“Azersu” Open Joint Stock Company

Consolidated financial statements

Year ended 31 December 2017
together with independent auditor’s report

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RSM

RSM Azerbaijan

Demirchi Tower 21st floor,
37 Khojaly ave, AZ1025,
Baku, Azerbaijan

T +994(12) 480 4571
F +994(12) 480 4563

www.rsm.az

Independent auditor's report to management and those charged with governance of "Azersu" OJSC

Opinion

We have audited the consolidated financial statements of "Azersu" OJSC and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the 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 the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements of the Group for the year ended December 31, 2016, were audited by another auditor who expressed unmodified opinion on those statements on June 30, 2017.

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.

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

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

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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.

29 June 2018

Baku, Azerbaijan

RSM Azerbaijan

Consolidated statement of financial position

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	31 December 2017	31 December 2016 (restated*)
Assets			
Non-current assets			
Property, plant and equipment	5	613,988	561,683
Intangible assets		44	66
Deferred tax assets	21	713	579
Total non-current assets		**614,745**	**562,328**
Current assets			
Inventories	7	30,450	5,936
Taxes receivable	6	23,449	25,850
Trade and other receivables	8	18,355	10,637
Prepayments		669	446
Restricted cash	9	2,177	1,425
Cash and cash equivalents	9	4,594	1,723
Total current assets		**79,694**	**46,017**
Total assets		**694,439**	**608,345**
Equity and liabilities			
Equity			
Share capital	10	400,000	400,000
Additional paid-in capital	10	1,568,732	1,568,067
Government investments	11	3,874,410	3,066,305
Accumulated losses		(5,904,502)	(5,396,152)
Total equity		**(61,360)**	**(361,780)**
Liabilities			
Non-current liabilities			
Interest-bearing loans and borrowings	12	219,573	379,114
Trade and other payables	15	76,288	79,440
Provisions	13	10,086	7,679
Total non-current liabilities		**305,947**	**466,233**
Current liabilities			
Interest-bearing loans and borrowings	12	19,232	42,815
Income tax payable		252	2,117
Taxes and penalties payable other than income tax	14	3,895	34,158
Trade and other payables	15	417,707	417,350
Deferred revenue	18	8,738	7,428
Provisions	13	28	24
Total current liabilities		**449,852**	**503,892**
Total liabilities		**755,799**	**970,125**
Total equity and liabilities		**694,439**	**608,345**

* Certain amounts shown here do not correspond to the 2016 consolidated financial statements and reflect adjustment made, refer to Note 2.

Signed and authorized for release on behalf of the Group on 29 June 2018.

Mr. Gorkhmaz Huseynov
Chairman

Mr. Zamin Hasanov
Deputy Head of Economics and Accounting Department

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	Year ended 31 December 2017	Year ended 31 December 2016
Sales revenue	18	165,745	159,837
Cost of sales	19	(85,727)	(84,578)
Gross profit		**80,018**	**75,259**
Administrative expenses	19	(31,216)	(19,883)
Selling and distribution expenses	19	(66,737)	(89,938)
Other operating expenses	19	(567,416)	(543,282)
Foreign exchange loss	19	(3,129)	(39,800)
Other income	20	83,866	5,840
Operating loss		**(504,614)**	**(611,804)**
Finance cost		(3,574)	(840)
Loss before tax		**(508,188)**	**(612,644)**
Income tax expense	21	(162)	(277)
Loss for the year		**(508,350)**	**(612,921)**
Other comprehensive income for the year		–	–
Total comprehensive loss for the year		**(508,350)**	**(612,921)**

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	Share capital	Additional paid-in capital	Government investments	Accumu-lated loss	Total equity
As at 31 December 2015 (restated*)		**400,000**	**151,912**	**3,932,882**	**(4,783,231)**	**(298,437)**
Increase in Additional paid-in capital	10	–	1,416,155	–	–	**1,416,155**
Net decrease in Government investments	11	–	–	(866,577)	–	**(866,577)**
Loss for the year		–	–	–	(612,921)	**(612,921)**
As at 31 December 2016 (restated*)		**400,000**	**1,568,067**	**3,066,305**	**(5,396,152)**	**(361,780)**

	Notes	Share capital	Additional paid-in capital	Government investments	Accumu-lated loss	Total equity
As at 31 December 2016		**400,000**	**1,568,067**	**3,066,305**	**(5,396,152)**	**(361,780)**
Increase in Additional paid-in capital	10	–	665	–	–	**665**
Net increase in Government investments	11	–	–	808,105	–	**808,105**
Loss for the year		–	–	–	(508,350)	**(508,350)**
As at 31 December 2017		**400,000**	**1,568,732**	**3,874,410**	**(5,904,502)**	**(61,360)**

* Certain amounts shown here do not correspond to the 2016 consolidated financial statements and reflect adjustment made, refer to Note 2.

