

Segment reporting, 2017

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segments*	*Total*
Revenue from external customers	88,701	8,739	27,226	5,682	0	130,349
Revenue between segments	0	34	0	0	-34	0
Total revenue	**88,701**	**8,773**	**27,226**	**5,682**	**-34**	**130,349**
Other income	0	0	0	1,586	0	1,586
Total income	**88,701**	**8,773**	**27,226**	**7,268**	**-34**	**131,935**
Goods, raw materials and services	-20,812	-1,796	-25,593	-1,739	34	-49,905
Other operating expenses and staff costs	-8,861	-3,412	-841	-1,309	0	-14,424
EBITDA	**59,028**	**3,566**	**792**	**4,220**	**0**	**67,606**
Depreciation and amortization (Note 10, 11)	-28,194	-3,446	-29	-2,817	0	-34,486
Net financial income (costs) (Note 21)	-10,206	-759	-2	-36	0	-11,003
Income tax (Note 15)	-5,000	0	0	0	0	-5,000
Net profit	**15,628**	**-639**	**761**	**1,367**	**0**	**17,118**
Total assets	**718,182**	**63,082**	**4,726**	**123,653**	**0**	**909,643**
Total liabilities	**345,103**	**29,255**	**3,074**	**186,022**	**0**	**563,454**
Additions to property, plant and equipment (Note 10)	16,519	6,154	0	6,137	0	28,809
Additions to intangible assets (Note 11)	2,480	440	79	378	0	3,376

Segment reporting, 2016

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Transactions between segments*	*Total*
Revenue from external customers	95,296	8,628	23,381	6,708	0	134,012
Revenue between segments	0	70	0	0	-70	0
Total revenue	**95,296**	**8,698**	**23,381**	**6,708**	**-70**	**134,012**
Other income	0	0	0	1,879	0	1,879
Total income	**95,296**	**8,698**	**23,381**	**8,586**	**-70**	**135,891**
Goods, raw materials and services	-21,425	-932	-22,482	-1,892	70	-46,661
Other operating expenses and staff costs	-7,682	-3,374	-864	-1,342	0	-13,262

EBITDA	**66,189**	**4,393**	**35**	**5,351**	**0**	**75,968**
Depreciation and amortization (Note 10, 11)	-31,576	-3,530	-143	-2,879	0	-38,128
Net financial income (costs) (Note 21)	-10,466	-847	-2	-62	0	-11,377
Income tax (Note 15)	-7,750	0	0	0	0	-7,750
Net profit	**16,397**	**15**	**-110**	**2,410**	**0**	**18,713**
Total assets	**723,757**	**58,166**	**2,082**	**119,717**	**0**	**903,722**
Total liabilities	**349,918**	**28,340**	**1,992**	**174,399**	**0**	**554,649**
Additions to property, plant and equipment (Note 10)	19,453	1,655	0	3,593	0	24,701
Additions to intangible assets (Note 11)	1,521	231	73	224	0	2,049

Revenue by geographical location of customers, 2017

in thousands of euros	*Regulated electricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Total*
Estonia	87,879	8,320	13,442	3,261	112,903
Norway	0	0	0	0	0
Latvia	0	0	2,660	15	2,675
Finland	0	0	1,292	2,033	3,325
Lithuania	0	0	9,832	332	10,164
Russia	0	419	0	41	460
Other	822	0	0	0	822
Total revenue	**88,701**	**8,739**	**27,226**	**5,682**	**130,349**

Revenue by geographical location of customers, 2016

in thousands of euros	*Regulated elecricity network services*	*Regulated gas network services*	*Balancing services*	*Other*	*Total*
Estonia	89,111	8,628	8,659	3,246	109,644
Norway	168	0	0	0	168
Latvia	0	0	2,907	64	2,971
Finland	222	0	1,625	2,051	3,898
Lithuania	113	0	10,190	679	10,982
Russia	0	0	0	668	668
Other	5,682	0	0	0	5,682
Total revenue	**95,296**	**8,628**	**23,381**	**6,708**	**134,012**

Note 7

BANK ACCOUNTS AND DEPOSITS

in thousands of euros	*31.12.2017*	*31.12.2016*
Cash and cash equivalents	81,997	52,997
Restricted cash*	0	21,778
Short-term deposits	40,000	0
Long-term deposits**	0	40,000

* As at 31.12.2016, the financial statement line "Restricted cash" included financial aid allocated by the European Union to Elering for construction of cross-border gas transmission capacities. Under the agreement, these deposits are not allowed to be used for purposes other than specified in the agreement to finance the investments. As at 31.12.2017, the deposits are reclassified to cash and cash equivalents as Elering plans to use the assets within three months after the balance sheet day.

