“AZERBAIJAN RAILWAYS” CLOSED JOINT STOCK COMPANY

The International Financial Reporting Standards Consolidated Financial Statements and Independent Auditors’ Report
For the Year Ended December 31, 2017

“AZERBAIJAN RAILWAYS” CLOSED JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2017

The following statement is made with a view to distinguish respective responsibilities of the management and those of the independent auditors in relation to the International Financial Reporting Standards ("IFRS") consolidated financial statements of "Azerbaijan Railways" Closed Joint Stock Company ("ADY" or the "Company") and its subsidiaries (collectively referred to as the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group as at December 31, 2017, the results of its operations, changes in equity and cash flows for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with the applicable legislation and accounting standards;
- Taking such steps that are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

The consolidated financial statements of the Group for the year ended December 31, 2017 were authorized for issue on September 28, 2018 by the Management of the Company.

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2018
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2018
Baku, the Republic of Azerbaijan

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INDEPENDENT AUDITORS' REPORT

To the Management of "Azerbaijan Railways" Closed Joint Stock Company:

Qualified Opinion

We have audited the consolidated financial statements of "Azerbaijan Railways" Closed Joint Stock Company ("ADY" or the "Company") and its subsidiaries (together referred to as the "Group"), which comprise the consolidated statement of financial position as at December 31, 2017, and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

In our opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the accompanying consolidated financial statements present fairly, in all material respect, the financial position of the Group as at December 31, 2017 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Qualified Opinion

We were not able to observe the counting process of inventory balances as at December 31, 2017, since the date of year-end inventory count procedures performed by the Group was prior to our engagement acceptance date. We were also unable to satisfy ourselves by alternative means concerning the quantity of inventory held as at December 31, 2017 and December 31, 2016, which were stated in the consolidated statement of financial position at AZN 81,176 thousand and AZN 58,089 thousand, respectively. As a result of these matters, we were as well unable to determine whether any adjustment might have been found necessary in respect of recorded or unrecorded inventories, and the elements presented in the consolidated statement of comprehensive income, statement of changes in equity and cash flows.

As described in Note 17 to the consolidated financial statements, as at December 31, 2017 the Group was not in compliance with certain covenants stipulated in the borrowing agreements signed with International Bank for Reconstruction and Development, BNP Paribas (Suisse) S.A., Credit Suisse AG, VTB Bank (the Republic of Austria).

Breach of these covenants may result in early withdrawal of funds by the lenders and therefore, these borrowings should be classified as current. According to the representations of the management, although the Group has breached number of covenants imposed by the agreements mentioned above, the risk of early withdrawal of funds is remote and these borrowings should be classified according to their contractual repayment schedules, rather than current liabilities. We were not able to obtain appropriate and sufficient audit evidence to support management's representations and consequently, we were unable to satisfy ourselves regarding appropriateness of classification of these borrowings between current and non-current categories.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;

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

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.

Baker Tilly Azerbaijan

September 28, 2018
Baku, the Republic of Azerbaijan

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2017

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	December 31, 2017	December 31, 2016
ASSETS			
Non-current assets:			
Property, plant and equipment	8	3,119,835	2,957,499
Intangible assets	9	393	420
Prepayment for property, plant and equipment	10	277,660	325,114
Deferred tax asset	11	1,704	3,102
Total non-current assets		**3,399,592**	**3,286,135**
Current assets:			
Inventories	12	81,176	58,089
Loans receivable	13	49,352	60,817
Trade and other receivables	14	61,973	31,562
Cash and cash equivalents	15	49,388	147,757
Other current assets	16	116,090	65,216
Total current assets		**357,979**	**363,441**
TOTAL ASSETS		**3,757,571**	**3,649,576**
LIABILITIES AND EQUITY			
LIABILITIES:			
Non-current liabilities:			
Long-term borrowings	17	2,326,266	1,351,483
Finance lease obligations	18	43,710	74,921
Trade and other payables	19	-	175,075
Other non-current liabilities	20	20,119	22,822
Total non-current liabilities		**2,390,095**	**1,624,301**
Current liabilities:			
Short-term borrowings	17	222,499	522,393
Finance lease obligations	18	14,804	21,633
Trade and other payables	19	153,808	221,612
Taxes payable other than income tax	21	8,188	10,871
Income tax payable		30	165
Advances received	22	101,852	138,324
Salaries payable		8,788	7,294
Other current liabilities		664	407
Total current liabilities		**510,633**	**922,699**
Total liabilities		**2,900,728**	**2,547,000**

"AZERBAIJAN RAILWAYS" CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2017 (Continued)
(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	December 31, 2017	December 31, 2016
EQUITY:			
Share capital	23	806,062	726,147
Government investments	24	1,174,509	946,205
Accumulated loss		(1,103,384)	(539,567)
Currency translation reserve		(13,281)	(14,872)
Other reserve		(16,026)	(16,026)
Equity attributable to equity holders of the parent		**847,880**	**1,101,887**
Non-controlling interests		8,963	689
Total equity		**856,843**	**1,102,576**
TOTAL LIABILITIES AND EQUITY		**3,757,571**	**3,649,576**

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2018
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2018
Baku, the Republic of Azerbaijan

The notes on pages 12-80 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2017
(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	Year ended December 31, 2017	Year ended December 31, 2016
Revenues			
Cargo revenues		253,776	261,573
Construction revenues	25	73,175	61,913
Passenger revenues		14,791	13,164
Other revenues	26	42,906	26,384
Total revenues		**384,648**	**363,034**
Operating expenses			
Depreciation and amortization	8,9	(175,656)	(157,600)
Wages, salaries and related contributions		(88,483)	(68,907)
Material, repairs and maintenance		(10,299)	(14,123)
Electricity costs		(17,999)	(13,217)
Construction costs	25	(71,592)	(63,091)
Taxes other than income tax	27	(27,729)	(21,994)
Fuel expenses		(6,994)	(7,022)
Washing cost of bedding sets		(582)	(786)
Rent expenses		(1,710)	(2,805)
Bank commissions		(2,254)	(5,808)
Other operating costs	28	(24,298)	(15,077)
Total operating expenses		**(427,596)**	**(370,430)**
Other income/(expense)			
Bad debt expense	29	(31,559)	(81,550)
Foreign exchange loss		(102,104)	(190,421)
Loss on impairment of property, plant and equipment	8	(265,808)	(229,386)
Loss on damaged and obsolete inventory	12	(391)	(70)
Loss on disposal of property, plant and equipment		(511)	(713)
Finance costs	30	(95,029)	(64,710)
Gain on bargain purchase		-	653
Other (expense)/income, net	31	(14,884)	7,957
Loss before income tax		**(553,234)**	**(565,636)**
Income tax (expense)/benefit	11	(2,309)	68,950
Net loss for the year		**(555,543)**	**(496,686)**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2017 (Continued)

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	Year ended December 31, 2017	Year ended December 31, 2016
Other comprehensive income/(loss)			
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods - Exchange differences on translation of foreign operations		1,591	(1,968)
TOTAL COMPREHENSIVE LOSS FOR THE YEAR		**(553,952)**	**(498,654)**
Attributable to:			
Equity holder of the parent		(563,817)	(497,302)
Non-controlling interests		8,274	616
NET LOSS FOR THE YEAR		**(555,543)**	**(496,686)**
Attributable to:			
Equity holder of the parent		(562,226)	(499,270)
Non-controlling interests		8,274	616
TOTAL COMPREHENSIVE LOSS FOR THE YEAR		**(553,952)**	**(498,654)**

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2018
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2018
Baku, the Republic of Azerbaijan

The notes on pages 12-80 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2017

(In thousands of Azerbaijani Manats unless otherwise indicated)

	Share capital	Government investments	Accumulated loss	Currency translation reserve	Other reserve	Non-controlling interests	Total equity
January 1, 2016	**726,147**	**607,098**	**(42,265)**	**(12,904)**	**(16,026)**	**-**	**1,262,050**
Government investments during the year	-	339,107	-	-	-	-	339,107
Contribution in share capital of subsidiaries by non-controlling shareholders	-	-	-	-	-	73	73
Total comprehensive (loss)/income for the year	-	-	(497,302)	(1,968)	-	616	(498,654)
December 31, 2016	**726,147**	**946,205**	**(539,567)**	**(14,872)**	**(16,026)**	**689**	**1,102,576**
Transfer and registration of government investments into share capital	79,915	(79,915)	-	-	-	-	-
Government investments during the year	-	308,219	-	-	-		308,219
Total comprehensive (loss)/income for the year	-	-	(563,817)	1,591	-	8,274	(553,952)
December 31, 2017	**806,062**	**1,174,509**	**(1,103,384)**	**(13,281)**	**(16,026)**	**8,963**	**856,843**

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2018
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2018
Baku, the Republic of Azerbaijan

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"AZERBAIJAN RAILWAYS" CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017
(In thousands of Azerbaijani Manats unless otherwise indicated)

	Notes	Year ended December 31, 2017	Year ended December 31, 2016 (reclassified)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Loss before income tax		(553,234)	(565,636)
Adjustments for non-cash items:			
Depreciation and amortization	8,9	175,656	157,600
Loss on impairment of property, plant and equipment	8	265,808	229,386
Finance costs	30	95,029	64,710
Bad debt expense	29	31,559	81,550
Change in provision for warranties		(548)	3,831
Change in provision for damaged and obsolete inventory	12	391	70
Change in provision for loss on construction contracts		(3,328)	(13,079)
Foreign exchange loss		102,104	190,421
Other non-cash adjustments		7,715	(10,066)
Gain on bargain purchase		-	(653)
Loss on disposal of property plant and equipment		511	713
Cash flows from operating activities before changes in operating assets and liabilities		**121,663**	**138,847**
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Change in inventories		(10,862)	(14,972)
Change in trade and other receivables		(33,370)	(4,061)
Change in other current assets		(7,802)	(19,140)
Increase/(decrease) in operating liabilities:			
Change in trade and other payables		(41,096)	(23,227)
Change in advances received		(36,864)	(5,868)
Change in taxes payable other than income tax		(1,671)	(5,318)
Change in salaries payable		1,474	1,049
Change in other current liabilities		803	(500)
Net cash (outflow)/inflow from operating activities		**(7,725)**	**66,810**
Income tax paid		(1,053)	-
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment		(538,432)	(297,725)
Net investments in loans receivable		(9,164)	(4,852)
Purchase of a subsidiary, net of cash acquired		-	682
Purchase of intangible assets		(107)	(82)
Interest received		-	1,949
Net cash used in investing activities		**(547,703)**	**(300,028)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings		1,249,368	324,513
Repayment of borrowings		(799,613)	(112,974)
Repayment of finance leases		(34,532)	(15,107)
Proceeds from government investments		195,300	214,366
Changes in restricted cash accounts		(53,372)	-
Interest paid		(93,303)	(43,395)
Contribution in subsidiaries by non-controlling shareholders		-	73
Net cash inflow from financing activities		**463,848**	**367,476**

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017 (Continued)
(In thousands of Azerbaijani Manats unless otherwise indicated)

		Year ended December 31, 2017	Year ended December 31, 2016
Effect of foreign exchange differences on cash and cash equivalents		(5,736)	5,380
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(98,369)	139,638
CASH AND CASH EQUIVALENTS, *at the beginning of the year*	15	147,757	8,119
CASH AND CASH EQUIVALENTS, *at the end of the year*	15	49,388	147,757

Non-cash transactions

The principal non-cash transactions during the year ended December 31, 2017 included acquisition of property, plant and equipment items through direct payment of government of the Republic of Azerbaijan and other fund providers to the third parties under the loan agreements in the amount of AZN 82,440 thousand and AZN 162,144 thousand, respectively (2016: acquisition of property, plant and equipment items through direct payment of fund providers to the third parties under the loan agreements in the amount of AZN 124,741 thousand and through finance lease agreement in the amount of AZN 534,652 thousand).

On behalf of the Management:

Javid Gurbanov
General Director

September 28, 2018
Baku, the Republic of Azerbaijan

Fuad Safarov
Head of Finance and Economy department

September 28, 2018
Baku, the Republic of Azerbaijan

The notes on pages 12-80 form an integral part of these consolidated financial statements.

1. THE GROUP AND ITS OPERATIONS

Corporate Information

"Azerbaijan Railways" Closed Joint Stock Company ("ADY" or the "Company") was re-established on February 15, 2010 pursuant to the decree of the President of the Republic of Azerbaijan No. 383 "On Foundation of Azerbaijan Railways Closed Joint Stock Company" dated July 20, 2009 in connection with the development of overall railways system, meeting the increasing requirement of population and economy for transportation and freight services, improvement of management and increase of efficiency in the railways system.

The Company is 100% owned by the Cabinet of Ministers of the Republic of Azerbaijan (the "Government").

The legal address of the Company is 230 Dilara Aliyeva Street, Baku, The Republic of Azerbaijan.

The Group operates a government regulated nationwide railway system providing freight transportation, railway passenger transportation, services and maintenance of railway infrastructure within the Republic of Azerbaijan.

The detailed main activities of the Group include ensuring a secure transportation of cargoes, passengers, posts as well as baggage in time by railways, formation of trains and organization of traffic on railways, provision of passenger and freight transportation services, maintenance and exploitation of unique production infrastructure, application of unique technical normative, provision of services for locomotive transportation, provision of current repair services for locomotives and trains, organization of security services on railways, protection of sites attached to railways and approval of those sites by relevant executive powers, production of necessary construction and raw materials to construct railways, construction of permanent and administrative buildings for railways, fulfillment of transportation on the basis of contracts and public orders, provision of transportation-expedition services, modernization of railways infrastructure being in use, application of telecommunication and information technologies to control services and organization of disaster-salutary services on railways.

The total length of main railways in the Republic of Azerbaijan is 2,954 km as at the reporting date; the operational length is 2,132 km, including 803 km of bilateral roads. The roads consist of 192 stations. Over 14 million tons of freight is carried and over 2.4 million passengers are transferred annually.

Structure and projects of the Group

The Government controls the structure of the Group and establishes the long-term structure of the railway operations in the Republic of Azerbaijan. Since 2009, the Government has been in the process of restructuring the railway system in the Republic of Azerbaijan which included the establishment of the Group, the disposal of certain service businesses not related to main operations out of the Group the introduction of government investments for the improvement of the railway infrastructure.

According to the decree of the President of the Republic of Azerbaijan signed on September 18, 2015 the Group has been taken off from subordination to the Ministry of Transportation of the Republic of Azerbaijan and is directly reporting to the Cabinet of Ministers of the Republic of Azerbaijan starting from the decree date.

The Government, through the Group, is continuing to restructure the railway transportation system in the Republic of Azerbaijan and has developed a mid-term development strategy for the years between 2015-2020 that includes a significant investment in the railways system. Within this strategy the Group has developed a detailed restructuring action plan, to be implemented by 2020, which will result in the establishment of robust railways infrastructure, improvement of the quality and commerciality of freight and passenger transportation services, increase of security matters in transportation, application of latest technologies in the railways system, acquisition of new locomotives, replacing direct current electrification with more efficient alternating current electrification, etc.

Pursuing the decree No. 1974 of the President of the Republic of Azerbaijan, the Government is also financing Baku-Tbilisi-Kars railway route. The funding of Baku-Tbilisi-Kars new railway line project is provided by the State Oil Fund of the Republic of Azerbaijan. The construction of this transport corridor will connect railway network of Azerbaijan, Georgia and Turkey and will serve increasing the transit potential of regional countries. Currently, the estimated date of completion of the construction is the second half of 2018.

On December 1, 2014, as part of the Azerbaijan Railways Reconstruction Project the Group entered into an agreement with Moravia Steel A.S. to supply equipment and materials, and perform related works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The project commenced in the beginning of 2015 and is planned to be completed in 4.5 years. In order to finance this project the Group signed a loan in the amount of EUR 458,861 thousand from HSBC Bank plc on April 14, 2015.

In 2016 the Group commenced construction of railway linking Astara (the Republic of Azerbaijan) and Astara (the Islamic Republic of Iran) as part of the International North-South Transport Corridor. The project commenced during 2016 which includes construction of 10 km railway line and railway bridge. The Government of the Republic of Azerbaijan invested about $60 million for performing related works and services to complete construction of the railway corridor between Astara (the Republic of Azerbaijan) and Astara (the Islamic Republic of Iran), as well as the construction of a railway station and cargo terminals in the territory of the Islamic Republic of Iran. As part of the project four terminals are planned to be built for the cargo storage - container, general cargo, oil and grain. At the first stage, it is planned to launch two terminals - container and general cargo. It is planned that the Republic of Azerbaijan will have the right to operate the Astara-Astara line and a railway station in the Islamic Republic of Iran’s Astara for 15 years as well as the terminals located in the Islamic Republic of Iran’s Astara, for 25 years.