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of cash flows

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	Year ended 31 December 2017	Year ended 31 December 2016
Operating activities			
Loss before tax		(508,188)	(612,644)
Non-cash adjustments to reconcile loss before tax to net cash flows			
Depreciation of property, plant and equipment and amortization cost	19	11,269	19,005
Change in impairment of trade and other receivables	8	(7,881)	16,568
Change in provision	13	2,411	(2,504)
Finance cost		3,574	840
Impairment of property, plant and equipment and intangible assets	19	567,416	543,282
Foreign exchange loss/(gain)		2,978	40,088
Loss on disposal of property, plant and equipment		257	–
		71,836	**4,635**
Working capital adjustments			
Inventories		(24,514)	(351)
Taxes receivable		2,401	(887)
Trade and other receivables		163	(17,612)
Deferred revenue		1,310	2,467
Trade and other payables		1,330	(8,759)
Prepayment		(222)	536
Taxes and penalties payable other than income tax		(32,233)	(5,780)
		20,071	**(25,751)**
Income tax paid		(191)	(261)
Net cash flows used in operating activities		**19,880**	**(26,012)**
Investing activities			
Purchase of property, plant and equipment		(17,065)	(24,026)
Purchase of intangible assets		(95)	(48)
Net cash flows used in investing activities		**(17,160)**	**(24,074)**
Financing activities			
Proceeds from borrowings		–	48,906
Repayment of borrowings		–	(636)
Net cash flows from financing activities		**–**	**48,270**
Foreign exchange gain on cash and cash equivalents		151	(288)
Net (decrease)/increase in cash and cash equivalents		**2,871**	**(2,104)**
Cash and cash equivalents at the beginning of the year	9	**1,723**	**3,827**
Cash and cash equivalents at the end of the year	9	**4,594**	**1,723**

The accompanying notes form an integral part of these consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

1. The Group's principal activity

Azersu Open Joint Stock Company ("Azersu OJSC") and its subsidiaries (the "Group") were established by the Decree of President of Republic of Azerbaijan on 11 June 2004 in accordance with legislation and are domiciled in the Republic of Azerbaijan. The Group is 100% owned by the government of the Republic of Azerbaijan (the "Government") and is a natural monopoly in charge of the implementation of the Government policy and strategy in the field of water supply, drinking water supply and sanitation services in the Republic of Azerbaijan. The Group's main functions pertain to extraction of water from sources followed by treatment as filtering and stabilization of water specification to make available to consumers' use, distribution and sale within the Republic of Azerbaijan.

The registered address of the Group is 67, Moscow avenue, AZ1012, Baku, the Republic of Azerbaijan.

2. Basis of preparation and significant accounting policies

Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

Going concern

The going concern basis assumes that the Group will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The Group's current liabilities exceeded its current assets by AZN 370,158 and AZN 457,875 as at 31 December 2017 and 2016, respectively, due to significant current investments in the infrastructure projects. The Group incurred a net loss of AZN 508,350 during the year ended 31 December 2017 (31 December 2016: AZN 612,921). The Group is part of the Government monopoly for supply of water and sewerage services and the Government keeps on investing to sustain the operations of the Group along with current investment projects.

The Group is actively involved in investing activities of construction of new water pipelines and sewerage systems in the Republic of Azerbaijan and receives subsidies from the Government on a regular basis. Historically the Group has had operating losses, negative cash flows from operations, and working capital deficit. The main reason of that, tariffs for services established by the Tariff (price) Council of the Republic of Azerbaijan are below the cost of the Group's water and sewerage services. According to the results of the annual monitoring of the revenues and expenditure estimates for the year 2017 carried out by the Ministry of Finance of the Republic of Azerbaijan, the cost per m^3 of water and sewerage services for the Group is AZN 1.17. According to the Group' report for the year ended December 31, 2017 which has been prepared with the basis of consequent legislation, the cost of one m^3 of water and sewerage services is AZN 1.41 and the average selling price is 0.74 AZN. During the reporting year, the cost of 1 m^3 of water and sewerage service is approximately 2 times more than the average selling price.

Management has developed a Master-Plan related to construction of new infrastructure projects as well as repair of existing facilities for future generation of cash inflows, which will enable the Group to increase its subscribers, collection of receivables and reduce sales losses. Moreover, on 13 May 2016 Tariff Council of the Republic of Azerbaijan approved increase of water prices and waste water treatment tariffs charged to customers. These new tariffs have been effective from 16 May 2016. Eventually this will lead to enhance the Group's financial position upon completion of the capital projects which are currently under construction. The Group continues to remain dependent on its ability to obtain sufficient funding from the Government to sustain operations and complete its current investment projects.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Going concern (continued)

These conditions give rise to an uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. However, the Government as an ultimate shareholder of the Group has an incentive to continue to support financing the Group because of its social contribution and importance to the country. Management believes that appropriate measures are being taken for the Group to continue its operational existence in the foreseeable future. Accordingly, the Group applied going concern basis in preparing its consolidated financial statements.

Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of "Azersu" OJSC and its subsidiaries as at 31 December 2017. Subsidiaries are all entities (including special-purpose entities) over which the Group has control, being the power to govern the financial and operating policies so as to obtain benefits from its activities, generally accompanying a shareholding of more than one half of the voting rights.

Subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All intra-group balances, transactions, unrealized gains and losses resulting from intra-group transactions and dividends are eliminated in full.

Foreign currency translation

All amounts in these consolidated financial statements are presented in thousands of Azerbaijani manats ("AZN"), unless otherwise stated.

The functional currency of "Azersu" OJSC and its subsidiaries is AZN as the majority of the Group's revenues, costs, inventory purchased, and trade liabilities are either priced, incurred, payable or otherwise measured in AZN.

The transactions executed in foreign currencies are initially recorded in AZN by applying the appropriate rates of exchanges prevailing at the date of transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange ruling at the reporting date.

Foreign exchange gains and losses resulting from the re-measurement of monetary assets into the functional currency are recognized in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of gain or loss on change in fair value in the item (i.e., the translation differences on items whose fair value gain or loss is recognized in other comprehensive income ("OCI") or profit or loss are also recognized in OCI or profit or loss, respectively).

AZN is not a fully convertible currency outside the territory of the Republic of Azerbaijan. Within the Republic of Azerbaijan, official exchange rates are determined daily by the Central Bank of the Republic of Azerbaijan ("Central Bank"). Transactions denominated in foreign currencies are recorded at the official exchange rate on the date of the transaction.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Foreign currency translation (continued)

The official rates of exchange used for translating foreign currency balances were as follow:

	31 December 2017	31 December 2016
1 USD / 1 AZN	1.7001	1.7707
1 EUR / 1 AZN	2.0307	1.8644
1 SDR / 1 AZN	2.4153	2.3729

Fair value measurement

Depending on their classification financial instruments are carried at fair value, or amortized cost as described below.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Fair value measurement (continued)

Amortized cost is the amount at which the financial instrument was recognized at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment loss. Accrued interest includes amortization of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest rate method. Accrued interest income and accrued interest expense are not presented separately and are included in the carrying values of related statement of consolidated financial position items.

The effective interest rate method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument.

Financial assets

Initial recognition and measurement

Financial assets within the scope of International Accounting Standard ("IAS") 39 *Financial Instruments: Recognition and Measurement* are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition. All financial assets are recognized initially at fair value.

The Group has not designated any financial assets upon initial recognition at fair value through profit or loss, held-to-maturity investments, available-for-sale financial assets, or as derivatives.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method, less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method. The effective interest rate method amortization is included in finance income in the statement of profit or loss and other comprehensive income. The losses arising from impairment are recognized in the statement of profit or loss and other comprehensive income in finance cost for loans and in cost of sales or selling and distribution expenses for receivables.

Derecognition

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

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through"

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

Derecognition (continued)

- arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognizes an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

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 have 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 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.

Financial assets carried at amortized cost

For financial assets carried at amortized cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognized, are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the loss is recognized in profit or loss. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to finance costs in the consolidated statement of profit or loss and other comprehensive income.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial liabilities

Initial recognition and measurement

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognized initially at fair value and, in the case of loans and borrowings, carried at amortized cost. This includes directly attributable transaction costs.

The Group's financial liabilities include trade and other payables and loans and borrowings.

The Group has not designated any financial liabilities upon initial recognition as financial liabilities at fair value through profit or loss, or as derivatives designated as hedging instruments in an effective hedge.

Subsequent measurement

The measurement of financial liabilities depends on their classification as follows:

Interest-bearing loans and borrowings

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the statement of profit or loss and other comprehensive income when the liabilities are derecognized as well as through the effective interest rate method amortization process.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method. The effective interest rate method amortization is included in finance cost in the statement of profit or loss and other comprehensive income.

Derecognition

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the consolidated statement of profit or loss and other comprehensive income.

Offsetting of financial instruments

Financial assets and financial liabilities are offset with the net amount reported in consolidated statement of financial position only if there is a current enforceable legal right to offset the recognized amounts and intent to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

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.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Property, plant and equipment

Property, plant and equipment are stated at cost as described below, less accumulated depreciation and provision for impairment, where required.