** As at 31.12.2016, the financial statement line "Long-term financial deposits" included long-term deposits at banks. Three contracts in the amount of EUR 30,000 thousand are concluded with Nordea Bank AB Estonia branch. Maturity date of these deposits is 19.01.2018 and the interest rate is 0.19%. One contract in the amount of EUR 10,000 thousand is concluded with Swedbank. The maturity date of the deposit is 20.01.2018.a and the interest rate is 0.1%. All contracts are denominated in euros. As at 31.12.2017, the long-term deposits are reclassified to short-term deposits and recorded under the financial statement line "Short-term financial deposits".

Bank accounts and deposits:

in thousands of euros	*31.12.2017*	*31.12.2016*
Bank accounts and deposits at banks		
with Moody's credit rating of Aa3*	119,522	86,336
with Moody's credit rating of A2	0	1,004
with Moody's credit rating of A1*	2,475	27,436
Total bank accounts and deposits at banks	**121,997**	**114,776**

** Two banks without credit rating at which Elering holds its money are Estonia-based subsidiaries of international banks with Moody's credit ratings of Aa3 (2016: A1).*

Note 8

TRADE AND OTHER RECEIVABLES

in thousands of euros	*31.12.2017*	*31.12.2016*
Trade receivables		
Accounts receivable	27,511	26,437
• incl. PTR-Limited auction receivables	327	1,186
Other receivables	**9**	**1**
• Interest receivables	9	1
Total financial assets within trade and other receivables in the statement of financial position	**27,521**	**26,438**
Tax receivables	4	4
Prepayments	190	240
Total trade and other receivables	**27,715**	**26,682**

Analysis by credit quality of trade receivables is as follows:

in thousands of euros	*31.12.2017*	*31.12.2016*
Accounts receivable not yet due		
• Distribution networks	21,093	21,658
• Other clients	5,880	4,525
Total accounts receivable not yet due	**26,973**	**26,183**
Accounts receivable past due but not classified as doubtful (IAS 39)		
• 1 to 90 days overdue	538	254
Total accounts receivable past due but not classified as doubtful	**538**	**254**
Total accounts receivable past due	**538**	**254**
Total trade receivables	**27,511**	**26,437**

In the reporting period and in 2016, Elering did not write down any receivables. Further information on receivables from related parties is disclosed in Note 23.

Note 9

INVENTORIES

in thousands of euros	*31.12.2017*	*31.12.2016*
Fuel oil	2,610	2,351
Natural gas reserves	123	268
Natural gas balance	261	154
Other materials at warehouses	733	770
Total inventories	**3,727**	**3,543**

Elering maintains fuel reserves for the purposes of emergency reserve power plants, natural gas reserves and natural gas balance for providing gas-related transmission and balancing services, respectively, and inventories of other materials used for repairs of gas equipment and gas pipelines.

Note 10

PROPERTY, PLANT AND EQUIPMENT

in thousands of euros	*Land*	*Buildings*	*Facilities*	*Machinery and equipment*	*Other*	*Construction in progress*	*Total*
Property, plant and equipment on 01.01.2016							
Cost on 01.01.2016	5,968	43,259	512,297	461,974	341	0	1,023,839
Accumulated depreciation	0	-6,879	-151,737	-117,289	-186	0	-276,091
Carrying amount on 01.01.2016	**5,968**	**36,380**	**360,560**	**344,685**	**155**	**0**	**747,748**
Construction in progress	0	0	0	0	0	16,963	16,963
Prepayments	15	0	0	0	0	0	15
Total property, plant and equipment on 01.01.2016	**5,983**	**36,380**	**360,560**	**344,685**	**155**	**16,963**	**764,726**
Movements 01.01.2016-31.12.2016							
Additions	117	0	0	10	0	24,236	24,363
Reclassified from construction in progress	0	537	11,943	11,899	6	-24,384	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	338	338
Disposals and write-offs at carrying amount	-13	0	0	-465	0	0	-478
Depreciation charge	0	-2,925	-15,531	-18,798	-73	0	-37,327
Transfers	0	0	-8,179	8,179	0	0	0
Total movements 01.01.2016-31.12.2016	**104**	**-2,388**	**-11,767**	**825**	**-67**	**190**	**-13,105**
Cost on 31.12.2016	6,071	41,570	502,098	491,453	182	0	1,041,375
Accumulated depreciation	0	-7,578	-153,305	-145,944	-95	0	-306,922
Carrying amount on 31.12.2016	**6,071**	**33,992**	**348,793**	**345,510**	**88**	**0**	**734,453**
Construction in progress	0	0	0	0	0	17,153	17,153
Prepayments	15	0	0	0	0	0	15
Total property, plant and equipment on 31.12.2016	**6,086**	**33,992**	**348,793**	**345,510**	**88**	**17,153**	**751,621**
Movements 01.01.2017-31.12.2017							
Additions	114	0	0	0	0	28,340	28,454
Reclassified from construction in progress	0	7,108	3,756	18,017	25	-28,907	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	371	371
Disposals and write-offs at carrying amount	-49	0	-4	-165	0	0	-218
Depreciation charge	-15	0	0	0	0	0	-15
Prepayments	0	-1,200	-13,462	-19,023	-26	0	-33,711
Total movements 01.01.2017-31.12.2017	**51**	**5,908**	**-9,710**	**-1,171**	**-1**	**-196**	**-5,119**
Property, plant and equipment on 31.12.2017							
Cost on 31.12.2017	6,137	48,575	505,418	506,999	202	0	1,067,330
Accumulated depreciation	0	-8,674	-166,335	-162,659	-115	0	-337,784
Carrying amount on 31.12.2017	**6,137**	**39,900**	**339,083**	**344,339**	**87**	**0**	**729,546**