The project of restoring the former electric railway lines serving to Baku in order to improve considerably passenger transportation was started at the end of 2017. The construction works commenced from the Sabunchu station and AZN 100 million were allocated for the “Baku Ring Railway construction” project. As part of “Baku Ring Railway construction” project, the Baku-Sumgait railway line started to operate from 2015 with stops at two stations – Bilajari and Khirdalan. The purpose of the project is to put into use additional passenger stations and expand the direction of Baku-Sumgait railway via Bakikhanov, Zabrat-1, Zabrat-2, Pirshagi, Fatmai, Novkhani stations and further to Sumgait.

(In thousands of Azerbaijani Manats unless otherwise indicated)

The Government of the Republic of Azerbaijan is the party in the financing of the second phase of the Reconstruction of Railways Project and is obliged to provide EUR 74,937 thousand advance payment in two installments. The aggregate amount of these installments shall not be less than 15% of the project cost. The Government has made a payment of the first installment in the amount of EUR 39,739 thousand on November 1, 2015 and the second installment in the amount of EUR 40,334 thousand during the year ended December 31, 2017. This installment was provided as a loan to the Group. The details of the loan is described in Note 17.

Subsidiaries and structural changes in departments

ADY's major subsidiaries included in the consolidation as at and for the year ended December 31, 2017 are as follows:

Name of the Company/Branches	Nature of business	Group's equity interest
"Capital Construction" and "Technical Supervision" LLC	Construction management and supervision	100%
"Nakhchivan Railways" LLC	Freight and passenger transportation, construction works	100%
"Administrative Management" LLC	Administrative support	100%
"Railway Services" LLC	Construction works	100%
#11 Limited Liability Company	Construction works	100%
#5 Limited Liability Company	Construction works	100%
"Capital Repairs" LLC	Construction management and supervision	100%
"Absheron Volleyball Club" Ltd	Sport	100%
"Locomotive Volleyball Club" Ltd	Sport	100%
"Locomotive Women Volleyball Club" LLC	Sport	100%
"Azerrail Volleyball Club" LLC	Sport	100%
"ADY Express" LLC	Logistics services	100%
Georgia branch of ADY	Construction works	100%
"ADY Container" LLC	Management of container transportation	100%
"ADY Property" LLC	Management of real estates	100%
"AzRus Trans" CJSC	Freight transportation	51%
"Astara Grain Terminal" LLC	Logistics hub	50%

ADY's major subsidiaries included in the consolidation as at and for the year ended December 31, 2016 are as follows:

Name of the Company/Branches	Nature of business	Group's equity interest
"Capital Construction" and "Technical Supervision" LLC	Construction management and supervision	100%
"Nakhchivan Railways" LLC	Freight and passenger transportation, construction works	100%
"Administrative Management" LLC	Administrative support	100%
"Railway Services" LLC	Construction works	100%
#11 Limited Liability Company	Construction works	100%
#5 Limited Liability Company	Construction works	100%
"Capital Repairs" LLC	Construction management and supervision	100%
"Locomotive Women Volleyball Club" LLC	Sport	100%
"Azerrail Volleyball Club" LLC	Sport	100%
"ADY Express" LLC	Logistics services	100%
Georgia branch of ADY	Construction works	100%
"AzRus Trans" CJSC	Freight transportation	51%
"Astara Grain Terminal" LLC	Logistics hub	50%

(In thousands of Azerbaijani Manats unless otherwise indicated)

Information of subsidiaries established during the year ended December 31, 2017 is provided below:

Establishment of "ADY Container" Ltd.

"ADY Container" Ltd. was incorporated under the Republic of Azerbaijan law on June 23, 2017. The share capital of this company constitutes the amount of AZN 50,000 comprised of 2 shares with par value of AZN 25,000 each fully owned by "Azerbaijan Railways" Closed Joint Stock Company. The main activity of the Company is to improve the quality and safety of rail freight transportation, and efficient and centralized management of container transportations.

Establishment of "ADY Property" Ltd.

"ADY Property" Ltd. was incorporated under the Republic of Azerbaijan law on April 27, 2017. The share capital of this company constitutes the amount of AZN 200 comprised of 2 shares with par value of AZN 100 each fully owned by "Azerbaijan Railways" Closed Joint Stock Company. The main activity of the Company is management of real estates.

Establishment of "Absheron Volleyball Club" Ltd.

"Absheron Volleyball Club" Ltd was incorporated under the Republic of Azerbaijan law on April 27, 2017. The share capital of this company constitutes the amount of AZN 200 comprised of 2 shares with par value of AZN 100 each fully owned by "Azerbaijan Railways" Closed Joint Stock Company. The main activity of the Company is arranging sporting events.

Establishment of "Locomotive Volleyball Club" Ltd.

"Locomotive Volleyball Club" Ltd was incorporated under the Republic of Azerbaijan law on January 24, 2017. The share capital of this company constitutes the amount of AZN 200 comprised of 1 share with par value of AZN 200 fully owned by "Azerbaijan Railways" Closed Joint Stock Company. The main activity of the Company is arranging sporting events.

The summarized financial information of the significant subsidiaries acquired and established during 2017, based on amounts before inter-company eliminations is provided below:

Summarized statement of financial position as at December 31, 2017:

	"ADY Container" LLC	**"ADY Property" LLC**
ASSETS		
Non-current assets:		
Property, plant and equipment	22	-
Intangible assets	2	-
Total non-current assets	**24**	**-**
Current assets:		
Trade and other receivables	583	50
Cash and cash equivalents	49	78
Other current assets	3	3
Total current assets	**635**	**131**
TOTAL ASSETS	**659**	**131**

(In thousands of Azerbaijani Manats unless otherwise indicated)

	“ADY Container” LLC	“ADY Property” LLC
LIABILITIES AND EQUITY		
LIABILITIES:		
Current liabilities:		
Trade and other payables	560	85
Taxes payable other than income tax	19	2
Advances received	-	22
Total current liabilities	**579**	**109**
Total liabilities	**579**	**109**
EQUITY:		
Share capital	50	-
Retained earnings	30	22
Total equity	**80**	**22**
TOTAL LIABILITIES AND EQUITY	**659**	**131**

Summarized statement of comprehensive income for the year ended December 31, 2017:

	“ADY Container” LLC	“ADY Property” LLC
Revenues		
Cargo revenues	738	-
Other revenues	-	50
Total revenues	**738**	**50**
Operating expenses		
Depreciation and amortization	(7)	-
Wages, salaries and related contributions	(50)	(16)
Rent expense	(50)	-
Bank commission	(2)	(1)
Other operating costs	(591)	(5)
Total operating expenses	**(700)**	**(22)**
Profit before income tax	**38**	**28**
Income tax expense	(8)	(6)
Net profit for the year	**30**	**22**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**30**	**22**

Information of subsidiaries acquired and established during the year ended December 31, 2016 is provided below:

(In thousands of Azerbaijani Manats unless otherwise indicated)

Acquisition of "Karvan Logistics" LLC

On February 5, 2016, in accordance with Order #16/us/01, the Group acquired 100% of the shares of "Karvan Logistics" LLC, an unlisted company based in the Republic of Azerbaijan and specializing in the logistics services. The Group renamed the company name to "ADY Express" LLC. The share capital of "ADY Express" LLC constitutes the amount of AZN 100 comprised of 100 shares par value of AZN 1 fully owned by the Group.

The fair values of the identifiable assets and liabilities of "Karvan Logistics" LLC as at the date of acquisition were:

	Fair value recognized on acquisition
Assets	
Property, plant and equipment	35
Trade and other receivables	722
Cash and cash equivalents	682
Other current assets	1,092
Total assets	**2,531**
Liabilities	
Trade and other payables	172
Advances received	1,701
Other current liabilities	5
Total liabilities	**1,878**
Total identifiable net assets at fair value	**653**
Gain on bargain purchase	653
Purchase consideration transferred	0.1

From the date of acquisition, "ADY Express" LLC contributed AZN 82,808 thousand of revenue and AZN 1,817 thousand to profit before tax from continuing operations of the Group, till the end of 2016. If the combination had taken place at the beginning of the year, revenue from continuing operations for the year ended December 31, 2016 would have been AZN 90,350 thousand and profit before tax from continuing operations for the Group would have been AZN 2,432 thousand.

Establishment of "AzRusTrans" LLC

On September 6, 2016, the Company has entered into the agreement with "Rusagrotrans" LLC to establish "AzRusTrans" LLC to provide logistics services.

The initial share capital of this company is AZN 150,000 equally divided into 150,000 shares with nominal value of AZN 1 each. The shareholdings and the initial number of shares of the parties is as follows:

(In thousands of Azerbaijani Manats unless otherwise indicated)

- “Azerbaijan Railways” CJSC owns 51% of the share capital, i.e. 76,500 shares with total nominal value of AZN 76,500;
- “Rusagrotrans” LLC owns 49% of the share capital, i.e. 73,500 shares with total nominal value of AZN 73,500.

Establishment of “Astara Grain Terminal” LLC

“Astara Grain Terminal” LLC was incorporated under the Republic of Azerbaijan law on September 23, 2016. The share capital of this company constitutes the amount of AZN 100 comprised of 100 shares with par value of AZN 1 equally owned by “ADY Express” LLC and “Yasha Inshaat” LLC. The main activity of the Company is warehousing services.

The summarized financial information of the subsidiaries acquired and established during 2016, based on amounts before inter-company eliminations is provided below:

Summarized statement of financial position as at December 31, 2016:

	“ADY Express” LLC	**“AzRusTrans” LLC**	**“Astara Grain Terminal” LLC**
ASSETS			
Non-current assets:			
Property, plant and equipment	114	59	10
Total non-current assets	**114**	**59**	**10**
Current assets:			
Inventories	-	-	12
Trade and other receivables	6,673	81	-
Cash and cash equivalents	701	503	43
Other current assets	3,576	-	24
Total current assets	**10,950**	**584**	**79**
TOTAL ASSETS	**11,064**	**643**	**89**
LIABILITIES AND EQUITY			
LIABILITIES:			
Current liabilities:			
Trade and other payables	1,374	43	100
Taxes payable other than income tax	-	29	-
Income tax payable	-	20	-
Advances received	7,489	1,813	-
Other current liabilities	5	1	-
Total current liabilities	**8,868**	**1,906**	**100**
Total liabilities	**8,868**	**1,906**	**100**
EQUITY:			
Share capital	-	150	-
Retained earnings/(Accumulated loss)	2,196	(1,413)	(11)
Total equity	**2,196**	**(1,263)**	**(11)**
TOTAL LIABILITIES AND EQUITY	**11,064**	**643**	**89**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Summarized statement of comprehensive income for the year ended December 31, 2016:

	"ADY Express" LLC	"AzRusTrans" LLC	"Astara Grain Terminal" LLC
Revenues			
Cargo revenues	90,350	1,313	-
Other revenues	-	162	-
Total revenues	**90,350**	**1,475**	**-**
Operating expenses			
Transportation cost	(88,154)	-	-
Depreciation and amortization	(19)	(3)	-
Wages, salaries and related contributions	(363)	(20)	(6)
Material, repairs and maintenance	(20)	(2)	-
Taxes other than income tax	(72)	(4)	(1)
Fuel expenses	(78)	-	-
Other operating costs	-	(2,951)	(4)
Total operating expenses	**(88,706)**	**(2,980)**	**(11)**
Other income			
Foreign exchange gain	843	21	-
Other income	-	91	-
Profit/(loss) before income tax	**2,487**	**(1,393)**	**(11)**
Income tax expense	(331)	(20)	-
Net profit/(loss) for the year	**2,156**	**(1,413)**	**(11)**
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR	**2,156**	**(1,413)**	**(11)**

Acquisition of interest in "MSP International AZ" LLC

On October 1, 2016, "Railway Services" LLC, subsidiary of the Group acquired 5% interest in the voting shares of "MSP International AZ" LLC. The initial share capital of the Company is AZN 50,000 equally divided into 100 shares with nominal value of AZN 500 each.

The shareholdings and the initial number of shares of the parties is as follows:

- "Railway Services" LLC owns 5% of the share capital, i.e. 5 shares with total nominal value of AZN 2,500;
- "MSP International" s.r.o. owns 95% of the share capital, i.e. 95 shares with total nominal value of AZN 47,500.

During 2016, the Group made structural changes in the Infrastructure Department and Department of Maintenance and Operations to increase operational effectiveness and efficiency. New structure of the Infrastructure Department consists of 35 sub-departments.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Common control business combination

The Ministry of Transportation of the Republic of Azerbaijan transferred ownership of the Georgian branch of "Azeravtoyol" OJSC (previously named as "Azeryolservis" OJSC) from "Azeravtoyol" OJSC to the Group through issuing order # 34/u on March 2, 2015. In accordance with this order, all assets and liabilities of the Georgia Branch of the Group (the "Branch") were combined to the balances of the Group.

The summarized financial information of the branch as at the transfer date is provided below. This information is based on the amounts reported in the branch's financial statements prepared in accordance with IFRS adjusted for the purposes of the consolidation into these consolidated financial statements before intercompany eliminations and hence it differs from the information presented in the IFRS financial statements of the branch.

	As at transfer date
Non-current assets	384
Current assets	76,903
Non-current liabilities	(7,471)
Current liabilities	(85,842)
Total net assets	**(16,026)**

Total net assets in the amount of AZN 16,026 thousand was recognized in other reserve.

Pricing policy

The pricing policy of the Group for international freight is conducted based on "Tariff policy" on International Freight adopted by CIS in Tariff Conference held annually according to Tariff Agreement dated February 17, 1993. The General Director of the Group approves the pricing policy. Prices exclude Value Added Tax ("VAT"). The tariffs are denominated in CHF. However, payments in USD and Euro are also accepted. The prices in USD and EUR are converted using average exchange rates for USD and EUR announced by Reuters till last three months the prices in CHF are announced. Prices in CHF are announced annually no later than December 1. Payments are translated to AZN using CBAR exchange rates.

Generally, the total cargo transportation price payable by a shipper of cargo consists of the following components: a charge for locomotive traction and infrastructure services and a charge for the use of a railcar. If a customer uses a railcar owned or leased by the Group, railcar component is also subject to tariff regulation.

Tariff policy is not applied for pricing of local freight. Local freight tariffs are set by the Group, reviewed annually and priced in AZN.

Liquidity

As at December 31, 2017 and 2016, the Group's current liabilities exceeded its current assets by AZN 152,652 thousand and AZN 559,258 thousand, respectively, which is to a large extent explained by the nature of the Group's current liabilities mainly represented by payables for construction, development, modernization and maintenance of property, plant and equipment as a part of Group's investment program, as well as by advances received for construction works. The Group makes significant changes in the general business terms of its contracts with credit lenders. Details are described in Note 35.

The Group is investing in expansion, modernization and maintenance of its property, plant and equipment. The Group finances its investment activities through cash generated from operations and short-term and long-term borrowings and governmental financing received in the form of grants.

The Management uses the following instruments in order to manage the Group's liquidity and overcome the negative liquidity gap in subsequent periods:

- continuous monitoring and management of credit portfolio structure aiming at extending its duration and maintaining even flows of borrowings repayment in future periods;
- maintaining diversified sources of external borrowings, including borrowings from commercial banks;
- entering into long-term and medium-term credit agreements with local banks to ensure sufficiency of available financial resources;
- using short-term bridge facilities to ensure smooth cash flows to finance investments and operations.

Management believes that through twelve months after the date of authorization of these consolidated financial statements, there will be sufficient funding from (a) existing cash balances, (b) cash generated from operations, (c) debt financing and (d) government support.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"). The consolidated financial statements provide comparative information in respect of the previous period.

Principles of Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an investee so as to obtain benefits from its activities.

Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive income of subsidiaries is attributed to the owners of the Group and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of the branch and subsidiaries to bring their accounting policies into line with those used by other members of the Company.

All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Business combinations and acquisition of non-controlling interests

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

Contingent consideration, resulting from business combinations, is valued at fair value at the acquisition date as part of the business combination. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 "Financial Instruments: Recognition and Measurement", is measured at fair value with the changes in fair value recognized in the statement of profit or loss in accordance with IAS 39.

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognized at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognized in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Common control business combinations

IFRS 3, "Business Combinations" does not apply to a business combination of entities or businesses under common control. A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. The management used "predecessor value method" for accounting of such transactions as this provides the most relevant and reliable information in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". A predecessor value method involves accounting for the assets and liabilities of the acquired business using existing carrying values. The difference between the acquirer's cost of investment and the acquiree's equity is presented as a separate reserve within equity on consolidation.

Going concern

These consolidated financial statements have been prepared on the assumption that the Group will be able to continue its operation on a going concern basis for the foreseeable future. Management views the Group as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations of the Republic of Azerbaijan.

Accordingly, assets and liabilities are recorded on the basis that the Group will be able to realize its assets and discharge its liabilities in the normal course of business. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the Group's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern.

Management's assessment of the going concern assumption involves making a judgment, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain.

Other basis of presentation criteria

These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN"), unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention, except property, equipment and intangible assets which are stated at fair value as deemed cost.

Property, plant and equipment and intangible assets

Property, equipment and intangible assets are carried at historical cost less accumulated depreciation and amortization and any recognized impairment loss.

Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

Depreciation and amortization are charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. The estimated useful lives, residual values and depreciation/amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following useful lives (years):

Superstructure	13-27
Roadbed	50-75
Railway vehicles	9-12
Buildings and similar constructions	35-40
Operating equipment	8-15
Intangible assets	5-10
Other fixed assets	5-10

Expenditures related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

Expenditures relating to track renewals are capitalized to the extent that the flow of the future economic benefits is probable and those expenditures can be reliably measured. The replaced assets are valued at lower of cost and net realizable value and transferred to inventories or property, plant and equipment, as applicable. The excess of the carrying value of the replaced assets over their net realizable value is recognized as an expense in the consolidated statement of comprehensive income. All property that does not provide future economic benefit is expensed immediately in the consolidated statement of comprehensive income.

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives.

The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

At the end of each reporting period, the Group reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

An item of property, plant and equipment and intangible assets is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit and loss accounts.

Prepayments

Prepayments are carried at cost less 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 will itself be classified as non-current upon initial recognition.

Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit and loss accounts 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 value of the prepayment is written down accordingly and a corresponding impairment loss is recognized in profit and loss accounts.

Inventories

Inventories are recorded at the lower of cost and net realizable value. Cost of inventory is determined on the weighted average cost basis. The cost of finished goods and work in progress includes raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses. Inventories are reported net of provisions for damaged or obsolete items.

Financial instruments

The Group recognizes financial assets and liabilities in its consolidated statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit and loss accounts.

Financial assets

Financial assets are classified into the following specified categories: financial assets “at fair value through profit or loss” (FVTPL), “held-to-maturity” investments, “loans and receivables” and “available-for-sale” (AFS) financial assets. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at FVTPL

Financial assets classified as held for trading are included in the category “financial assets at fair value through profit or loss”. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the profit and loss accounts.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity.

Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method.

Gains and losses are recognized in profit and loss accounts when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories.

After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to profit and loss accounts. However, interest calculated using the effective interest method is recognized in profit and loss accounts.

Loans receivable

Loans receivable are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

Loans receivable are initially recognized at a fair value plus related transaction costs. The difference between the fair value of consideration given and the fair value of the loans receivable is recognized as a loss on initial recognition and included in the consolidated statement of comprehensive income according to nature of these losses. Subsequently, the balances are carried at amortized cost using the effective interest method. Loans receivable are carried net of any allowance for impairment losses.

Financial guarantee contracts

Financial guarantee contracts issued by the Group are the contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specific debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are initially recognized as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the best estimate of expenditure required to settle present obligation at the reporting date and the amount initially recognized less, when appropriate, cumulative amortization.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, then the Group establishes fair value using a valuation technique. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments.

Trade and other receivables

Trade and other receivables are carried at amortized cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognized in the consolidated statement of comprehensive income.

The primary factors that the Group considers whether a receivable is impaired is its overdue status and realizability of related collateral, if any.

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 amortized cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the cash flow statement. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date are included in other non-current assets.

VAT deposit account

The Value Added Tax ("VAT") deposit account system is introduced in 2008 by the Ministry of Taxes of the Republic of Azerbaijan which aims prevention of VAT misuse. From January 1, 2008 on the basis of amendments to the Tax Code, the amount of VAT refund is considered the tax amount which is paid, according to the submitted VAT invoices to the taxpayer's VAT deposit account in the framework of transactions carried out in this account.

By the support of this module the taxpayer pays the amount of VAT indicated on the VAT invoices to the VAT deposit account of another taxpayer. At the same time tax obligations to the state budget regarding all kinds of taxes and VAT amounts on the import transactions which is necessary to be paid to the customs committee, can be paid by taxpayers through the VAT deposit account. Information about paid amounts is transferred by the Ministry of Taxes to the Main State Treasury ("MST") and then to the Central Bank of the Republic of Azerbaijan ("CBAR"). CBAR on the basis of information submitted by the Main State Treasury ensures the transformation of amounts to the relevant local treasury authorities. The Ministry of Taxes ensures inclusion of amounts which is noted in the submitted information to the taxpayer's personal files. The current system is connected with the Automated Tax Information System of the Ministry of Taxes. At the same time online exchange of information was organized with the MST and CBAR.

Implementation of the VAT deposit account makes it possible to timely control payments and refunded VAT amounts. Taxpayers who have tax debts can only transfer these amounts to the state budget. Taxpayers can make payments to the state budget without visiting banks, to the sub-accounts of other taxpayers and to the customs committee through the deposit account. The Ministry of Taxes automatically controls all transactions carried out through the deposit account using special software.

Use of balances in the VAT deposit account is restricted and can be used only for transactions connected with VAT and other applicable taxes.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity;
- Other financial assets may be reclassified to available for sale or held-to-maturity categories only in rare circumstances.

A financial asset classified as available-for-sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit and loss accounts is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

De-recognition of financial assets

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On de-recognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit and loss accounts.

On de-recognition of a financial asset other than in its entirety (for example, when the Group retains an option to repurchase part of the transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the Group retains control), the Group allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer.

The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit and loss accounts. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Financial liabilities

Financial liabilities are classified as either "financial liabilities at FVTPL" or "other financial liabilities".

Financial liabilities at FVTPL

Financial liabilities are classified as FVTPL when the financial liability is either held for trading or it is designated as at FVTPL.
Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognized in profit and loss accounts. The net gain or loss recognized in profit and loss accounts incorporates any interest paid on the financial liability and is included in the "other income, net" line item in the consolidated statement of comprehensive income.

Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Borrowings

Borrowings are carried at amortized cost using the effective interest method.

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of the asset. All other borrowing costs are expensed in the period in which they occur.

Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Finance leases

Assets held under finance leases are initially recognized as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Group’s general policy on borrowing costs. Contingent rentals are recognized as expenses in the periods in which they are incurred.

Operating leases

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit and loss accounts on a straight-line basis over the lease term.

The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Where the Group is a lessor, rental income from operating lease is recognized on a straight line basis over the term of relevant lease. Initial direct costs in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized over the lease term.

Trade and other payables

Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortized cost using the effective interest method.

Advances received

Advances received from customers refers to an item that will initially be recorded as a liability, but is expected to become an asset over time and/or through the normal operations of the business. Advances received from customers are initially recorded at the fair value of consideration received plus any directly attributable transaction costs, and subsequently are carried at amortized cost.

De-recognition of financial liabilities

The Group derecognizes financial liabilities when, and only when, the Group’s obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss accounts.

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the consolidated statement of financial position when the Group has a legally enforceable right to set off the recognized amounts and the Group intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Group does not offset the transferred asset and the associated liability.

Provisions

Provisions are recognized when the Group 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 obligation can be made.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation.

When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Taxation

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax expense. The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group’s current tax expense is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the consolidated statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the consolidated statement of financial position if:

- The Group has a legally enforceable right to set off current income tax assets against current income tax liabilities; and

- Deferred income tax assets and the deferred income tax liability relate to income taxes levied by the same taxation authority on the same taxable entity.

Value added tax

The difference of output VAT and claimable input VAT is payable to the state budget within 20 days following the reporting month. Output value added tax related to sales is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis.

VAT related to sales and purchases is recognized in the statement of financial position on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

Land tax

Owners and users of land in the Republic of Azerbaijan are subject to land tax at varying rates. The rate of tax varying from AZN 0.06 up to AZN 20 depends on the type of land, i.e. agricultural, industrial, construction, communication, trading or residential land, as well as the location of land.

The reporting period is a calendar year. For legal entities owning or using the land the deadline for tax filing is May 15 of each year, while the tax should be paid in equal installments no later than August 15 and November 15.

Property tax

Except for cases when the property has been insured at a value exceeding its residual value and the property tax is then calculated on the market value, the taxable base for resident legal entities and non-resident legal entities with permanent establishment is the average annual residual value of their fixed assets. Thus, an average annual residual value of fixed assets owned by such legal entities is subject to a property tax at the rate of 1%. At the same time, the taxable base in respect of resident and non-resident individuals comprises of buildings and their parts, as well as resident individuals’ water and air transportation means, where the property tax rate varies depending on the type of asset owned.

The reporting period is a calendar year. Legal entities, owning the fixed assets, have to file the tax return no later than March 31 of the year following the reporting period. The property taxpayer legal entities remit the tax by way of advances (20% of the last year’s property tax) by the 15th of the second month of each quarter with the final balancing payment due no later than the filing deadline mentioned above.

The Republic of Azerbaijan also has various other taxes, which are assessed on the Group’s activities. These taxes are included in the consolidated statement of comprehensive income.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects. Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared.

Dividends that are declared after the reporting date are treated as a subsequent event under International Accounting Standard 10 “Events after the Reporting Date” (“IAS 10”) and disclosed accordingly.

Government investments

According to the decree No. 183 of the Cabinet of the Ministers of the Republic of Azerbaijan dated October 22, 2010, all government investments allocated to the state companies of the Republic of Azerbaijan for the purposes of improvement of the infrastructure and enhancement of their operations since 2007 should be included in the share capital of these entities.

The Group policy is that government investments are initially recorded in government investments line in the equity until they are registered in relevant government agencies. It is then classified as share capital when all necessary documentary works are completed and amounts are registered in relevant government agency.

Other reserve

Other reserve represents the difference between the acquirer’s cost of investment and the acquiree’s equity under common control business combinations.

Revenue and expense recognition

Revenues are recognized when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenues can be measured reliably.

Revenues and expenses are accounted for at the time the actual flow of related goods and services occurs and transfer of risks and rewards has been completed, regardless of when cash or its equivalent is received or paid, and are reported in the statement of comprehensive income in the period to which they relate. The Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as a principal or an agent.

Transportation services

In respect of services related to cargo transportation, revenue is recognized by reference to the stage of completion of the transportation at the reporting date provided that the stage of completion of the transportation or other specific condition has been met and the amount of revenue can be measured reliably. In the event that either of the conditions above is not met as at the reporting date, the recognition of revenue is deferred to the date when transportation is completed, i.e. cargo delivered to the place of destination. The stage of completion is determined as a percentage of services performed to date to total services to be performed.

In respect of services related to passenger transportation, revenue is recognized when transportation is completed.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Revenue from construction services

The Group renders significant construction services to third parties under long-term construction contracts.

Revenue from construction services rendered is recognized in the consolidated statement of comprehensive income on a monthly basis in accordance with the actual volume of works completed. The stage of completion is assessed monthly.

When the outcome of the contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. The Group provides for estimated losses on uncompleted contracts in the period, in which such losses are identified.

Interest income and expenses

Interest income and expenses are recorded using the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of such an instrument, taking into consideration all contractual terms of the instrument.

Employee benefits

Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and child care services) are accrued in the year in which the associated services are rendered by the employees of the Group.

Foreign currency translation

The functional currency of the Group is the currency of the primary economic environment, in which it operates. The Group's functional currency is AZN.

Financial assets and liabilities denominated in foreign currencies are translated into AZN at the appropriate spot rates of exchange of the CBAR ruling at the end of reporting date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in foreign exchange translation gain/(loss) account.

The exchange rates at reporting date used by the Group in the preparation of the consolidated financial statements are as follows:

	December 31, 2017	December 31, 2016
USD/AZN	1.7001	1.7707
EUR/AZN	1.9463	1.8644
GEL/AZN	0.6514	0.6663
CHF/AZN	1.7374	1.7351
RUR/AZN	0.0295	0.0293
KZT/AZN	0.0051	0.0053

Foreign currency translational reserve

On consolidation, the assets and liabilities of foreign operations are translated into AZN at the rate of exchange prevailing at the reporting date and their statements of comprehensive income are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation purposes are recognized in other comprehensive income. On disposal of a foreign operation, the component of the other comprehensive income relating to that particular foreign operation is recognized in profit and loss accounts.

Contingent liabilities and assets

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes to the financial statements unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The preparation of consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and disclosure of contingent liabilities during the reporting period.

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest information available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

The most significant estimates relate to the depreciable lives of property, plant and equipment, impairment of non-financial and financial assets, fair value of financial instruments, provision for obsolete inventory, provision for tax and legal contingencies and deferred taxation. Actual results could differ from these estimates.

Useful life of property, plant and equipment

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation recognized in profit and loss accounts.

Impairment of property, plant and equipment and other non-financial assets

The Group assesses at each reporting date whether there is any indication that an asset or any of the Groups' cash-generating units ("CGU"s) may be impaired and determines recoverable amount of an asset or a CGU if impairment indicators are identified. Recoverable amount is the higher of an asset's or CGUs fair value less costs of disposal and its value in use. When the carrying amount of an asset or a CGU exceeds its recoverable amount, the asset or CGU is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used.

The Group bases its value in use calculation on detailed budgets and forecast calculations which are prepared separately for each of the Group’s CGU to which the individual asset is allocated. These budgets estimates and forecasts generally cover the period of 5 years. For longer periods, a long-term growth rate is determined and applied to projected future cash flows after the tenth year.

Due to significant uncertainties regarding future changes in the tariff-setting policy management cannot predict what effect changes in fiscal and political policies may have on the Group’s remaining investment or ability to make future investments in property, plant and equipment, which may affect the recoverable amount of such investments. Management plans to revisit such an assessment at the time more certainty regarding factors outlined above exist and upon finalization of Group’s property, plant and equipment registers for the movements in property, plant and equipment, including the effects of impairment and accounting for components, in accordance with its accounting policy. Accordingly, the amount of impairment loss may be revised.

The value of the CGUs was calculated by discounting the future cash flows at the rate of 7.2% on pre-tax base and impairment charge of AZN 265,808 thousand (2016: AZN 229,386 thousand) has been recognized in consolidated statement of comprehensive income to write-down the book value of certain property, plant and equipment with regard to the functional use of these assets. The discount rate calculation is based on the specific circumstances of the Group and its operating segments and derived from its weighted average cost of capital (“WACC”). In calculating WACC the cost of equity was estimated using peer group data and the cost of debt is based on interest bearing borrowings, the Group is obliged to service. Specific risks are incorporated by applying individual beta factors, market risk and size of the Group. The beta factors are evaluated annually based on publicly available market data. If the estimated WACC used in the calculation had been 1% higher than management’s estimate, the aggregate amount of impairment loss would have been AZN 907,408 thousand higher (2016: AZN 633,314 thousand higher). 6.96% is the threshold level where there is no need for impairment (2016: 6.23%).

These estimates, including the methodologies used, may have a material impact on the amount of any property, plant and equipment and other non-financial assets impairment.

As at December 31, 2017 and 2016 the Group has provided allowance against prepayment for inventories and services made in the amount of AZN 39,113 thousand and AZN 30,840 thousand, correspondingly.

Inventory valuation

Inventory is valued at the lower of cost or net realizable value. The Group records an allowance to reduce the carrying value of obsolete and slow-moving inventory to net realizable value, when appropriate. The actual value realized on disposition of such inventory may differ from the net realizable value; any such difference could have a significant impact on future operating results.

As at December 31, 2017 and 2016 the Group has provided allowance for loss on damaged and obsolete inventory in the amount of AZN 8,238 thousand and AZN 12,500 thousand, correspondingly.

Recoverability of VAT

At each reporting date the Group assesses the recoverability of VAT arising on purchase of goods and services. The Group can only receive these amounts through an offset against future VAT liability or collection from the tax authorities. In assessing the recoverability of the VAT receivable, the Group considers information from the internal tax department regarding projected VAT liability, correspondence with government tax authorities, and historical recovery experience. The actual amount of VAT recovery could differ materially from the Groups estimate and this could materially impact operating results.

Impairment of financial assets

The Group assesses, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred ‘loss event’) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and when observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

As at December 31, 2017 and 2016 the Group has provided allowance for impairment losses in the amount of AZN 135,186 thousand and AZN 114,210 thousand for loans receivable and allowance for bad debt in the amount of AZN 93,178 thousand and AZN 90,868 thousand for trade and other receivables, respectively.

Litigations

The Group exercises considerable judgment in measuring and recognizing provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgment is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as legal counsel. Revisions to the estimates may significantly affect future operating results.

Current taxes

Azerbaijani tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group’s entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group’s entities may be assessed additional taxes, penalties and interest, which can be significant.

Periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As at December 31, 2017, the management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group’s tax, currency and customs positions will be sustained.

Fair value of financial instruments

Where the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Construction contract

When the outcome of a construction contract cannot be estimated reliably revenue is recognized only to the extent of contract costs incurred that it is probable will be recoverable; and contract costs are recognized as an expense in the period in which they are incurred. An expected loss on the construction contract is recognized as an expense immediately. The expected loss is assessed based on analysis performed by the management of the Group in accordance with approved project budget.

4. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

In the current year, the Group has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2017. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Group's accounting policies that have affected the amounts reported for the current or prior years.

Amendments to IAS 7 "Statement of Cash Flows" – The Group has applied these amendments for the first time in the current year. The amendments are intended to clarify IAS 7 to improve information provided to users of consolidated financial statements about an entity's financing activities.

To achieve this objective, the IASB requires that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

Amendments to IAS 12 "Income Taxes" – The amendments to IAS 12 "Income Taxes" clarify how to account for deferred tax assets related to debt instruments measured at fair value and clarify recognition of deferred tax assets for unrealized losses, to address diversity in practice.

Annual Improvements to IFRS Standards 2014-2016 Cycle, IFRS 12 "Disclosure of Interests in Other Entities" – The Group has applied the amendments to IFRS 12 included in Annual Improvements to IFRS Standards 2014-2016 cycle for the first time in the current year. The other amendments included in this package are not yet mandatorily effective and they have not been early adopted by the Group.

IFRS 12 states that an entity need not provide summarized financial information for interests in subsidiaries, associates or joint ventures that are classified as held for sale. The amendment clarifies that this is the only concession from disclosure requirements of IFRS 12 for such interests.

Unless otherwise described above, the new Standards and Interpretations are not expected to significantly affect the Group's consolidated financial statements.

(In thousands of Azerbaijani Manats unless otherwise indicated)

5. STANDARDS AND INTERPRETATIONS ISSUED AND NOT YET ADOPTED

At the date of authorization of these consolidated financial statements, other than the Standards and Interpretations adopted by the Group in advance of their effective dates, the following Interpretations were in issue but not yet effective.

Annual Improvements to IFRS Standards 2014-2016 Cycle contains amendments to IFRS 1 and IAS 28 which are not yet mandatorily effective for the Group.

Standard	Subject of amendment
IFRS 1 "First-time Adoption of International Financial Reporting Standards"	Deletion of short-term exemptions for the first-time adopters: The amendments delete the short-term exemptions in IFRS 1 that relate to IFRS 7, IAS 19, IFRS 12 and IAS 27.
IAS 28 "Investments in Associates and Joint Ventures"	Measuring an associate or joint venture at fair value: The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

The amendments to IFRS 1 and IAS 28 are effective for annual periods begin on or after January 1, 2018.

The IASB and FASB have issued their joint revenue recognition standard, IFRS 15 "Revenue from Contracts with Customers", which replaces all existing IFRS and US GAAP revenue requirements. IFRS 15 specifies how and when an IFRS reporter will recognize revenue as well as requiring such entities to provide users of consolidated financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 was issued in May 2014 and applies to an annual reporting period beginning on or after January 1, 2018. An earlier application is permitted. This standard might have significant effect on the consolidated financial statements. Yet the management has not estimated the effect of adoption of this standard.

Amendments to IAS 40 "Transfers of Investment Property" are intended to clarify that an entity can only reclassify a property to/from investment property when, and only when, there is evidence that a change in the use of the property occurred. The amendments are effective for periods beginning on or after January 1, 2018. Earlier application is permitted. An entity applies the amendments to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is also permitted if that is possible without the use of hindsight.

IFRIC 22 "Foreign Currency Transactions and Advance Consideration" addresses foreign currency transactions or parts of transactions where:

- there is consideration that is denominated or priced in a foreign currency;
- the entity recognizes a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and
- the prepayment asset or deferred income liability is non-monetary.

The Interpretations Committee came to the following conclusion that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The interpretation applies to annual reporting periods beginning or after January 1, 2018. An earlier adoption is permitted.

IFRS 9 "Financial Instruments" – in July 2014, IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

- From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives to be assessed based on a combination of the entity`s business model for managing the assets and the instruments` contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortized cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortized cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as requirements of IAS 39;
- IFRS 9 requires the Group to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis. The Group expects to apply the simplified approach and record lifetime expected losses on all trade receivables. The Group expects a significant impact on its equity due to the unsecured nature of its loans and receivables, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – January 1, 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to have an effect on the classification and measurement of the Group`s financial assets, but no impact on the classification and measurement of the Group`s financial liabilities. The Group expects a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward looking elements to determine the extent of the impact.

Amendments to IFRS 2 "Share-Based Payment" – The IASB have published final amendments to IFRS 2 "Share-based Payment" that clarify the classification and measurement of share-based payment transactions. Classification and Measurement of Share-based Payment Transactions contains the following clarifications and amendments:

Accounting for cash-settled share-based payment transactions that include a performance condition

Until issue of these amendments, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

Classification of share-based payment transactions with net settlement features

The IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

Accounting for modifications of share-based payment transactions from cash-settled to equity-settled

Until issue of these amendments, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognized in respect of the cash-settled share-based payment is derecognized and the equity-settled share-based payment is recognized at the modification date fair value to the extent services have been rendered up to the modification date;
- Any difference between the carrying amount of the liability as at the modification date and the amount recognized in equity at the same date would be recognized in profit and loss immediately.

The amendments are effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

IFRS 16 “Leases”, which specifies how and IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 16 was issued on January 13, 2016 and applies to an annual reporting period beginning on or after January 1, 2019.

IFRS 17 “Insurance contracts” was issued in May 2017 and replaced IFRS 4 “Insurance contracts”. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 “Insurance Contracts” to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

IFRIC 23 “Uncertainty over Income Tax Treatments” addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- whether tax treatments should be considered collectively;
- assumptions for taxation authorities’ examinations;
- the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- the effect of changes in facts and circumstances.

The interpretation applies to annual reporting periods beginning on or after January 1, 2019.

Annual Improvements to IFRS Standards 2015-2017 Cycle contains amendments to four International Financial Reporting Standards (IFRSs) as result of the IASB’s annual improvements project.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Standard	Subject of amendment
IFRS 3 "Business Combinations" and IFRS 11 "Joint Arrangements"	The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
IAS 12 "Income Taxes"	The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises.
IAS 23 "Borrowing Costs"	The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

The amendments are all effective for annual periods beginning on or after January 1, 2019.

Amendments to IAS 28 "Investments in Associations and Joint Ventures" – The IASB has published amendments to IAS 28 regarding the long-term interest in associates and joint Ventures. According to the amendment the entity should apply IFRS 9 to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendment is effective for annual periods beginning on or after January 1, 2019.

Amendments to IFRS 9 "Financial Instruments" – The IASB has published amendments to IFRS 9 regarding prepayment features with negative compensation and modifications of financial liabilities.

Prepayment Features with Negative Compensation amends the existing requirement of IFRS 9 regarding termination rights in order to allow measurement at amortized cost even in the case of negative compensation payments. The IASB also clarifies that the entity recognizes any adjustment to the amortized cost of the financial liability arising from a modification or exchange in profit or loss at the date of modification or exchange.

The amendment is effective for annual periods beginning on or after January 1, 2019.

6. RECLASSIFICATIONS

Certain reclassifications have been made to the consolidated financial statements as at December 31, 2016 to conform to the presentation as current year presentation provides better view of the consolidated statement of the financial position and consolidated statement of comprehensive income of the Group.

7. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Related parties are defined in IAS 24 "Related Party Disclosures". Parties are generally considered to be related if one party has the ability to control the other party, is under common control, 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. The Group's immediate parent and ultimate controlling party is the Government of Azerbaijan.

The Group applied the exemption in paragraph 25 of IAS 24 "Related Party Disclosures" regarding the disclosure requirement for government related entities.

A reporting entity is exempt from the disclosure requirements of paragraph 18 of IAS 24 "Related Party Disclosures" in relation to related party transactions and outstanding balances, including commitments, with:

(a) a government that has control or joint control of, or significant influence over, the reporting entity; and

(b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

The nature of transactions with government related entities include purchase of electricity, borrowings, government investments, sales, construction services, rendering and receiving other services, etc.

Compensation paid to directors for their services in full or part-time executive management positions is made up of a contractual salary. During the years ended December 31, 2017 and 2016 the remuneration of members of the key management included salaries and compensations classified as short-term in accordance with IAS 19 "Employee Benefits".

During the year ended December 31, 2017, the remuneration of key management personnel included salaries, discretionary bonuses and other short-term benefits totaling AZN 605 thousand (2016: AZN 305 thousand).

(In thousands of Azerbaijani Manats unless otherwise indicated)

8. PROPERTY, PLANT AND EQUIPMENT

Movements in the carrying amount of property, plant and equipment were as follows:

	Super-structure	Roadbed	Railway vehicles	Buildings and similar constructions	Operating equipment	Construction in progress	Other	Total
Initial cost								
January 1, 2016	**1,423,230**	**539,612**	**460,707**	**248,224**	**96,501**	**455,730**	**16,420**	**3,240,424**
Additions	632	200	87,246	13,694	58,171	689,018	3,806	852,767
Internal transfer	75,849	-	-	-	-	(75,849)	-	-
Disposals	(11,933)	-	(1,393)	(462)	(367)	-	(101)	(14,256)
Effect of translation to presentation currency	63	-	-	178	19	-	965	1,225
December 31, 2016	**1,487,841**	**539,812**	**546,560**	**261,634**	**154,324**	**1,068,899**	**21,090**	**4,080,160**
Additions	12,741	-	41,072	5,815	35,500	522,538	5,912	623,578
Internal transfer	250,252	-	-	21,165	1,098	(272,515)	-	-
Disposals	(26,033)	-	(2,124)	(407)	(1,609)	-	(1,644)	(31,817)
Effect of translation to presentation currency	-	-	62	4	12	-	7	85
December 31, 2017	**1,724,801**	**539,812**	**585,570**	**288,211**	**189,325**	**1,318,922**	**25,365**	**4,672,006**
Accumulated depreciation								
January 1, 2016	**(411,688)**	**(71,201)**	**(112,041)**	**(47,241)**	**(48,766)**	**(40,519)**	**(10,462**	**(741,918)**
Charge for the year	(79,039)	(5,991)	(50,820)	(6,790)	(13,926)	-	(3,375)	(159,941)
Impairment charge	(82,710)	(37,746)	-	(17,119)	(7,496)	(83,723)	(591)	(229,385)
Eliminated on disposal	7,372	-	558	462	246	-	78	8,716
Effect of translation to presentation currency	(3)	-	-	(3)	(1)	-	(126)	(133)
December 31, 2016	**(566,068)**	**(114,938)**	**(162,303)**	**(70,691)**	**(69,943)**	**(124,242)**	**(14,476**	**(1,122,661**
Charge for the year	(89,873)	(5,991)	(54,777)	(7,579)	(19,363)	-	(4,249)	(181,832)
Impairment charge	(85,004)	(32,887)	(29,095)	(16,499)	(7,939)	(93,795)	(589)	(265,808)
Eliminated on disposal	13,862	-	2,124	215	1,101	-	859	18,161
Effect of translation to presentation currency	-	-	(27)	-	(1)	-	(3)	(31)
December 31, 2017	**(727,083)**	**(153,816)**	**(244,078)**	**(94,554)**	**(96,145)**	**(218,037)**	**(18,458**	**(1,552,171**
Net book value:								
December 31, 2017	**997,718**	**385,996**	**341,492**	**193,657**	**93,180**	**1,100,885**	**6,907**	**3,119,835**
December 31, 2016	**921,773**	**424,874**	**384,257**	**190,943**	**84,381**	**944,657**	**6,614**	**2,957,499**

During the year ended December 31, 2017 the Group purchased and put into use a ballast railway cleaning machine, a machine for railway construction and a crane on the rail track of the railway between Baku and Beyuk-Kyasik. The major part of these transactions were financed by the loan attracted from HSBC Bank plc.

During the year ended December 31, 2017 the Group repaired 8 passenger cars. Capital repair works were performed by M Steel Project a.s. and financed by the loan attracted from HSBC Bank plc.

During the year ended December 31, 2016 the Group purchased and put into use two ballast dozer, two machines with towing and buffer equipment, a machine for renewal of ties, a dynamic stabilizer on the rail track of the railway between Baku and Beyuk-Kyasik and two Stadler 4-Car double deck electrical multiple units type KISS trains on Baku-Sumgait mainline track. The operations were financed by the loan attracted from HSBC Bank plc and “Credit Suisse” AG.

During the years ended December 31, 2016 and December 31, 2015 the Group also purchased and put into use 600 tank wagons for oil and petroleum transportations, 401 covered wagons, 1000 open-top wagons, 400 multi-purpose flat wagons, 300 grain wagons, 100 cement hopper wagon, 200 container flat wagon and 100 ballast hopper wagon from UVZ International s.a.r.l.

Ten diesel locomotives have been leased from Hanseatic Rail LLC and put into use during the year ended December 31, 2016.

As described in Note 3, as at December 31, 2017, the Group performed impairment test on CGU level and as a result recognized impairment losses for property, plant and equipment during 2017 in the amount of AZN 265,808 thousand (2016: AZN 229,385 thousand).

As at December 31, 2017 and 2016, property, plant and equipment with the carrying amounts of AZN 123,954 thousand (EUR 63,651 thousand as per contract), AZN 5,269 thousand (USD 3,096 thousand and AZN 5,482 thousand as per contract) and AZN 14,945 thousand were pledged as collateral under the borrowings obtained from Credit Suisse AG, “Azer Turk Bank” OJSC and other banks, respectively.

Property, plant and equipment as at December 31, 2017 include borrowing costs incurred in connection with the construction of property, plant and equipment. Borrowing costs capitalized as property, plant and equipment during 2017 amounted to AZN 8,928 thousand (2016: AZN 4,841 thousand).

The historical cost of items held under finance leases at December 31, 2017 and 2016 was AZN 79,091 thousand. Leased assets are pledged as security for the related finance lease.

As at December 31, 2017 depreciation charge in the amount of AZN 6,310 thousand was included in the cost of construction in progress (2016: AZN 2,447 thousand).

Disposal of property, plant and equipment was partly written off through profit or loss under loss on disposal of property, plant and equipment and partly written-off to the inventory account.

(In thousands of Azerbaijani Manats unless otherwise indicated)

9. INTANGIBLE ASSETS

	Intangible assets
Initial cost	
January 1, 2016	**515**
Additions	82
December 31, 2016	**597**
Additions	107
December 31, 2017	**704**
Accumulated amortization	
January 1, 2016	**(71)**
Amortization charge	(106)
December 31, 2016	**(177)**
Amortization charge	(134)
December 31, 2017	**(311)**
Net book value:	
December 31, 2017	**393**
December 31, 2016	**420**

10. PREPAYMENT FOR PROPERTY, PLANT AND EQUIPMENT

The prepayment for property, plant and equipment in the amount of AZN 277,660 thousand and AZN 325,114 thousand as at December 31, 2017 and 2016, respectively, mainly represents the outstanding prepayments related to the purchase of freight locomotives from Alstom Transportand S.A., railroad passenger cars from "Stadler", as well as works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik.

11. INCOME TAXES

The Group measures and records its current income tax payable and its tax bases related to assets and liabilities in accordance with the statutory tax regulations of the Republic of Azerbaijan and the Republic of Georgia where the Group operates, which differ from IFRS.

The Group is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2017 and 2016 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by taxation bases' differences for certain assets.

Tax legislation of the CIS region in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Group may be assessed additional taxes, penalties and interest which could be material for these financial statements.

Temporary differences as at December 31, 2017 and 2016 comprise:

	December 31, 2017	December 31, 2016
Deductible temporary differences:		
Tax losses carry forward	478,996	653,802
Other non-current liabilities	20,118	22,822
Loans receivable	135,186	114,209
Trade and other payables	29,227	12,517
Other current assets	32,000	23,727
Borrowings	26,880	12,763
Trade and other receivables	93,178	90,868
Inventories	3,928	6,126
Total deductible temporary differences	**819,513**	**936,834**
Taxable temporary differences:		
Property, plant and equipment	(279,148)	(675,133)
Total taxable temporary differences	**(279,148)**	**(675,133)**
Net deductible temporary differences	540,365	261,701
Net deferred tax asset at the statutory tax rate (20%)	108,073	52,340
Deferred tax asset not recognized	(106,369)	(49,238)
Net deferred tax asset	**1,704**	**3,102**

Relationships between tax benefit and accounting loss for the year ended December 31, 2017 and 2016 are explained as follows:

	Year ended December 31, 2017	Year ended December 31, 2016
Loss before income tax	**(553,234)**	**(565,636)**
Theoretical tax charge at statutory rate of 20%	110,647	113,127
Valuation allowance for deferred tax assets	(112,513)	(43,680)
Tax effect of permanent differences	(443)	(497)
Income tax (expense)/benefit	**(2,309)**	**68,950**
Current income tax expense	(911)	(545)
Deferred income tax (expense)/benefit	(1,398)	69,495
Income tax (expense)/benefit	**(2,309)**	**68,950**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Deferred income tax asset/(liability)	December 31, 2017	December 31, 2016
Beginning of the period	**3,102**	**(66,393)**
Change in the deferred income tax liability for the period charged to profit and loss accounts	(1,398)	69,495
End of the period	**1,704**	**3,102**

Valuation allowance for deferred tax assets	December 31, 2017	December 31, 2016
Beginning of the period	**(49,238)**	**(5,558)**
Valuation allowance	(112,513)	(43,680)
Write off of deferred tax assets	55,382	-
End of the period	**(106,369)**	**(49,238)**

12. INVENTORIES

	December 31, 2017	December 31, 2016
Spare parts and construction materials	80,097	57,449
Inventories held for sale	6,804	11,491
Fuel	1,789	961
Office supplies	197	100
Uniforms	102	99
Other	425	489
Less: Provision for obsolete and damaged inventories	(8,238)	(12,500)
Total inventories	**81,176**	**58,089**

Movements of provision for obsolete and damaged inventories are as follow:

	December 31, 2017	December 31, 2016
Provision at the beginning of the year	(12,500)	(33,777)
Loss on damaged and obsolete inventories	(391)	(70)
Disposal of assets	4,653	21,347
Provision at the end of the year	**(8,238)**	**(12,500)**

(In thousands of Azerbaijani Manats unless otherwise indicated)

13. LOANS RECEIVABLE

	December 31, 2017	December 31, 2016
Loans receivable	184,538	175,027
Less: Provision for impairment losses	(135,186)	(114,210)
Total loans receivable	**49,352**	**60,817**

As at December 31, 2017 the Group had loans receivable in the amount of AZN 184,538 thousand (2016: AZN 175,027 thousand). The management provided allowance against these receivables as at December 31, 2017 and 2016 in the amount of AZN 135,186 thousand and AZN 114,210 thousand, respectively.