Construction in progress	0	0	0	0	0	16,957	16,957
Total property, plant and equipment on 31.12.2017	**6,137**	**39,900**	**339,083**	**344,339**	**87**	**16,957**	**746,503**

Construction in progress mainly consists of substations, electricity transmission lines and gas pipelines. Upon completion, cost of these assets is recognised as cost of buildings, machinery and equipment and facilities.

Additions to construction in progress during the financial year include capitalised borrowing costs of EUR 371 thousand (2016: EUR 338 thousand). The capitalisation rate is 3.1% (2016: 3.2%).

Further information on operating lease of property, plant and equipment is disclosed in Note 22.

Note 11

INTANGIBLE ASSETS

in thousands of euros	*Acquired software & licenses*	*Right of use of land*	*Total*
Intangible assets on 01.01.2016			
Cost at 01.01.2016	4,404	1,602	6,006
Accumulated amortisation	-2,939	-118	-3,057
Carrying amount on 01.01.2016	**1,465**	**1,484**	**2,949**
Intangible assets not yet available for use	956	0	956
Total intangible assets on 01.01.2016	**2,421**	**1,484**	**3,905**
Movements 1.01.2016-31.12.2016			
Additions	2,039	10	2,049
Amortisation charge	-784	-17	-801
Total movements 1.01.2016-31.12.2016	1,255	-7	1,248
Total movements 1.01.2015-31.12.2015	**547**	**-16**	**531**
Intangible assets on 31.12.2016			
Cost at 31.12.2016	5,828	1,612	7,440
Accumulated amortisation	-3,675	-135	-3,810
Carrying amount on 31.12.2016	**2,153**	**1,477**	**3,630**
Intangible assets not yet available for use	1,523	0	1,523
Total intangible assets on 31.12.2016	**3,676**	**1,477**	**5,153**
Movements 1.01.2017-31.12.2017			
Additions	2,962	415	3,377
Amortisation charge	-755	-20	-775
Total movements 1.01.2017-31.12.2017	**2,207**	**395**	**2,602**
Intangible assets on 31.12.2017			
Cost at 31.12.2017	6,574	2,027	8,601
Accumulated amortisation	-3,905	-155	-4,060
Carrying amount on 31.12.2017	**2,669**	**1,872**	**4,541**

Intangible assets not yet available for use	3,214	0	3,214
Total intangible assets on 31.12.2017	**5,883**	**1,872**	**7,755**

Note 12

BORROWINGS

in thousands of euros	*31.12.2017*	*31.12.2016*
Short-term borrowings		
Current portion of long-term bank loans	8,138	5,704
Bonds issued	224,686	0
Total short-term borrowings	**232,824**	**5,704**
Long-term borrowings		
Long-term bank loan	129,439	137,570
Bonds issued	0	224,115
Total long-term borrowings	**129,439**	**361,685**
Borrowings are denominated in the following currencies:		
Borrowings denominated in euros	362,263	367,389
Total borrowings (Note 5)	**362,263**	**367,389**

Reconciliation of borrowings:

in thousands of euros	*Current portion of long-term bank loans*	*Current portion of bonds issued*	*Long-term bank loan*	*Bonds issued*	*Total borrowings*
Total borrowings on 01.01.2016	**2,381**	**0**	**153,227**	**223,569**	**379,177**
Repayment of borrowings	-12,381	0	0	0	-12,381
Transfers	15,704	0	-15,704	0	0
Non-cash movements	0	0	47	546	593
Total borrowings on 31.12.2016	**5,704**	**0**	**137,570**	**224,115**	**367,389**
Repayment of borrowings	-5,719	0	0	0	-5,719
Transfers	8,153	224,686	-8,153	-224,686	0
Non-cash movements	0	0	22	571	593
Total borrowings on 31.12.2017	**8,138**	**224,686**	**129,439**	**0**	**362,263**

The average effective interest rate on borrowings was 3.1% in 2017 (2016: 3.2%).