The net amount represents interest free loans granted to the entities in the amount of AZN 21,523 thousand (2016: AZN 43,697 thousand) and interest bearing loans (12% annual) granted to the entities regarding construction of Baku-Tbilisi-Kars railway route in the amount of AZN 27,829 thousand (2016: AZN 17,120 thousand) as at December 31, 2017.

14. TRADE AND OTHER RECEIVABLES

	December 31, 2017	December 31, 2016
Receivables from cargo services	135,802	110,518
Receivables from other services	10,852	8,454
Receivables from construction services	5,630	1,947
Receivables from security services	140	445
Other receivables	2,727	1,066
Less: Provision for impairment	(93,178)	(90,868)
Total trade and other receivables	**61,973**	**31,562**

Movements of provision for impairment recognized for receivables are as follow:

	December 31, 2017	December 31, 2016
Allowance for bad debts at the beginning of the year	(90,868)	(41,344)
Bad debt expense	(2,310)	(46,104)
Recovery of assets previously written off	-	(3,420)
Allowance for bad debts at the end of the year	**(93,178)**	**(90,868)**

(In thousands of Azerbaijani Manats unless otherwise indicated)

15. CASH AND CASH EQUIVALENTS

	December 31, 2017	December 31, 2016
Cash in bank accounts	46,880	146,989
Cash on hand	2,508	768
Total cash and cash equivalents	**49,388**	**147,757**

16. OTHER CURRENT ASSETS

	December 31, 2017	December 31, 2016
Prepayment for inventories and services	85,664	89,695
Restricted current accounts in banks	53,372	-
Input VAT	8,801	5,270
VAT receivable	5,781	-
Prepaid expenses	696	721
Advances to employees	367	362
Other prepaid taxes	522	8
Less: Provision for impairment	(39,113)	(30,840)
Total other current assets	**116,090**	**65,216**

Prepayments for inventories and services mainly comprise prepayments for the inventories and services related to the refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik, Baku-Sumgait mainline track and Baku-Tbilisi-Kars railway route.

Restricted current accounts in banks in the amount of AZN 53,372 thousand are related to the repayments of borrowings mainly from BNP Paribas (Suisse) S.A., Ceska Sporitelna S.A and Ceskoslovenska Obchodni S.A.

17. BORROWINGS

The borrowings as at December 31, 2017 comprise:

Lender name	Effective interest rate	Initial disbursed amount in Original CCY in thousands	CCY type	Outstanding amount in AZN in thousands	Origination date per contract/ amendment	Final maturity date
BNP Paribas (Suisse) S.A.						
Loan 1	Libor+3.75%	180,000	USD	92,655	Sep-28-2015	Feb-28-2020
VTB Bank Austria						
Loan 1	5.75%	195,000	USD	70,888	Feb-13-2014	Feb-25-2019
Credit Suisse AG						
Loan 1	Euribor+1.15%	73,735	EUR	127,589	Jun-15-2015	Jan-31-2030
Loan 2	Euribor+3%	11,194	EUR	10,771	Jun-15-2015	Jun-30-2020
HSBC Bank plc						
Loan 1	Euribor+1%	243,445	EUR	467,931	Apr-14-2015	Jun-30-2025
Loan 1	Euribor+1%	72,982	EUR	116,304	Apr-14-2015	Jan-31-2027
Ceska Sporitelna S.A						
Loan 1	Euribor+1.45%	64,039	EUR	117,757	Feb-25-2016	Feb-2-2022
Ceskoslovenska Obchodni S.A						
Loan 1	Euribor+1.45%	82,000	EUR	166,631	Feb-26-2016	Aug-26-2022
Societe Generale						
Loan 1	Euribor+1%	99,698	EUR	204,505	Mar-30-2016	Oct-15-2031
"Kapital Bank" OJSC						
Loan 1	4.6%	136,579	USD	233,176	Jul-4-2017	Jul-4-2019
"International Bank of Azerbaijan" OJSC						
Loan 1	4%	49,500	USD	82,538	Jul-18-2017	Jul-18-2020
"Demir Bank" OJSC (currently under liquidation)						
Loan 1	14%	7,500	USD	2,550	Feb-24-2015	Dec-31-2017
"Bayburt Group Construction" Ltd.						
Loan 1	0%	15,455	EUR	3,259	May-17-2016	May-17-2026
"Agrar Credit" NBCO						
Loan 1	4.5%	9,495	AZN	7,859	Jan-26-2017	Jan-26-2019
The Government of the Republic of Azerbaijan						
Loan 1	Libor+Variable Spr	21,554	USD	36,643	Sep-18-2009	Dec-15-2030
Loan 2	0.2%	39,739	EUR	80,698	Nov-1-2015	Jul-31-2021
Loan 3	0%	10,000	EUR	20,307	Apr-7-2016	Apr-7-2020
Loan 4	1%	213,000	USD	362,280	Dec-15-2017	Jun-15-2032
Loan 5	1%	344,000	AZN	344,424	Dec-15-2017	Jun-15-2031
TOTAL				**2,548,765**		

The borrowings as at December 31, 2016 comprise:

Lender name	Effective interest rate	Initial disbursed amount in Original CCY in thousands	CCY type	Outstanding amount in AZN in thousands	Origination date per contract/ amendment	Final maturity date
BNP Paribas (Suisse) S.A.						
Loan 1	Libor+3.75%	180,000	USD	178,602	Sep-28-2015	Feb-28-2020
VTB Bank Austria						
Loan 1	5.75%	195,000	USD	169,986	Feb-13-2014	Feb-25-2019
Credit Suisse AG						
Loan 1	Euribor+1.15%	73,735	EUR	117,140	Jun-15-2015	Jan-31-2030
Loan 2	Euribor+3%	11,194	EUR	13,845	Jun-15-2015	Jun-30-2020
HSBC Bank plc						
Loan 1	Euribor+1%	174,650	EUR	325,618	Apr-14-2015	Jun-30-2025
Cargill Financial Services International, Inc.						
Loan 1	Libor+5.5%	13,689	USD	24,239	Dec-29-2016	Dec-15-2017
Loan 2	Libor+5.5%	13,689	USD	24,239	Dec-29-2016	Dec-19-2017
Loan 3	Libor+5.5%	10,936	USD	19,365	Dec-29-2016	Dec-22-2017
Loan 4	Libor+5.5%	8,745	USD	15,485	Dec-29-2016	Dec-27-2017
Loan 5	Libor+5.5%	10,936	USD	19,365	Dec-29-2016	Dec-29-2017
Ceska Sporitelna S.A						
Loan 1	Euribor+1.45%	61,279	EUR	114,561	Feb-25-2016	Feb-2-2022
Ceskoslovenska Obchodni S.A						
Loan 1	Euribor+1.45%	65,885	EUR	122,921	Feb-26-2016	Aug-26-2022
Societe Generale						
Loan 1	Euribor+1%	99,698	EUR	186,181	Mar-30-2016	Oct-15-2031
"Kapital Bank" OJSC						
Loan 1	4.3%	50,000	USD	85,849	Feb-11-2016	Feb-11-2019
Loan 2	5.4%	94,990	USD	168,198	Apr-5-2016	Apr-5-2019
Loan 3	5.4%	14,749	USD	7,871	Apr-5-2016	Jun-3-2016
"International Bank of Azerbaijan" OJSC						
Loan 1	16%	10,000	AZN	7,779	Mar-3-2014	Mar-3-2016
Loan 2	4.5%	59,697	USD	45,880	Mar-11-2014	Mar-11-2017
Loan 3	16%	193	USD	342	Feb-3-2015	Feb-3-2016
Loan 4	3%	35,000	USD	59,628	Oct-30-2015	Apr-30-2017
"Demir Bank" OJSC (currently under liquidation)						
Loan 1	14%	7,500	USD	7,947	Feb-24-2015	Dec-31-2017
"Azer Turk Bank" OJSC						
Loan 1	8%	3,000	USD	5,312	Aug-25-2015	Aug-25-2016
"Karvan Logistics" LLP						
Loan 1	0%	15,455	EUR	28,815	May-17-2016	May-17-2026
The Government of the Republic of Azerbaijan						
Loan 1	Libor+Variable Spr	18,058	USD	31,975	Sep-18-2009	Dec-15-2030
Loan 2	0.2%	39,739	EUR	74,089	Nov-1-2015	Jul-31-2021
Loan 3	0%	10,000	EUR	18,644	Apr-7-2016	Apr-7-2020
TOTAL				**1,873,876**		

(In thousands of Azerbaijani Manats unless otherwise indicated)

A reconciliation of the opening and closing amounts of borrowings with relevant cash and non-cash changes from financing activities is stated below:

January 1, 2017	1,873,876
Cash changes	
Proceeds	1,249,368
Repayment	(799,613)
Interest paid	(65,038)
Non-cash changes	
Proceeds	162,144
Repayment	(30,479)
Interest expense	85,901
Effect of foreign exchange differences	72,606
December 31, 2017	**2,548,765**

BNP Paribas (Suisse) S.A.

In 2008, the Group signed a long term loan facility agreement with "BNP Paribas" (Suisse) S.A. for the amount of USD 220,000 thousand with two tranches. The attracted funds were directed towards (a) the purchase of transport and other capital equipment, (b) short-term debt refinancing, (c) general corporate purposes and (d) to pay any commitment fees.

In 2010, the Group signed an addendum to the main agreement and the loan facility amount was amended to the USD 295,000 thousand with two additional tranches.

On December 1, 2014, BNP Paribas, Sumitomo Mitsui Banking Corporation Europe limited, Siemens Bank Gmbh, Banque Cantonale de Geneve (BCGE) provided credit line in the amount of USD 180,000 thousand, in order to reorganize debt finance of the Group and on September 28, 2015, the Group signed an addendum to the credit line agreement and payment terms were amended.

On April 21, 2017 the Group signed an amendment to the agreement with BNP Paribas (Suisse) S.A. According to the amendment, grace period granted till July, 2018 and monthly principal payments reduced from USD 2,600 thousand to USD 1,000 thousand starting from July, 2018. The Group will make bulk repayment in the amount of USD 35,500 thousand on February, 2020.

The information about effective interest rates are described in the table above.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with "BNP Paribas" (Suisse) S.A. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2017 and 2016. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

VTB Bank (Austria) AG

In 2013, the Group entered into USD 120,000 thousand and USD 20,000 thousand loan agreement and supplemental agreement, respectively with VTB Bank (Austria) AG. The amounts borrowed were partly utilized in financing of capital expenditure of the Group and restructuring of other borrowings with higher interest rates. In 2014, the Lender agreed to increase the amount of facility to USD 195,000 thousand by making available to the Group a further loan in an aggregate of USD 55,000 thousand.

According to the Key Restructuring Terms agreed with VTB Bank (Austria) AG on May 2017, the Group has repaid principal amounts of USD 15,000 thousand and USD 8,000 thousand on May and June 2017, respectively. Subsequently on July 13, 2017, the Group signed "Second Amendment and Restatement Agreement". According to the agreement, starting from July 2017 the Group has to repay monthly principal in the amount of USD 1,000 thousand till January 2019. The Group will make bulk repayment in the amount of USD 28,670 thousand on February, 2019. The new effective interest rate is 5.75%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with VTB Bank (Austria) AG. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2017 and 2016. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

Credit Suisse AG

On June 15, 2015 the Group signed an export credit facility agreement with Credit Suisse AG for the amount of up to EUR 73,735 thousand. The amounts borrowed were used for the financing of five Stadler 4-Car double deck electrical multiple units type KISS trains. The loan matures in 2030 and bears annual interest rate of Euribor + 1.15%.

On June 15, 2015 the Group also signed a commercial loan agreement with Credit Suisse AG for the amount of up to EUR 11,194 thousand in connection with the financing of five Stadler 4-Car double deck electrical multiple units type KISS trains. The loan matures in 2020 and bears annual interest rate of Euribor + 3%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with Credit Suisse AG. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2017 and 2016. The Management believes that breach of covenants would not lead to early withdrawal of these borrowings and therefore these borrowings are classified according to their original payment schedules in the liquidity analysis.

HSBC Bank plc

On April 14, 2015 the Group signed a credit facility agreement with HSBC Bank plc for the amount of EUR 458,861 thousand. The amounts borrowed were directed for the financing of the rehabilitation of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The loan matures in 2025, bears annual interest rate of Euribor + 1% and is guaranteed by the government.

The credit facility in an aggregate amount of EUR 458,861 thousand available in two tranches is as follows:

- a tranche in an aggregate amount of EUR 243,445 thousand, and
- a tranche in an aggregate amount of EUR 215,416 thousand.

The Group is obliged to comply with certain covenants as stipulated in the loan agreement signed with HSBC Bank plc. The Group complied with financial covenants stipulated in the loan agreement as at December 31, 2017 (the Group failed to comply with some covenants stipulated in the loan agreement as at December 31, 2016).

Cargill Financial Services International, Inc.

On December 29, 2016 the Group signed five credit facility agreements with Cargill Financial Services International, Inc. for the total amount of USD 57,995 thousand. The amounts borrowed were directed for the financing of the construction of railways, reconstruction of rail cars and core activity on provision of transportation services to exporters.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreements signed with Cargill Financial Services International, Inc. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2016.

On December 18, 2017 the Group has repaid all borrowed amounts from Cargill Financial Services International, Inc. with the new loan received from Ministry of Finance in the amount of USD 213,000 thousands.

Ceska Sporitelna S.A

On February 25, 2016 the Group signed a credit facility agreement with Ceska Sporitelna S.A. for the amount of EUR 64,051 thousand. The amount borrowed was directed towards the modernization and reconstruction of up to 50 km Baku-Sumgait mainline track in the Republic of Azerbaijan and delivery of special machinery, technology and services. The loan matures in 2022 and bears annual interest rate of Euribor+1.45%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreements signed with Ceska Sporitelna S.A. The Group complied with financial covenants stipulated in the loan agreement as at December 31, 2017 (the Group failed to comply with some covenants stipulated in the loan agreement as at December 31, 2016).

Ceskoslovenska Obchodni S.A

On February 26, 2016 the Group signed a credit facility agreement with Ceskoslovenska Obchodni S.A for the amount of EUR 82,000 thousand. The amount borrowed was directed towards the modernisation and reconstruction of 8.3 km railway from Azerbaijan to Iran and delivery of special machinery, technology and services. The loan matures in 2022 and bears annual interest rate of Euribor+1.45%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreements signed with Ceskoslovenska Obchodni S.A. The Group complied with financial covenants stipulated in the loan agreement as at December 31, 2017 (the Group failed to comply with some covenants stipulated in the loan agreement as at December 31, 2016).

Societe Generale

On March 30, 2016 the Group signed a credit facility agreement with Societe Generale for the amount of EUR 276,995 thousand. The amount borrowed was directed towards the purchase of 50 locomotives from Alstom Transport S.A. The loan matures in 2031 and bears annual interest rate of Euribor+1%.

The Group is obliged to comply with certain financial covenants as stipulated in the loan agreement signed with Societe Generale. The Group complied with financial covenants stipulated in the loan agreement as at December 31, 2017 and 2016.

On March 30, 2016 the Ministry of Finance of the Republic of Azerbaijan signed a government guarantee contract with the parties acting as a government guarantor for the Group.

"Kapital Bank" OJSC

On February 11, 2016 and on April 5, 2016 the Group signed credit facility agreements with "Kapital Bank" OJSC for the amounts of USD 50,000 thousand and USD 14,749 thousand, respectively. The amounts borrowed were directed for the enhancement of operations and general corporate purposes. The loans mature in 2019 and bear annual interest rate of 4.3% and 5.4%, respectively.

On April 5, 2016, the Group signed loan restructuring agreement with "Kapital Bank" OJSC to the main agreements signed in the prior years in the amount of USD 10,750 thousand, USD 15,000 thousand, USD 5,000 thousand and USD 73,000 thousand. The loan agreement amount was amended to USD 94,990 thousand with interest rate of 5.4%, which matures in 2019.