Elering has used the following types of facilities for financing purposes:

- **Loans from the European Investment Bank**
  Elering has two loans with outstanding balance of EUR 104,558 thousand. The maturity date of the loans is 2031 and 2033, the interest rate is floating which is the sum of 6-month Euribor and the margin. In 2017, Elering repaid loans in the amount of EUR 2,370 thousand.

- **Loans from the Nordic Investment Bank**
  Elering has two loans with outstanding balance of EUR 33,019 thousand. The maturity date of the loans is 2025-2033. Interest rate is floating which is the sum of 6-month Euribor and margin. In 2017 Elering repaid loans in the amount of EUR 3,349 thousand (2016: EUR 12,381 thousand).

- **Eurobonds**
  In 2011, Elering issued Eurobonds with the maturity of seven years and the nominal value of EUR 225 million and these bonds are listed on London stock exchange. Bonds' coupon is fixed at 4.625% p.a. and interest payments are made once a year.

- **Loans to reduce the refinancing risk of the bonds**

In December 2017 Elering entered into two loan agreements with Estonian banks in a total volume of EUR 200,000 thousand. Elering has not taken out these loans as of 31 December 2017, and it has to pay a commitment fee. Elering will take out the loans if, for any reason, refinancing the bonds does not prove to be possible or rational at the planned time (12.07.2018). Elering has to repay the loans by January 2019 at the latest. In a period when loans are not taken out, Elering pays a commitment fee. If loans are taken out, Elering pays interest which is based on Euribor.

Under its loan agreements, Elering has undertaken to comply with certain financial covenants (shareholder's equity to total assets ratio and net debt to EBITDA ratio). Elering's financial indicators complied with all contractual covenants.

Note 13

TRADE AND OTHER PAYABLES

in thousands of euros	*31.12.2017*	*31.12.2016*
Trade payables	15,924	14,119
• Including payables for PTR-Limited auction	0	1,288
Payables for purchased property, plant and equipment and intangible assets	2,448	1,750
Subsidies due to electricity producers	7,440	2,850
Subsidies due to biogas producers	1,232	0
Other payables	316	307
Total financial liabilities within trade and other payables without accrued interests	**27,360**	**19,026**
Accrued interests from borrowings carried at amortised cost (Note 12)	5,017	5,101
Total financial liabilities within trade and other payables in the statement of financial position	**32,378**	**24,127**
Taxes payable		
VAT	1,359	1,712
Social security tax	326	298
Personal income tax	169	156
Unemployment insurance tax	20	18
Contributions to mandatory funded pension	16	15
Corporate income tax and income tax on fringe benefits	9	7
Excise tax	199	314
Pollution tax	1	1
Total taxes payable	**2,098**	**2,521**
Accrued expenses - employee benefits		
Wages and salaries	364	350
Bonuses	450	450
Holiday pay	139	127
Social security and unemployment insurance tax	199	201
Termination benefits	0	18
Total accrued expenses - employee benefits	**1,152**	**1,145**
Other payables	**372**	**170**
Total trade and other payables	**36,000**	**27,963**

Further information on payables to related parties is disclosed in Note 23.

Note 14

DEFERRED INCOME

Income from connection and other service fees

tuhandetes eurodes	*2017*	*2016*
Deferred income from connection and other	**28,707**	**29,567**
Connection and other service fees received	2,948	947
Connection and other service fees recognised as revenue (Note 16)	-1,369	-1,807
Deferred income from connection and other service fees at the end of the period	**30,286**	**28,707**

Deferred income from government grants

in thousands of euros	*2017*	*2016*
Deferred income from government grants at the beginning of the period	**68,110**	**47,567**
Grants received (Note 7)*	17	21,866
Grants used for operating expenses (Note 17)	-17	-149
Grants recognised as revenue (Note 17)	-1,174	-1,174
Deferred income from government grants at the end of the period	**66,936**	**68,110**

Deferred income from congestion fees

in thousands of euros	*2017*	*2016*
Deferred congestion income at the beginning of the period	**62,479**	**49,521**
Congestion fees received during the period	5,668	12,993
Recognised as income (Note 17)	-178	-35
Deferred congestion income at the end of the period	**67,969**	**62,479**

Total deferred income	**165,191**	**159,296**

In 2016, grants in the amount of EUR 21,778 thousand were received on restricted account (see Note 7).

Note 15

EQUITY

Elering's share capital consists of 189,890 shares with the nominal value of EUR 1,000 (31.12.2016: 189,890 shares with the nominal value of EUR 1,000). The shares have been paid for in full.

In 2017, no resolution of sole shareholder was made on increase of share capital. In 2016, share capital was increased by EUR 32 million by resolution of sole shareholder and it was paid for in cash. The share capital was registered on 5 July 2016.

Dividends totalling EUR 20 million were paid out in 2017 (in 2016 dividends were paid in the amount of EUR 31 million). Dividends per share totalled EUR 105 (2016: EUR 163).

Income tax of EUR 5 million was incurred upon distribution of dividends (2016: EUR 7.75 million).

As of 31.12.2017, Elering's statutory reserve capital totalled EUR 12,898 thousand (31.12.2016: EUR 11,962 thousand). As at 31.12.2017, Elering has the obligation to additionally transfer EUR 856 thousand (31.12.2016: EUR 936 thousand) to reserve capital. In 2017 Elering transferred to statutory reserve EUR 936 thousand (2016: EUR 1,219 thousand).

The distributable retained earnings of Elering as of 31.12.2017 amounted to EUR 143,402 thousand (31.12.2016: EUR 147,220 thousand). The income tax applicable to the net profit distributable as dividends is 20/80 (2016: 20/80). As of 31.12.2017, it would be possible to distribute EUR 114,037 thousand as net dividends (31.12.2016: EUR 117,027 thousand) and the corresponding income tax would amount to EUR 28,509 thousand (31.12.2016: EUR 29,257 thousand). These numbers are calculated taking into account the obligation to transfer certain amount of retained earnings to statutory reserve capital.

Lisa 16

REVENUE

Analysis of revenue by activity

in thousands of euros	*2017*	*2016*
Sales of balancing and regulation services		
Balancing electricity	19,771	21,373
Balancing gas	5,991	489
Regulation services	1,465	1,519
Total sales of balancing electricity and regulation services	**27,226**	**23,381**
Sales of electricity and gas network services		
Electricity network services	87,879	89,147
Gas network services	8,320	8,698
Revenue from connection fees (Note 14)	1,369	1,807
Other network services	1,282	6,816
Total sales of network services	**98,851**	**106,469**
Sales of other goods and services		
Lease of transmission equipment (Note 22)	916	915
Sales of scrap metal	25	28
Other services	3,278	3,214
Other goods	52	6
Total sales of other goods and services	**4,272**	**4,163**
Total revenue	**130,349**	**134,012**

Note 17

OTHER INCOME

in thousands of euros	*2017*	*2016*
Government grants related to acquisition of property, plant and equipment (Note 14)	1,174	1,174
Congestion income (Note 14)	178	35
Dividends from long-term financial investments	118	59
Profit from sale of property, plant and equipment	57	40
Fines, penalties and compensations received	18	296
Grants for operating expenses (Note 14)	17	149
Other income	25	127
Total other income	**1,586**	**1,879**

Note 18

GOODS, RAW MATERIALS AND SERVICES

in thousands of euros	*2017*	*2016*
Electricity and gas purchased to provide the balancing service		
Purchase of balancing energy	17,972	19,254
Purchase of balancing gas	5,413	473
Purchase of power regulation service	1,929	2,409
Expenses of emergency reserve power plant to provide balancing services	249	281
Total electricity purchased to provide the balancing service	**25,563**	**22,417**
System services		
Operating expenses of emergency reserve power plant	1,088	262
Reactive energy	459	366
Total system services expenses	**1,547**	**628**
Losses in electricity and gas network		
Electricity network losses	11,614	14,409
Gas network losses	314	307
Total electricity and gas to compensate for network losses	**11,927**	**14,716**
Maintenance and repair works		
On facilities and equipment related to core activities	6,835	4,923
On production buildings and sites	680	460
Other	345	319
Disassembly works and waste processing	295	99
Total maintenance and repair works	**8,155**	**5,800**
Other costs		
Other costs	2,298	2,420
Operative switching and dispatching management expenses	414	680
Total other costs	**2,713**	**3,100**
Total goods, raw materials and services	**49,905**	**46,662**