On July 4, 2017, the Group signed loan restructuring agreement with "Kapital Bank" OJSC to the main agreements signed in the prior years in the amount of USD 50,000 thousand and USD 94,990 thousand. The loan agreement amount was amended to USD 136,579 thousand with interest rate of 4.6%. The Group will repay monthly interest and bulk principal repayment will be made after 2 years from restructuring date. The new effective interest rate is 4.6%.

"International Bank of Azerbaijan" OJSC

In 2014 and 2015 the Group obtained 7 loans from "International Bank of Azerbaijan" OJSC. The amounts borrowed were directed for the financing of capital expenditures, construction of Baku-Tbilisi-Kars railway route and general corporate purposes.

On April 28, 2017 the Group also signed a credit agreement with "International Bank of Azerbaijan" OJSC for the amount of USD 200,000 thousand. On July 27, 2017, the Group signed an addendum to the main agreement and the loan maturity date was amended to September 28, 2017. The loan bears annual interest rate of 1.25%. On November 16, 2017 the Group has repaid the loan with the proceeds from credit agreement signed with Ministry of Finance in the amount of AZN 344,000 thousands.

On July 14, 2017, the Group signed loan restructuring agreement with "International Bank of Azerbaijan" OJSC. According to the agreement loans received from the bank in prior years (in the amount of USD 35,000 thousand, USD 59,697 thousand, USD 193 thousand, AZN 10,000 thousand) and also loans received from "Azer-Turk Bank" OJSC in the amount of USD 3,000 thousand were consolidated as a single loan. The Group will repay interest on annual basis and bulk principal repayment will be made at the end of 3 year grace period. The new effective interest rate is 4%.

More detailed information about these loans is described in the table above. No financial covenants were stipulated in the borrowing agreements with "International Bank of Azerbaijan" OJSC.

The Government of the Republic of Azerbaijan

On December 18, 2009, the Government of the Republic of Azerbaijan and the International Bank for Reconstruction and Development (the "IBRD") have agreed to lend a credit facility in the amount equivalent to USD 450,000 thousand in order to finance "Rail Trade and Transport Facilitation project of the Republic of Azerbaijan". The Project's original completion date of September 30, 2013 has been extended to December 31, 2017 on September 17, 2013. The Project's four month grace period for making last disbursement date has been ended on April 30, 2018.

On June 27, 2013, the Government of the Republic of Azerbaijan and the IBRD agreed to restructure the Project by providing additional financing in the amount of USD 220,000 thousand and extending the closing date to December 31, 2017. The additional financing was planned to be used for full replacement of power supply and signalling systems on the East-West Main Line. The IBRD and the Group agreed on cancellation as of May 17, 2018 the undisbursed credit line balance of USD 119,757 thousand and USD 128,350 thousand from the loan accounts "Rail Trade and Transport Facilitation Project – Loan No 7509-AZ" and "Rail Trade and Transport Facilitation Project – Loan No 8282-AZ".

The objective of the project is to improve railway services in the Republic of Azerbaijan, as well as the competitiveness, financial sustainability, operating and cost efficiency and capacity of the Group in particular along the east-west transport corridor.

The Project consists of the following components:

Component 1: Rehabilitation of East-West Main Line

Provision of goods, works and services to: (a) rehabilitate about 240 km of mainline track; (b) convert power supply on the East-West Main Line; and (c) upgrade signalling, compatible with new 25kV AC power supply system.

On June 27, 2013 the IBRD and the Government of Republic of Azerbaijan agreed to restructure the Loan Agreement and correspondently, additional 298 km of mainline track was included in the scope of Component 1.

Component 2: New Mainline Locomotives

Provision of goods and services in order to provide mainline 25kV AC electric locomotives to operate on the east-west corridor.

The Government of the Republic of Azerbaijan and IBRD agreed to finance the new mainline locomotives directly using the funds of the Government of Republic of Azerbaijan and requested the IBRD to reallocate USD 202,000 thousand to the rehabilitation of the East-West mainline of Component 1.

Component 3: Modernization of Azerbaijan Railway Services

Provision of goods, works, services and training in order to: (a) support the implementation of the restructuring and development of Azerbaijan Railways, including, but not limited to, for the transition to the IFRS and legal restructuring of the Azerbaijan Railways; and (b) improve its oil spill prevention capacity.

Component 4: Project Implementation

Support of the Project Implementation Unit for effective implementation of the Project, through provision of goods, consultants' services and training.

The loan facility was expected to be used as follows:

	Allocation of the Loan (expressed in thousands USD)				**Percentage of expenditure to be financed by IBRD**
	Original	**Revised original**	**Additional financing**	**Total**	
(1) Goods, works, consultants' services, training and incremental operating costs for Component 1 of the Project	232,875	434,875	211,950	646,825	100%
(2) Goods for Component 2 of the Project	202,000	-	-	-	0%
(3) Goods, works, consultants' services, training and incremental operating costs for Components 3 and 4 of the Project	14,000	14,000	7,500	21,500	85%
(4) Front-end fee	1,125	1,125	550	1,675	0.25% of the total disbursement
TOTAL	**450,000**	**450,000**	**220,000**	**670,000**	

Following this agreement, the Group signed project agreement with Government of the Republic of Azerbaijan on the same date and loan agreement with the Government subsequently.

According to the loan agreement, the Group takes obligation for the repayment of financing to be received from IBRD for the Component 3 in the amount of USD 21,500 thousand and for the Component 4 in the amount of USD 54 thousand and related interest costs.

The Government of the Republic of Azerbaijan in its turn takes obligation for the repayment of financing to be received from IBRD for the Component 1 in the amount of USD 646,825 thousand and for the Component 4 in the amount of USD 1,621 thousand and related interest costs.

The interest rate was determined as Libor+Variable Spread. Variable Spread is the rate to be effective on the repayment dates of loan, which is determined by the IBRD semi-annually.

The Group is obliged to comply with certain financial covenants as stipulated in the project agreement in connection with loan agreement signed with IBRD. The Group failed to comply with some financial covenants stipulated in the loan agreement as at December 31, 2017 and 2016.

On November 1, 2015 the Group signed a loan agreement with the Ministry of Finance of the Republic of Azerbaijan for the amount of EUR 39,739 thousand. The amounts borrowed were directed for the financing of the rehabilitation of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The loan matures in 2021 and bears annual interest rate of 0.2%.

On April 7, 2016 the Group signed a credit line agreement with the Ministry of Finance of the Republic of Azerbaijan and "International Bank of Azerbaijan" OJSC, acting as arranger for the amount of EUR 10,000 thousand. The amounts borrowed were directed for the financing of the rehabilitation of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik. The loan matures in 2020.

On November 15, 2017 the Group signed an agreement with the Ministry of Finance in the amount of AZN 344,000 thousands. The amounts borrowed were directed for repayment of borrowing received from "International Bank of Azerbaijan" on April 28, 2017 in the amount of USD 200,000 thousand. According to the agreement, grace period for principal repayment was granted till December 2021 and scheduled to be repaid on semi-annual basis. Interest repayment will start from July 2018 and also scheduled to be repaid on semi-annual basis. The maturity date is June 15, 2031. The effective interest rate is 1% per annum.

On December 18, 2017 the Group signed an agreement with the Ministry of Finance in the amount of USD 213,000 thousands. The amounts borrowed were directed for repayment of borrowing received from Cargill Financial Services International Inc. and trade payable to UVZ International s.a.r.l.. According to the agreement, grace period for principal repayment was granted till December 2022 and scheduled to be repaid on semi-annual basis. Interest repayment will start from June 2018 and also scheduled to be repaid on semi-annual basis. The maturity date is June 15, 2032. The effective interest rate is 1% per annum.

No covenants were stipulated in the borrowing agreement with this lender.

Other loans

During the years ended December 31, 2017 and 2016, the Group also obtained general purpose loans from "Agrarcredit" CJSC NBCO and "Karvan Logistics" LLP, "Azer-Turk Bank" OJSC, "DemirBank" OJSC (currently under liquidation), and "International Bank of Azerbaijan-Georgia" OJSC, respectively.

(In thousands of Azerbaijani Manats unless otherwise indicated)

On July 19, 2016 the Group signed a tripartite credit agreement with "Karvan Logistics" LLP and "Bayburt Group Construction" Ltd. for the amount of EUR 15,455,000. The subject of the contract is the regulation of relationships regarding the transfer of the claim rights arising out interest-free loan agreement between the Group and "Karvan Logistics" LLP dated May 17, 2016. The contract is effective on the date of its signing and shall be valid till the parties fulfil their obligations.

The Group was the guarantor of the loan taken by "Transoil" LLC from "International Bank of Azerbaijan" OJSC on February 24, 2014 for the amount of AZN 15,000 thousand. On August 11, 2015 the loan was transferred from "International Bank of Azerbaijan" OJSC to "Agrarcredit" CJSC NBCO. On January 26, 2017 the Group signed a resolution with "Agrarcredit" CJSC NBCO for the amount of AZN 9,495 thousand for the non-repaid portion of the loan.

The information about these loans are described in the table above. No financial covenants were stipulated in the borrowing agreements with these lenders.

18. FINANCE LEASE OBLIGATIONS

The Group entered into finance lease agreement with "Hanseatic Rail" LLC and "Hanseatic Transport" LLC for purchase of 4 electric locomotives in 2015 and 50 passenger wagons in 2013, respectively. The lease term is 6.5 years and 8.5 years with the effective interest rate of 4% and 12%, respectively. The Group also entered into finance lease agreement with BRK Leasing LLC for purchase of 10 highway diesel locomotives in 2015. The lease term is 10 years with the effective interest rate of 5.85%.

On August 18, 2017, the Group signed lease restructuring agreement with Hanseatic Transport LLC. According to the new agreement the Group made a bulk repayment in the amount of USD 8,775 thousand and new repayment schedule was created, also interest rate decreased from 12% to 5%.

The present value of the net minimum lease payments as at December 31, 2017 and 2016 are as follows:

	December 31, 2017	December 31, 2016
Finance lease liabilities:		
Not later than 1 year	17,662	28,793
Later than 1 year and not later than 5 years	51,077	87,671
Total minimum lease payments	**68,739**	**116,464**
Less: unearned finance income	(10,225)	(19,910)
	58,514	**96,554**
Representing lease liabilities:		
Current	14,804	21,633
Non-current	43,710	74,921
Total	**58,514**	**96,554**

Finance charges for the year ended December 31, 2017 amounted to AZN 7,956 (year ended December 31, 2016: AZN 8,920 thousand) and are included in "interest expense" line in the consolidated statement of comprehensive income.

(In thousands of Azerbaijani Manats unless otherwise indicated)

A reconciliation of the opening and closing amounts of finance lease obligations with relevant cash and non-cash changes from financing activities is stated below:

January 1, 2017	96,554
Cash changes	
Repayment	(34,532)
Interest paid	(7,956)
Non-cash changes	
Interest expense	7,956
Effect of foreign exchange differences	(3,508)
December 31, 2017	**58,514**

19. TRADE AND OTHER PAYABLES

	December 31, 2017	December 31, 2016
Payables for property, plant and equipment, current	1,602	62,133
Payables for construction work	57,301	59,377
Trade payables for inventories and other services	55,171	46,309
Payables for other services	32,991	46,486
Payables for electricity	2,255	2,909
Other payables	4,488	4,398
Total trade and other payables, current	**153,808**	**221,612**
Payables for property, plant and equipment, non-current	-	164,537
Payables for other services, non-current	-	10,538
Total trade and other payables, non-current	**-**	**175,075**

Payables for property, plant and equipment includes interest-bearing payables to UVZ International S.a.r.l. for purchase of new 3,101 multipurpose wagons of various models. In accordance with Annex #1 to the contract, the supplier provided the Group with an instalment payment opportunity for the period of 5 years at the annual interest rate of 20%.

Payables for other services include payables to “Georgian Railways” JSC for rent of railway vehicles in the amount of AZN 11,205 thousand and AZN 12,533 thousand as at December 31, 2017 and 2016, respectively.

20. OTHER NON-CURRENT LIABILITIES

	December 31, 2017	December 31, 2016
Provision for construction losses	2,721	4,876
Warranty provision	17,398	17,946
Total other non-current liabilities	**20,119**	**22,822**

(In thousands of Azerbaijani Manats unless otherwise indicated)

21. TAXES PAYABLE OTHER THAN INCOME TAX

	December 31, 2017	December 31, 2016
VAT payable	-	4,763
Customs fee payable	4,093	4,093
Social tax payable	4,095	1,976
Personal income tax payable	-	39
Total taxes payable other than income tax	**8,188**	**10,871**

22. ADVANCES RECEIVED

The advances received in the amount of AZN 101,852 thousand as at December 31, 2017 represented the outstanding advances related to the "Construction of Baku-Tbilisi-Kars railway route", works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik, as well as advances received for logistic services which will be provided by ADY Express LLC (2016: AZN 138,324 thousand related to the "Construction of Baku-Tbilisi-Kars railway route" and works and services for a complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik).

23. SHARE CAPITAL

On August 10, 2017, the Cabinet of Ministers of the Republic of Azerbaijan introduced an amendment to the resolution on approval of the charter and structure of the Company, dated February 15, 2010.

Authorized share capital of the Group increased by AZN 79,915 thousand and equalled to AZN 806,062 thousand through transfer of the amounts invested by the Government to the share capital. Accordingly, the number of the Group's shares in circulation with face value of AZN 2 each, increased by 39,958 thousand units and equalled to 403,031 thousand units.

The share capital of the Company as at December 31, 2016 amounted to AZN 726,147 thousand ordinary shares with par value of AZN 2 each.

24. GOVERNMENT INVESTMENTS

In order to improve and enhance the operations and the infrastructure of the Group, the Government has allocated subsidies to the Group under the several government programs.

According to the decree #183 of the Cabinet of the Ministers of the Republic of Azerbaijan dated October 22, 2010, all government investments allocated to the state companies of the Republic of Azerbaijan for the purposes of improvement of infrastructure and enhancement of their operations since 2007 should be included in the share capital of these entities.

As described in Note 2 to the consolidated financial statements in accordance with IFRS, all these subsidies were initially recorded in government investments line in the equity until they are registered in relevant government agencies, the management registered AZN 127,147 thousand and AZN 79,915 thousand of government investment as share capital in 2014 and 2017, respectively. The management of the Group is now working on registering the rest of subsidies as share capital.

The government investments amounted to AZN 1,174,509 thousand and AZN 946,205 thousand as at December 31, 2017 and 2016, respectively. The investments were as follows:

Reference to the decree of the Cabinet of Ministers and other sources	**Purpose of investment**	**Amount in thousands of AZN**
2007-2015		**607,098**
2016		
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Share of IBRD in "Rail Trade and Transport Facilitation project"	111,654
	Share of Government in "Rail Trade and Transport Facilitation project"	22,315
Decrees of Cabinet of Ministers # 424s and # 398s as at 30-Dec-2014	Payment of VAT in "Reconstruction of Railways project"	36,714
Decree of Cabinet of Ministers # 231s as at 24-July-2015 and Order of Ministry of Finance # i-144	Reconstruction of road infrastructure in "Baku-Sumgait-Baku" route	46,000
Decree of Cabinet of Ministers # 95s as at 22-Feb-2016	Repair and construction works on the railways within the "International North-South Transport Corridor", including construction of Astara Azerbaijan-Astara Iran railway	45,000
Decree of Cabinet of Ministers # 95s as at 22-Feb-2016	Share of Government in purchasing 50 units of freight locomotives from Alstom Transport S.A.	77,424
	Total amount for 2016	**339,107**
	Total allocated amount as at December 31, 2016	**946,205**
2017		
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Share of IBRD in "Rail Trade and Transport Facilitation project"	82,440
	Share of Government in "Rail Trade and Transport Facilitation project"	23,300
Decrees of Cabinet of Ministers # 424s and # 398s as at 30-Dec-2014	Payment of VAT in "Reconstruction of Railways project"	134,232
Decree of Cabinet of Ministers # 95s as at 22-Feb-2016	Share of Government in purchasing 50 units of freight locomotives from Alstom Transport S.A.	1,768
Repayment of debt to HSBC Bank plc by the Government on behalf of the Group	Repayment of loan facility received from HSBC Bank plc for "Reconstruction of Railways project"	30,479
Decree of Cabinet of Ministers # 447s as at 21-Jun-2017	Construction of two locomotive depots for 50 units of freight locomotives from Alstom Transport S.A.	4,000
Decree of Cabinet of Ministers # 424s as at 30-Dec-2014	Reconstruction of a metal bridge over Kur river at 253 km in the "Yevlakh-Malay" direction	12,000
	Repair and construction works on the railways within the "International North-South Transport Corridor", including construction of Astara Azerbaijan-Astara Iran railway	20,000
	Total amount for 2017	**308,219**
Decree of Cabinet of Ministers # 325 as at 10-Aug-2017	**Registered as and transferred to the share capital**	**(79,915)**
	Total allocated amount as at December 31, 2017	**1,174,509**

During the year ended December 31, 2013 and 2012 the Group signed agreement with the third parties regarding the installation of signalling system and power conversion facilities on Baku to Beyuk-Kyasik railway route with estimated cost of USD 288,140 thousand (related taxes approximating of USD 51,860 thousand will be financed by the Government) and USD 337,123 thousand (related taxes approximating of USD 60,682 thousand will be financed by the Government), correspondingly, under the “Rail Trade and Transport Facilitation project” financed by IBRD. The estimated completion date for both projects is 2018. The Government is responsible for repayment of above mentioned loan facility and total investment in these projects will be included in the equity of the Group according to the Group’s policy.