Note 19

OTHER OPERATING EXPENSES

in thousands of euros	*2017*	*2016*
Research and development costs (R&D)	1,289	1,082
Research and consulting	1,172	911
Telecommunication	1,044	1,036
Training and other miscellaneous operating expenses	844	707
Information technology	801	532
Office expenses	651	657
Security, insurance and occupational safety	239	242
Transportation and tools	158	157
Other expenses	175	135
Total other operating expenses	**6,374**	**5,457**

Note 20

STAFF COSTS

in thousands of euros	*2017*	*2016*
Base salaries, additional remuneration, bonuses, vacation pay	5,792	5,600
Termination benefits	21	44
Other remuneration	193	182
Total remuneration to employees	**6,007**	**5,826**
Social security tax	1,999	1,936
Unemployment insurance tax	43	42
Total staff costs	**8,049**	**7,804**
• Including compensations to the member of the Management and Supervisory Board		
Salaries, additional remuneration bonuses, vacation pay	378	351
Social security tax	136	127
Fringe benefits	28	28
Income tax on fringe benefits	7	7
Total compensations to the members of the Management and Supervisory Boards	**549**	**513**

Average number of employees	**222**	**225**
Average number of employees by type:		
Persons working under an employment contract	219	222
Persons providing services under law of obligations act	3	8
Members of the Management and Supervisory Boards	8	7
The average monthly pay of all employees	2,174	2,074

Three members of the Management Board receive compensation for premature termination of their employment contracts, such compensation amounts up to the three months' salary.

Note 21

FINANCIAL INCOME AND COSTS

in thousands of euros	*2017*	*2016*
Financial income		
Interest income	71	17
Other financial income	0	1
Total financial income	**71**	**18**
Financial costs		
Interest expenses	-11,439	-11,728
Foreign exchange losses	-4	-2
Other financial costs	-2	-4
Total financial costs	**-11,445**	**-11,733**
Less: capitalised borrowings costs (Notes 10,11)	371	338
Total financial costs recognised in the statement of comprehensive income	**-11,074**	**-11,395**
Net financial income (costs)	**-11,003**	**- 11,377**

Note 22

OPERATING LEASE

Elering as a lessor

Operating lease revenue

in thousands of euros	*2017*	*2016*
Buildings	96	85
Transmission equipment	916	915
Total operating lease revenue	**1,012**	**1,000**

Transmission equipment
Elering has an operating lease contract under which the free fibres of the fibre-optic cable fixed to the line masts are leased out. This cable also acts as a lightning protection cord for the lines and the fibres are used by Elering for its technical communication. The free fibres have been leased out to Tele2 Eesti AS. The lease contract contains a restriction under which Elering cannot give its transmission equipment out for use by other companies operating in the telecommunications field. The contract is effective until 31.03.2025. Annual lease payments vary depending on the length of fibres leased out during the year.

Information about assets (facilities) leased out under operating leases

in thousands of euros	*31.12.2017*	*31.12.2016*
Cost	6,240	5,633
Accumulated depreciation at the end of period	-4,732	-4,388
Carrying amount	**1,508**	**1,245**

Depreciation charge

in thousands of euros	*2017*	*2016*
Depreciation charge	171	354

Estimated future lease payments under operating leases

in thousands of euros	*31.12.2017*	*31.12.2016*
Not later than 1 year	916	916
Later than 1 year and not later than 5 years	3,664	3,664
Later than 5 years	2,061	3,893
Total future minimum lease payments	**6,641**	**8,473**

Elering as a lessee

Operating lease expenses

in thousands of euros	*2017*	*2016*
Buildings	449	480
Transport equipment	100	110
Other machinery and equipment	101	20
Total operating lease expenses	**650**	**610**

All operating leases where Elering is a lessee can be terminated upon a short notice.

Note 23

BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Parties are generally considered to be related if the parties are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

In preparing financial statements of Elering, the following parties have been considered as related parties:

I Republic of Estonia and the entities under its control or significant influence;
II Management and Supervisory Boards of Elering;
III Close family members of the persons described above and the entities under their control or significant influence

The outstanding balances with related parties were as follows

in thousands of euros	*31.12.2017*	*31.12.2016*
Trade receivables		
Companies controlled or significantly influenced by the State	20,832	20,144
Total trade receivables	**20,832**	**20,144**
• incl. from network operators	18,529	19,130
Trade payables and other liabilities		
Companies controlled or significantly influenced by the State	2,899	3,280
Total trade payables and other liabilities	**2,899**	**3,280**

Income and expense items with related parties were as followst:

in thousands of euros	*Related party*	*2017*	*2016*
Revenue from sale of goods	Companies controlled or significantly influenced by the State	7,014	6,428
Revenue from sale of services	Companies controlled or significantly influenced by the State	83,742	82,413
Revenue from sale of goods and services		**90,756**	**88,841**
Purchase of goods	Companies controlled or significantly influenced by the State	4,175	3,901
Purchase of services	Companies controlled or significantly influenced by the State	3,373	3,649
Purchase of goods and services		**7,548**	**7,550**
Expenditures on non-current assets	**Companies controlled or significantly influenced by the State**	**349**	**256**

- Revenue from sale of goods is incurred by the sale of imbalance energy and imbalance gas.
- Revenue from sale of services is incurred mainly from sale of electricity and gas network services.
- The purchase of goods results from the purchase of imbalance energy and gas.
- The purchase of services results from regulation, operative switching, dispatching management and maintenance and repair services.

Transactions with companies under the significant influence of the members of the Supervisory and Management Boards or their close relatives

in thousands of euros	*2017*	*2016*
Purchase of services	84	6

Key management personnel compensations are disclosed in Note 20.

No receivables from related parties were written off in 2017 and 2016.

Note 24

CONTINGENT LIABILITIES AND COMMITMENTS

Obligation to tolerate utility networks
On the basis of a judgment made by the Supreme Court in 2012, pursuant to which the current amounts of the fees paid for tolerating utility networks and structures were annulled, in 2017 the situation remained unclear and while landowners were still entitled to claim payment for tolerating utility networks and structures, the method for determining justified fees was still not regulated by law. However, in 2017 the Riigikogu completed the Act on Amendments to the Law of Property Implementation Act and Other Acts with which the unclear situation in respect of payments for tolerating utility networks and structures will be liquidated in the future. The new Act will be passed at the beginning of 2018 and it will enter into force on 1 January 2019. According to the regulation, the aforementioned costs are included in the calculation of network charges, but there may be a time lag between the payments of compensation and indemnification through network charges, when the payments have to be financed from other sources.

Capital expenditure commitments
The network operator must develop the network within its service area in a way that ensures the continued provision of network services in accordance with the set requirements. At 31.12.2017, Elering has contractual capital expenditure commitments in respect of property, plant and equipment totalling EUR 81,701 thousand (31.12.2016: EUR 21,860 thousand).

Tax legislation
The tax authorities have the right to verify Elering's tax records up to 5 years from the time of submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. Elering's management estimates that there are not any circumstances which may lead the tax authorities to impose additional significant taxes on Elering.


INNOVATION

Independent auditor's report
To the Shareholder of Elering AS

(Translation of the Estonian original)*

Report on the audit of the financial statements

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Elering AS (the Company) as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

The Company's financial statements comprise:
- the statement of financial position as at 31 December 2017;
- the statement of comprehensive income for the year then ended;
- the cash flow statement for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

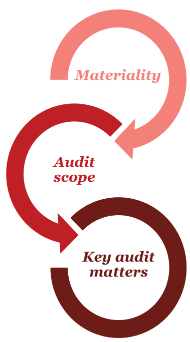
We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Company are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59[1] of the Auditors Activities Act of the Republic of Estonia.

AS PricewaterhouseCoopers, Pärnu mnt 15, 10141 Tallinn, Estonia; License No. 6; Registry code: 10142876
T: +372 614 1800, F: +372 614 1900, www.pwc.ee

Our audit approach

Overview



Materiality

Overall materiality is EUR 1.6 million, which represents approximately 2.5% of profit before interest, tax, depreciation and amortization (EBITDA).

Audit scope

The audit team performed full scope audit procedures for the Company.

Key audit matters

- Estimates involved in capitalisation of capital expenditures and determining their useful lives
- Accounting for congestion income

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

Materiality

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

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

Overall materiality	EUR 1.6 million
How we determined it	Approximately 2.5% of profit before interest, tax, depreciation and amortization (EBITDA), as disclosed in Note 6.
Rationale for the materiality benchmark applied	We have applied EBITDA as the benchmark because, as described in Note 6, it is one of the key measures the management uses to assess the Company's performance.