In June 2010, the Government of Azerbaijan Republic and Czech Export Bank signed an agreement regarding the financing of the “Construction of 317 km railway route from Baku to Beyuk-Kyasik project” (the “Project”) in the amount of EUR 215,000 thousand. Following this loan facility, the Group and Moravia Steel A.S. (the “Supplier”) which is a legal entity registered in the Czech Republic, signed an agreement on purchasing materials and services from the Supplier.

Total cost of the project was EUR 252,941 thousand where EUR 215,000 thousand was financed through loan facility and the rest of contract amount approximating of EUR 37,941 thousand and related taxes was financed by the Government. The Government is responsible for repayment of above mentioned loan facility and total investments in this project will be included in the equity of the Group according to the Group’s policy. The project was completed at the end of 2014.

After completion of “Construction of 317 km railway route from Baku to Beyuk-Kyasik project”, on December 1, 2014, the Group entered into an agreement with the Supplier to supply equipment and materials, and perform related works and services for a “Complete refurbishment of 600 km of the rail track of the railway between Baku and Beyuk-Kyasik”. The project commenced in the beginning of 2015 and is planned to be completed in 4.5 years. In order to finance this project the Group signed a loan in the amount of EUR 458,861 thousand from HSBC Bank plc. on April 14, 2015. The loan matures in 2025 and is guaranteed by the government. On December 21, 2017 the government has repaid the loan principal amounting EUR 15,215 thousand.

During the year ended December 31, 2017 and 2016 the Group received a grant in the amount of AZN 20,000 and AZN 45,000 thousand, respectively, for the financing of repair and construction works regarding the “International North-South Transport Corridor”, including construction of Astara Azerbaijan-Astara Iran railway based on decree of President of the Republic of Azerbaijan #1608 dated December 7, 2015 and decree of Cabinet of Ministers #95s dated February 22, 2016.

The Group signed an agreement with Societe Generale for the loan in the amount of EUR 276,995 thousand on March 30, 2016. The loan was granted for the purchase of 50 locomotives from Alstom Transport S.A. and is guaranteed by the Government. During the year ended December 31, 2016, 15% of the loan agreement was granted by the Government in the amount of AZN 77,424 thousand.

In March 2017, the Government of the Republic of Azerbaijan and French Development Agency signed an agreement regarding the financing of the construction of new railway locomotive depots for 50 units of freight locomotives purchased from Alstom Transport S.A. in the amount of EUR 112,500 thousand. During the year ended December 31, 2017, the Group received a grant in the amount of AZN 4,000 thousand from the Government based on decree of Cabinet of Ministers #447s dated June 12, 2017.

(In thousands of Azerbaijani Manats unless otherwise indicated)

25. CONSTRUCTION REVENUES AND CONSTRUCTION COSTS

In February 2007, the Republic of Azerbaijan, Georgia and Turkey signed agreement regarding construction of Baku-Tbilisi-Kars railway route. The State Oil Fund of the Republic of Azerbaijan extended financing in the amount of USD 750 million for this project. The Group is rendering construction services through its branch operated in the Republic of Georgia.

Construction revenues and associated construction costs during the year ended December 31, 2017 and 2016 derive from the construction of Baku-Tbilisi-Kars railway route. Total amount of contract is AZN 195,346 thousand.

	Year ended December 31, 2017	**Year ended December 31, 2016**
Construction revenues	73,175	61,913
Construction revenues	**73,175**	**61,913**

	Year ended December 31, 2017	**Year ended December 31, 2016**
Construction costs, including warranty costs	71,592	76,171
Reversal of construction loss recognized in prior years	-	(13,080)
Construction costs, net	**71,592**	**63,091**

	December 31, 2017	**December 31, 2016**
Receivables from construction services	5,630	1,947
Payables for construction work	57,301	59,377

26. OTHER REVENUES

	Year ended December 31, 2017	**Year ended December 31, 2016**
Revenue from rolling stock operations and maintenance services	20,497	17,855
Revenue from scrap metal sales	14,902	2,025
Revenue from rent of cargo cars, wagons and other properties	3,667	3,471
Revenue from security services	1,983	2,038
Revenue from wagon washing services	158	387
Revenue from water sales	157	144
Revenue from electricity sales	41	141
Others	1,501	323
Total other revenues	**42,906**	**26,384**

(In thousands of Azerbaijani Manats unless otherwise indicated)

27. TAXES OTHER THAN INCOME TAX

	Year ended December 31, 2017	Year ended December 31, 2016
Social tax	18,383	14,334
Property tax	6,086	4,406
Land tax	3,255	3,248
Others	5	6
Total taxes other than income tax	**27,729**	**21,994**

28. OTHER OPERATING COSTS

	Year ended December 31, 2017	Year ended December 31, 2016
Business trip expenses and trainings	3,712	2,572
Sanitation costs	3,554	932
Transportation expenses	3,164	970
Professional services and fees	2,729	2,251
Commercial expenses	1,726	519
Contribution to trade union and professional associations	1,499	1,155
Insurance costs	939	968
Security expenses	934	577
Communication costs	839	583
Water expenses	776	1,066
Printing costs	776	1,237
Office supplies	704	814
Representation costs	628	140
Sewerage expenses	451	52
Customs fees	230	143
Vehicle running costs	117	67
Natural gas expenses	83	84
Other	1,437	947
Total other operating costs	**24,298**	**15,077**

29. BAD DEBT EXPENSE

Bad debt expense during the year ended December 31, 2017 comprises allowances for loans receivable in the amount of AZN 20,976 thousand, allowances for other current assets in the amount of AZN 8,273 thousand, allowance for trade and other receivables in the amount of AZN 2,310 thousand (2016: allowances for loans receivable in the amount of AZN 29,131 thousand, allowances for other current assets in the amount of AZN 6,315 thousand and allowance for trade and other receivables in the amount of AZN 46,104 thousand).

(In thousands of Azerbaijani Manats unless otherwise indicated)

30. FINANCE COSTS

	Year ended December 31, 2017	Year ended December 31, 2016
Interest on debts and borrowings	85,901	51,510
Finance charges payable under finance leases	7,956	8,920
Total interest expense	**93,857**	**60,430**
Unwinding of discount and effect of changes in discount rate on provisions	1,172	4,280
Total finance costs	**95,029**	**64,710**

31. OTHER EXPENSES/(INCOME)

Other income mainly comprises of sponsorship fee received in the amount of AZN 4,181 thousand and gain from extinguishment of liabilities in the amount of AZN 2,575 thousand for the year ended December 31, 2017. Other expenses mainly comprises loss on guarantee contracts in the amount of AZN 12,586 thousand for the year ended December 31, 2017.

Other income mainly comprises of gain from extinguishment of liabilities in the amount of AZN 8,392 thousand and other expenses mainly comprises penalties charged by suppliers for the late payments in the amount of AZN 3,119 thousand for the year ended December 31, 2016.

32. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS

Legal proceedings

From time to time and in the normal course of business, claims against the Group are received. On the basis of its own estimates and both internal and external professional advice, management is of the opinion that no material losses will be incurred in respect of claims in excess of provisions that have been made in these financial statements.

Tax legislation

Tax, currency and customs legislation in the Republic of Azerbaijan and Commonwealth Independent States ("CIS") region is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activities of the Group may be challenged by the relevant authorities. Recent events within the region suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed.

Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances, reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained.

Capital expenditure commitments

As at December 31, 2017 and 2016 the Group’s capital commitments were associated with the borrowing facilities and government investment programs. The Group had commitment to the second phase of the installation of the signalling system and power conversion facilities on Baku to Beyuk-Kyasik railway route, Baku-Sumgait mainline track, construction of “Baku Ring Railway” and Astara Azerbaijan-Astara Iran railway route.

Finance lease commitments

The Group has finance lease contracts for various items of property, plant and equipment. The Group’s obligations under finance leases are secured by the lessor’s title to the leased assets. Future minimum lease payments under finance lease contracts, together with the present value of the net minimum lease payments are disclosed in Note 18.

Operating lease contracts are cancellable comprising mainly lease of production equipment and vehicles which are cancellable.

Environmental matters

The enforcement of environmental regulation in the Republic of Azerbaijan and CIS region is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognized immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

Tariff Regulation Policy

Potential reforms in tariff-setting policy may have a significant effect on the Group’s financial position and results of operations. The Group is continuously discussing the tariff setting policy, including both unification of such tariffs between domestic and foreign transportation and increases in the tariffs, with the Government of the Republic of Azerbaijan.

It is currently uncertain whether and when any further changes will be introduced in the tariff setting policy. These consolidated financial statements do not include any adjustments that might result from these uncertain effects. Such adjustments, if any, will be reported in the Group’s consolidated financial statements in the period when they become known and estimable.

Operating environment of the Group

The Group’s operations are conducted in the Republic of Azerbaijan. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Azerbaijani economy contracted by 1.3% growth (year-on-year) in the first half of 2017, driven by a decline in oil GDP (7.2%) as oil revenues were decreased due to production volumes and oil prices. On the upside, and despite continued banking sector distress, the non-oil economy expanded by 1.7% for the first time in over a year, supported by the strong performance of the agriculture and manufacturing sectors. Annual inflation remained high at 13-14% during 2017, driven mainly by an increase in government-controlled tariffs for electricity, water, and gas, and in domestic food prices. Citing inflationary pressures, the Central Bank of the Republic of Azerbaijan continued to tighten the monetary policy stance during 2017 by scaling up liquidity absorption operations. The manat has appreciated by 4.4% against the U.S. dollar since end-2016, reflecting its stronger external position and increased liquidity absorption operations. The troubled financial sector continues to exert a negative impact on the economy. Credit contracted by 15.6% in the first half of 2017, and the quality of assets continued to deteriorate. Per official statistics, the nonperforming loan ratio reached 13% in June 2017 compared to 9% at end 2016. Although manat deposits grew in the second quarter of 2017, the client deposits (corporate and household) shrank by 4.4% during the first seven months of 2017.

Starting from February, 2016 the Central Bank of the Republic of Azerbaijan has gradually increased refinancing rate from 5 to 15% during 2017 and the minimum capital adequacy ratio was lowered from 12% to 10%.

In February 2018, Standard & Poor’s, international credit agency, affirmed long and short-term sovereign credit rating of Azerbaijan in foreign and local currency at “BB+/B” upgrading rating outlook from negative to stable.

The Azerbaijani economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. While the Government has introduced a range of stabilization measures and plans to expedite reforms and support to banking system in response to current economic challenges. The Management believes it is taking appropriate measures to support the sustainability of the Group’s business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group’s results and financial position in manner not currently determinable.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Group’s operations and consequently what effect, if any, they could have on the financial position of the Group.

Amidst the ongoing crisis, the government of Azerbaijan shifted its oil-oriented economic policy, dominated for two decades, to the diversification of the economy. For that purpose, a “national strategic roadmap” was adopted to formulate a correct development strategy covering 11 sectors. The implementation of the “national strategic roadmap” was assigned to the newly formed “Center for Analysis of Economic Reforms and Communications,” the aim of which is analyzing the effectiveness of conducted reforms and making new proposals.

Significant measures have been taken in custom services and taxation as well. As of August 1, 2016, new regulations to ensure more operative and transparent custom clearance (a “green corridor” and other access systems) were implemented. The new simplified procedures are intended to stimulate imports and provide favorable conditions for business and external trade. As a continuation of reforms in customs, the reception of e-declarations is introduced minimize the contact of citizens with government officials. In order to amend the existing tax system, the decree approving the “Directions of Reforms in Taxation for 2016” was signed. The presidential decree requires the Ministry of Taxes to ensure that on-site and off-tax audits are performed within short periods of time and extend the coverage of electronic tax audits to limit face-to-face contacts with taxpayers. Another important amendment on monopolistic actions was made to the Criminal Code. Besides, the latest changes in December 2016 to Taxes Code “transfer pricing” will be applied against artificially exaggerated expenses and “voluntary tax disclosure” notion included in the Code which is highly practicable in greatest economies. Furthermore, in order to prevent additional exposure to financial sanctions by the tax authority because of tax liability miscalculation, the mechanism of “determination of tax liability in advance” principle will be in force. Along with them, implementation of electronic invoices will play an important role in prevention of tax evasion and will impact positively on tax system optimization.

Azerbaijan is also trying to benefit from regional connectivity initiatives to boost transit and trade. In particular, the country is one of the sponsors of the East–West and North–South transport corridors. Construction of the Baku–Tbilisi–Kars railway line, connecting the Caspian region with Turkey, was completed in 2017. The Trans-Anatolian Natural Gas Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP) will deliver natural gas from Azerbaijan's Shah Deniz gas field to Turkey and Europe. The economy is expected to expand from 2018 onward, supported by an acceleration of oil GDP as the Shah Deniz gas field-one of the largest gas fields in the world-begins production. Non-oil output will continue to grow at a slow pace due to limited credit growth and the weak business environment.

The consolidated financial statements reflect management's assessment of the impact of the Azerbaijani business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

Insurance

The Republic of Azerbaijan and CIS region insurance industry is in a developing stage: insurance market capacity and low variety of product line does not completely meet customers' requirements. Compulsory insurance common in other parts of the world is being introduced in stages and may not be available for some types of insurance.

Management has not approved insurance policy for the Group which sets general principles for the Group in respect of major terms of insurance contracts.

During the year ended December 31, 2017 and 2016, the Group did not maintain insurance coverage regarding major categories of its property. The Group did not maintain insurance coverage on business interruption as management assessed insurance expenses to be significantly higher than potential losses associated with this risk.

33. FINANCIAL RISK MANAGEMENT

The Group's principal financial instruments comprise bank loans, cash and bank deposits. The main purpose of these instruments is to raise finance for the Group's operations.

The Group has other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. The Group is exposed to credit and liquidity risks and market risk. Financial risks are monitored by Corporate Finance Department of the Group. Credit, currency and interest rate risks are regulated by corporate financial risks management policies. The Company also maintains centralized financial risk management policy at all subsidiaries.

Credit Risk

Credit risk is the risk that a counter party will fail to discharge an obligation and cause the Group to incur a financial loss. Cash is placed in financial institutions, which are considered at a time of deposit to have minimal risk of default. Management monitors the creditworthiness of the banks in which it deposits cash and ensures that the deposits placed by ADY in each financial institution do not exceed approved upper limit. These limits are recalculated quarterly in accordance with corporate policies, which include qualitative and quantitative analysis of financial institutions' performance.

(In thousands of Azerbaijani Manats unless otherwise indicated)

These limits are monitored and approved by the Company's Corporate Finance Department. Financial assets, which potentially subject the Group to credit risk, consist principally of trade receivables and loans receivables. The carrying amount of these financial assets, net of impairment, represents the maximum amount exposed to credit risk. With the exception for the matters discussed below, the Group has no significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the impairment already recorded.

The maximum exposure to credit risk is equal to the carrying amount of financial assets as at December 31, 2017 and 2016 which is disclosed below:

	December 31, 2017	December 31, 2016
Financial assets:		
Loans receivable	49,352	60,817
Trade and other receivables	61,973	31,562
Cash and cash equivalents (excluding cash on hand)	46,880	146,989
Other current assets (restricted current bank accounts)	53,372	-
	211,577	**239,368**

Maximum exposure of credit risk

The Group's maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch Rating. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The following table details credit ratings of financial assets held by the Group as at December 31, 2017 and 2016 (this information is prepared for all financial assets that are neither past due nor impaired):

	A+	A-	BB	B-	Not Rated	December 31, 2017 Total
Loans receivable	-	-	-	-	49,352	**49,352**
Trade and other receivables	-	-	-	-	61,973	**61,973**
Cash and cash equivalents	-	-	-	29,795	19,593	**49,388**
Other current assets (restricted current bank accounts)	1,325	13,872	-	-	38,175	**53,372**

	A+	A-	BB	B-	Not Rated	December 31, 2016 Total
Loans receivable	-	-	-	-	60,817	**60,817**
Trade and other receivables	-	-	-	-	31,562	**31,562**
Cash and cash equivalents	-	-	498	-	147,259	**147,757**

(In thousands of Azerbaijani Manats unless otherwise indicated)

Geographical risk concentration

The Management exercises control over the risk in the legislation and regulatory areas and assesses its influence on the Group's activities. This approach allows the Group to minimize potential losses from the investment climate fluctuations in the Republic of Azerbaijan and CIS region.