Key audit matters

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

Key audit matters	*How our audit addressed the key audit matters*
Estimates involved in capitalisation of capital expenditures, and determining their useful lives (refer to Note 2 “Summary of significant accounting policies”, Note 3 “Critical accounting estimates and judgments in applying accounting policies” and Note 10 “Property, plant and equipment” for further details). In 2017 the Company capitalised additions to property, plant and equipment (PPE), mainly related to the construction of electricity and gas transmission network, in the amount of EUR 28.5 million. Expenditures are capitalised if they create new or enhance the existing assets, and expensed if they relate to repair or maintenance of the assets. Classification of the expenditures involves judgment. The useful lives of PPE items are based on management’s estimates regarding the period during which the asset or its significant components will be used. The estimates are based on historical experience and market practice and take into consideration the physical condition of the assets. Capital expenditure is not considered to be an area of significant risk for our audit but as it requires considerable time and resource to audit due to its magnitude, it is considered to be a key audit matter.	We assessed whether the Company’s accounting policies in relation to the capitalisation of expenditures are in compliance with IFRS. We obtained a listing of capital expenditures incurred during the year and, on a sample basis, inspected contracts and underlying invoices to ensure the classification between capital and operating expenditure was appropriate. We evaluated whether the useful lives determined and applied by the management were in line with historical experience and the market practice. We checked whether the depreciation of self-constructed PPE items was commenced timely, by comparing the date of the reclassification from construction in progress to finished projects, with the date of the act of completion of the work. As a result of our work, we noted no material exceptions.
Accounting for congestion income (refer to Note 2 “Summary of significant accounting policies – Congestion income”, Note 3 “Critical accounting estimates and judgments in applying accounting policies” and Note 14 “Deferred income” for further details). In 2017 the Company has received congestion fees of EUR 5.7 million and the deferred congestion revenue as of 31 December 2017 amounted to EUR 68.0 million. Accounting for congestion fees received depends on	We assessed whether the Company’s accounting policy in relation to accounting for the congestions revenue is in compliance with IFRS. We evaluated the management’s assessment on whether and when the congestion fees will be used for constructions of new interconnection capacities. We corroborated the information received with the Management and Supervisory Board minutes of meetings describing future investments and with the capital expenditures budget. We reconciled the balances of deferred congestion

the purposes for which it will be used. Congestion fees used for constructions of new interconnection capacities are recognised as deferred income (similarly to government grants), until such constructions are completed. Congestion fees used for the reduction of network tariffs are recognised in profit and loss.

Determining the appropriate accounting requires judgment. Due to the size and related estimation uncertainty, it is considered a key audit matter.

income to the respective invoices and subsequent cash receipts.

Furthermore, we assessed the adequacy of the disclosures related to congestion income.

As a result of our work, we noted no material exceptions.

How we tailored our audit scope

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

The audit team performed full scope audit procedures for the Company.

Other information

The Management Board is responsible for the other information contained in the annual report in addition to the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the financial statements

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

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of the Company, as a public interest entity, for the financial year ended 31 December 2011. Our appointment has been renewed by tenders and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for the Company, as a public interest entity, of 7 years. In accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our appointment as the auditor of the Company can be extended for up to the financial year ending 31 December 2030.

AS PricewaterhouseCoopers

Ago Vilu
Certified auditor in charge, auditor's certificate no.325

14 March 2018

---

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

PROFIT ALLOCATION PROPOSAL

The retained earnings of Elering AS as of 31.12.2017 were EUR 143,402 thousand.

The Management Board of Elering AS proposes to the sole shareholder to allocate the retained earnings as follows:

To pay as dividends to the shareholder	EUR 20,000 thousand
To transfer to the statutory reserve capital	EUR 856 thousand
Not to distribute the remaining retained earnings	EUR 122,546 thousand

SIGNATURES OF THE MANAGEMENT TO THE 2017 ANNUAL REPORT

The signing of Elering AS 2017 Annual Report on 14.03.2018

Chairman of the Management Board
Taavi Veskimägi

Member of the Management Board
Peep Soone

Member of the Management Board
Kalle Kilk

THE REVENUE OF ELERING AS ACCORDING TO EMTAK 2008

The revenue of Elering AS is divided by the main areas of activities as follows:

*EMTAK** areas of activities		*2017*	*2016*
35121	Transmission of electricity – transmission through the transmission network	92,914	100,185
35221	Natural gas transmission	8,320	8,698
35141	Trade of electricity (balancing electricity)	21,236	22,892
35231	Trade of gas (balancing gas)	6,025	489
77399	Renting and leasing of other machinery, equipment and tangible goods	916	915
49501	Pipeline transport	460	668
47770	Retail sale of other second-hand goods	78	34
68201	Renting and operating of own or leased real estate	96	85
46699	Other sales	305	47

** EMTAK – classification of Estonian economic activities.*

Photos by: Laura Oks, Ain Köster

Kadaka tee 42 / 12915 Tallinn
Telephone: 715 1222
E-mail: info@elering.ee

www.elering.ee