The geographical concentration of financial assets and financial liabilities is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	December 31, 2017 Total
FINANCIAL ASSETS				
Loans receivable	49,352	-	-	49,352
Trade and other receivables	61,823	28	122	61,973
Cash and cash equivalents	49,010	-	378	49,388
Other current assets (restricted current bank accounts)	19,787	33,585	-	53,372
TOTAL FINANCIAL ASSETS	**179,972**	**33,613**	**500**	**214,085**
FINANCIAL LIABILITIES				
Borrowings	1,173,734	1,375,031	-	2,548,765
Finance lease obligations	-	24,180	34,334	58,514
Trade and other payables	34,227	22,320	97,261	153,808
Salaries payable	8,030	-	758	8,788
TOTAL FINANCIAL LIABILITIES	**1,215,991**	**1,421,531**	**132,353**	**2,769,875**
NET POSITION	**(1,036,019)**	**(1,387,918)**	**(131,853)**	**(2,555,790)**

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	December 31, 2016 Total
FINANCIAL ASSETS				
Loans receivable	60,817	-	-	60,817
Trade and other receivables	31,053	20	489	31,562
Cash and cash equivalents	147,400	-	357	147,757
TOTAL FINANCIAL ASSETS	**239,270**	**20**	**846**	**240,136**
FINANCIAL LIABILITIES				
Borrowings	542,331	1,331,545	-	1,873,876
Finance lease obligations	-	56,246	40,308	96,554
Trade and other payables	47,648	18,746	330,293	396,687
Salaries payable	6,497	-	797	7,294
TOTAL FINANCIAL LIABILITIES	**596,476**	**1,406,537**	**371,398**	**2,374,411**
NET POSITION	**(357,206)**	**(1,406,517)**	**(370,552)**	**(2,134,275)**

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Group's reputation.

(In thousands of Azerbaijani Manats unless otherwise indicated)

The Group manages liquidity risk by maintaining adequate cash reserves and borrowing facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The Group prepares a financial plan on a monthly basis which ensures that the Group has sufficient cash on demand to finance expected operational expenses, financial obligations and investing activities. The Group developed standard payment periods in respect of trade accounts payable and monitors the timeliness of payments to its suppliers and contractors.

The following tables summarize the maturity profile of the Group's financial liabilities based on contractual payment terms. Repayments, which are subject to notice, are treated as if notice were to be given immediately. Accordingly, the related liabilities were reported as payable within less than 1 year.

	Up to 1 month	**1 month to 3 months**	**3 months to 1 year**	**1 year to 5 years**	**Over 5 years**	**December 31, 2017 Total**
FINANCIAL ASSETS						
Loans receivable	49,352	-	-	-	-	49,352
Trade and other receivables	61,973	-	-	-	-	61,973
Cash and cash equivalents	49,388	-	-	-	-	49,388
Other current assets (restricted current bank accounts)	21,113	32,259	-	-	-	53,372
Total financial assets	**181,826**	**32,259**	**-**	**-**	**-**	**214,085**
FINANCIAL LIABILITIES						
Borrowings	34,563	35,452	152,484	1,226,966	1,099,300	2,548,765
Finance lease obligations	1,103	2,785	10,916	31,527	12,183	58,514
Total interest bearing financial liabilities	**35,666**	**38,237**	**163,400**	**1,258,493**	**1,111,483**	**2,607,279**
Trade and other payables	136,139	2,787	14,882	-	-	153,808
Salaries payable	8,788	-	-	-	-	8,788
Total financial liabilities	**180,593**	**41,024**	**178,282**	**1,258,493**	**1,111,483**	**2,769,875**
Liquidity gap	**1,233**	**(8,765)**	**(178,282)**	**(1,258,493)**	**(1,111,483)**	
Cumulative liquidity gap	**1,233**	**(7,532)**	**(185,814)**	**(1,444,307)**	**(2,555,790)**	

(In thousands of Azerbaijani Manats unless otherwise indicated)

The management of the Group plans to cover its negative liquidity gap through attracting new loans from lenders, government support and future operational cash inflows.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2016 Total
FINANCIAL ASSETS						
Loans receivable	60,817	-	-	-	-	60,817
Trade and other receivables	31,562	-	-	-	-	31,562
Cash and cash equivalents	147,757	-	-	-	-	147,757
Total financial assets	**240,136**	**-**	**-**	**-**	**-**	**240,136**
FINANCIAL LIABILITIES						
Borrowings	258,652	31,932	231,809	960,343	391,140	1,873,876
Trade and other payables	36,996	-	23,505	164,537	-	225,038
Finance lease obligations	7,642	3,469	10,522	63,411	11,510	96,554
Total interest bearing financial liabilities	**303,290**	**35,401**	**265,836**	**1,188,291**	**402,650**	**2,195,468**
Trade and other payables	158,161	2,950	-	10,538	-	171,649
Salaries payable	7,294	-	-	-	-	7,294
Total financial liabilities	**468,745**	**38,351**	**265,836**	**1,198,829**	**402,650**	**2,374,411**
Liquidity gap	**(228,609)**	**(38,351)**	**(265,836)**	**(1,198,829)**	**(402,650)**	
Cumulative liquidity gap	**(228,609)**	**(266,960)**	**(532,796)**	**(1,731,625)**	**(2,134,275)**	

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature, are crucial in determining the Group's liquidity and its susceptibility to fluctuations in interest rates and exchange rates.

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the statement of financial position as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the statement of financial position under the effective interest rate method.

(In thousands of Azerbaijani Manats unless otherwise indicated)

The maturity analysis of financial liabilities at December 31, 2017 is as follows:

	Demand and less than 1 month	From 1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Borrowings	38,181	41,249	185,133	1,314,676	1,148,615	2,727,854
Finance lease obligations	1,240	3,469	12,953	37,648	13,429	68,739
Total interest bearing financial liabilities	**39,421**	**44,718**	**198,086**	**1,352,324**	**1,162,044**	**2,796,593**
Trade and other payables	136,139	2,787	14,882	-	-	153,808
Salaries payable	8,788	-	-	-	-	8,788
Total potential future payments for financial obligations	**184,348**	**47,505**	**212,968**	**1,352,324**	**1,162,044**	**2,959,189**

The maturity analysis of financial liabilities at December 31, 2016 is as follows:

	Demand and less than 1 month	From 1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Borrowings	262,847	40,206	267,317	1,014,638	438,976	2,023,984
Trade and other payables	40,746	7,501	57,261	264,678	-	370,186
Finance lease obligations	9,953	4,788	14,053	75,067	12,604	116,465
Total interest bearing financial liabilities	**313,546**	**52,495**	**338,631**	**1,354,383**	**451,580**	**2,510,635**
Trade and other payables	158,161	2,950	-	10,538	-	171,649
Salaries payable	7,294	-		-	-	7,294
Total potential future payments for financial obligations	**479,001**	**55,445**	**338,631**	**1,364,921**	**451,580**	**2,689,578**

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk, such as equity price risk and commodity risk. Financial instruments affected by market risk include loans and borrowings, deposits, available-for-sale investments and derivative financial instruments.

(In thousands of Azerbaijani Manats unless otherwise indicated)

Interest rate risk

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating interest rates.

The Group borrows on both a fixed and variable rate basis and has other interest-bearing liabilities. The Group incurs interest rate risk on liabilities with variable interest rate.

Impact on loss before income tax:

	As at December 31, 2017		As at December 31, 2016	
	Interest rate +1%	Interest rate –1%	Interest rate +1%	Interest rate –1%
FINANCIAL LIABILITIES				
Borrowings	(25,488)	25,488	(18,739)	18,739
Trade and other payables	-	-	(2,250)	2,250
Finance lease obligations	(585)	585	(966)	966
Net impact on loss before income tax	**(26,073)**	**26,073**	**(21,955)**	**21,955**

Currency risk

The currency risk is the risk of losses due to adverse changes in foreign exchange rates with regard to the Group's assets and liabilities denominated in foreign currencies.

The Group maintains centralized currency risk management system, which establishes risk policy towards certain currencies and prescribes regular analysis of foreign currency risk exposure. This analysis includes the assessment of open foreign exchange position, forecast modeling of exchange rates and the analysis of deviations between forecast and budget rates.

The Group aims at maintaining a neutral open foreign exchange position through offset of outflows in a foreign currency by inflows in corresponding currency.

The Group is exposed to currency risk on selected receivables, payables and borrowings that are denominated in a currency other than the Group's functional currency. The currencies in which these transactions are denominated are primarily the US dollars, GEL, CHF, EUR and KZT.

(In thousands of Azerbaijani Manats unless otherwise indicated)

The Group’s exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD	GEL	EUR	KZT	CHF	December 31, 2017 Total
FINANCIAL ASSETS							
Loans receivable	-	49,352	-	-	-	-	49,352
Trade and other receivables	40,046	21,927	-	-	-	-	61,973
Cash and cash equivalents	20,961	27,117	349	655	2	304	49,388
Other current assets (restricted current bank accounts)	5	11,190	-	42,176	-	1	53,372
TOTAL FINANCIAL ASSETS	**61,012**	**109,586**	**349**	**42,831**	**2**	**305**	**214,085**
FINANCIAL LIABILITIES							
Borrowings	352,283	880,730	-	1,315,752	-	-	2,548,765
Finance lease obligations	-	24,180	-	-	34,334	-	58,514
Trade and other payables	30,630	57,202	26,340	17,707	-	21,929	153,808
Salaries payable	8,030	-	758	-	-	-	8,788
TOTAL FINANCIAL LIABILITIES	**390,943**	**962,112**	**27,098**	**1,333,459**	**34,334**	**21,929**	**2,769,875**
OPEN CURRENCY POSITION	**(329,931)**	**(852,526)**	**(26,749)**	**(1,290,628)**	**(34,332)**	**(21,624)**	

	AZN	USD	GEL	EUR	KZT	CHF	December 31, 2016 Total
FINANCIAL ASSETS							
Loans receivable	-	60,817	-	-	-	-	60,817
Trade and other receivables	31,053	319	165	-	25	-	31,562
Cash and cash equivalents	9,801	118,821	322	18,704	-	109	147,757
TOTAL FINANCIAL ASSETS	**40,854**	**179,957**	**487**	**18,704**	**25**	**109**	**240,136**
FINANCIAL LIABILITIES							
Borrowings	7,779	864,283	-	1,001,814	-	-	1,873,876
Finance lease obligations	-	56,246	-	-	40,308	-	96,554
Trade and other payables	34,591	60,449	25,796	225,456	2,142	48,253	396,687
Salaries payable	6,497	-	797	-	-	-	7,294
TOTAL FINANCIAL LIABILITIES	**48,867**	**980,978**	**26,593**	**1,227,270**	**42,450**	**48,253**	**2,374,411**
OPEN CURRENCY POSITION	**(8,013)**	**(801,021)**	**(26,106)**	**(1,208,566)**	**(42,425)**	**(48,144)**	

(In thousands of Azerbaijani Manats unless otherwise indicated)

Currency risk sensitivity

The following tables detail the Group's sensitivity to a 10 % increase and decrease in the respective currencies with regard to its net monetary position against the AZN. 10 % is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. A positive number below indicates an increase in profit and other equity where the AZN strengthens 10% against the relevant currency. For a 10% weakening of the AZN against the relevant currency, there would be a comparable impact on the profit and other equity, and the balances below would be negative.

	December 31, 2017		**December 31, 2016**	
	Change in exchange rate	**Net impact on loss before income tax**	**Change in exchange rate**	**Net impact on loss before income tax**
AZN/USD	10%	(85,253)	10%	(80,102)
	-10%	85,253	-10%	80,102
AZN/GEL	10%	(2,675)	10%	(2,611)
	-10%	2,675	-10%	2,611
AZN/EUR	10%	(129,063)	10%	(120,857)
	-10%	129,063	-10%	120,857
AZN/KZT	10%	(3,433)	10%	(4,243)
	-10%	3,433	-10%	4,243
AZN/CHF	10%	(2,162)	10%	(4,814)
	-10%	2,162	-10%	4,814

34. FAIR VALUE OF FINANCIAL INSTRUMENTS

As at December 31, 2017 and 2016 the Group had no financial instruments measured at fair value.

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorized.

		Fair value measurement using			
	Date of valuation	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**December 31, 2017 Total**
Assets for which fair values are disclosed					
Cash and cash equivalents	December 31, 2017	49,388	-	-	**49,388**
Loans receivable	December 31, 2017	-	-	49,352	**49,352**
Trade and other receivables	December 31, 2017	-	-	61,973	**61,973**
Other current assets (restricted current bank accounts)	December 31, 2017	53,372	-	-	**53,372**
Liabilities for which fair values are disclosed					
Borrowings	December 31, 2017	-	-	2,548,765	**2,548,765**
Finance lease obligations	December 31, 2017	-	-	58,514	**58,514**
Trade and other payables	December 31, 2017	-	-	153,808	**153,808**
Salaries payable	December 31, 2017	-	-	8,788	**8,788**

(In thousands of Azerbaijani Manats unless otherwise indicated)

		Fair value measurement using			
	Date of valuation	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**December 31, 2016 Total**
Assets for which fair values are disclosed					
Cash and cash equivalents	December 31, 2016	147,757	-	-	**147,757**
Loans receivable	December 31, 2016	-	-	60,817	**60,817**
Trade and other receivables	December 31, 2016	-	-	31,562	**31,562**
Liabilities for which fair values are disclosed					
Borrowings	December 31, 2016	-	-	1,873,876	**1,873,876**
Finance lease obligations	December 31, 2016	-	-	96,554	**96,554**
Trade and other payables	December 31, 2016	-	-	396,687	**396,687**
Salaries payable	December 31, 2016	-	-	7,294	**7,294**

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Company's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2017	**Fair value 2017**	**Unrecognized gain/(loss) 2017**	**Carrying value 2016**	**Fair value 2016**	**Unrecognized gain/(loss) 2016**
Financial assets						
Cash and cash equivalents	49,388	49,388	-	147,757	147,757	-
Loans receivable	49,352	49,352	-	60,817	60,817	-
Trade and other receivables	61,973	61,973	-	31,562	31,562	-
Other current assets (restricted current bank accounts)	53,372	53,372	-	-	-	-
Financial liabilities						
Borrowings	2,548,765	2,548,765	-	1,873,876	1,873,876	-
Finance lease obligations	58,514	58,514	-	96,554	96,554	-
Trade and other payables	153,808	153,808	-	396,687	396,687	-
Salaries payable	8,788	8,788	-	7,294	7,294	-
Total unrecognized change in unrealized fair value			**-**			**-**

Assets and liabilities for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, without a specific maturity and variable rate financial instruments.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

35. EVENTS AFTER THE REPORTING PERIOD

New borrowing from Asian Development Bank

On January 29, 2018 the Group signed a new borrowing agreement with Asian Development Bank in the amount of USD 175 million. The amounts borrowed were directed for the restructuring of certain borrowings. The borrowing is guaranteed by the Government of the Republic of Azerbaijan.

New borrowing from Credit Suisse AG

On February 9, 2018 the Group signed a new borrowing agreement with Credit Suisse AG in the amount of CHF 134 million. The amounts borrowed were directed for the financing of delivery of 20 railroad passenger cars, 4 Stadler 4-Car double deck electrical multiple units type KISS trains and retrofitting of 5 KISS trains. The borrowing is guaranteed by the Government of the Republic of Azerbaijan.

Change in legal structure of Freight Department

Subsequent to the year end, the Group made structural changes in the Freight Department to increase operational effectiveness and efficiency. New structure of the Freight Department consists of 15 sub-departments.

Transfer of departments

On April 13, 2018 and March 16, 2018 East Wagon Depot and Bilajari Washing Station of Freight Department have been transferred to "ADY Express" LLC, respectively.

Change in legal structure of "Capital Repairs" LLC

On August 8, 2018 the status of "Capital Repairs" LLC as a limited liability entity has been ceased for the period from August 8, 2018 to August 8, 2022.

Amendment to contract with Stadler Rail Group

On January 18, 2018 the Group amended contract terms with "Stadler Rail Group" for purchase of 30 units of railroad passenger cars. According to new amendment the Group will purchase 20 railroad passenger cars, 4 Stadler 4-Car double deck electrical multiple units type KISS trains and have access to modernisation of 5 Stadler 4-Car double deck electrical multiple units type KISS trains instead of 30 railroad passenger cars.

Construction of new railway locomotive depots

Subsequent to the year end, the Group started construction of new railway locomotive depots in Bilajari and Ganja. The construction will be financed by the Government of the Republic of Azerbaijan and French Development Agency. Total expected cost of the project is AZN 270 million.

Construction of Laki-Gabala railway

Subsequent to the year end, the Group started the construction of Laki-Gabala railway. The construction will be financed by the Government of the Republic of Azerbaijan.

Repair and modernisation of Baku-Yalama railway

Subsequent to the year end, the Group commenced repair and modernisation of Baku-Yalama railway. The construction will be financed by the Government of the Republic of Azerbaijan. Total expected cost of the project is AZN 207 million.