The initial cost of an asset comprises its purchase price or construction cost, any cost directly attributable to bringing the asset into operation, the initial estimate of decommissioning obligation, if any, and for qualifying assets, borrowing costs. The assets held under finance lease are also included within property, plant and equipment.

Development of tangible assets

Expenditure on the construction, installation or completion of infrastructure facilities such as pipelines and transmission facilities is capitalized within tangible assets according to nature. All minor repair and maintenance costs are expensed as incurred. Cost of replacing major parts components of property, plant and equipment items are capitalized and replaced part is retired.

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's or cash generating unit's fair value less costs to sell and its value in use. The carrying amount reduced to the recoverable amount and the impairment loss, if any, is recognized in the consolidated statement of profit or loss and other comprehensive income. An impairment loss recognized for an asset or cash generating unit in prior years is reversed if there are indicators that impairment loss may no longer exist or may have decreased.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are recognized in profit or loss.

Depreciation

Buildings, facilities, transmission devices are depreciated using straight-line method over the estimated useful lives. Machinery and equipment and vehicles are depreciated using reducing balance method. The reducing balance method of depreciation is calculated by applying the defined depreciation formula based on cost, residual value and useful life of an asset.

The estimated useful lives of the Group's property, plant and equipment are as follows:

Buildings and constructions	20 to 60 years
Facilities and transmission devices	3 to 40 years
Machinery and equipment	3 to 15 years
Vehicles	3 to 10 years
Office equipment	3 to 8 years

Land and assets under construction are not depreciated.

The expected useful lives of property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The residual value of an asset is the estimated amount that the Group would currently obtained from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life unless scrap value is significant. The assets' residual values are reviewed, and adjusted if appropriate, at each consolidated statement of financial position date.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is assigned by the FIFO method. Cost comprises direct purchase costs, cost of production, transportation and manufacturing expenses (based on normal operating capacity).

Operating lease

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lesser to the Group, the total lease payments are charged to profit or loss 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, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

When assets are leased out under an operating lease, the lease payments receivables are recognized as rental income on a straight-line basis over the lease term.

Borrowing costs

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 respective 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.

Borrowing costs for all eligible qualifying assets are capitalized.

Intangible assets

Intangible assets are stated at cost, less accumulated amortization and accumulated impairment losses. Intangible assets include rights, licenses and computer software.

The useful lives of intangible assets are assessed as either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life is reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the statement of profit or loss and other comprehensive income in the expense category consistent with the function of the intangible assets.

Intangible assets with indefinite useful lives are not amortized, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Impairment of non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's ("CGU") fair value less costs to sell and its value in use. It is determined for an individual asset, unless

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Impairment of non-financial assets (continued)

the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset 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 assessments 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. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

The Group bases its impairment calculation on detailed budgets and forecasts which are prepared separately for each of the Group's CGU to which the individual assets are allocated. These budgets and forecast calculations are generally covering a period of five years. For longer periods, a long-term growth rate is calculated and applied to project future cash flows after the fifth year.

Impairment losses of continuing operations, including impairment on inventories, are recognized in the consolidated income statement in those expense categories consistent with the function of the impaired asset, except for a property previously revalued where the revaluation was taken to other comprehensive income. In this case, the impairment is also recognized in other comprehensive income up to the amount of any previous revaluation.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized.

The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the income statement unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase.

Income taxes

Income taxes have been provided for in consolidated financial statements in accordance with the applicable legislation enacted by the reporting date. The income tax charge comprises current tax and deferred tax and is reflected in the consolidated statement of profit or loss and other comprehensive income.

Current income tax is the amount expected to be paid to or recovered from the state budget through taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes, other than on income, are recorded within operating expenses.

Deferred income tax is provided in full, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Value-added tax

The tax legislation allows the settlement of sales and purchases value-added tax ("VAT") on a net basis.

VAT payable represents VAT related to sales that is payable to the state budget through tax authorities upon recognition of sales to customers under timing methods envisaged in the legislation, net of VAT on purchases which have been settled at the statement of financial position date. VAT related to sales which have not been settled at the statement of financial position date (VAT deferral) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT where applicable. The deferred liability related VAT is maintained until the debtor is written off for tax purposes.

VAT recoverable relates to purchases which have not been settled at the statement of financial position date. VAT recoverable is reclaimable against VAT on sales upon payment for the purchases.

Provisions for liabilities and charges

Provisions for liabilities and charges are liabilities of uncertain timing or amount. They are accrued when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are not recognized for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

Government investments

Government investments are made in the form of cash contributions, transfer of other state-owned entities or transfer of all or part of the Government's share in other entities. Transfer of the state-owned entities to the Group is recognized as contribution through consolidated equity statement in the amount being the fair value of the transferred entity (in case of transfer by the Government of its share in other entities – the transferred share in the fair value of the respective entity).

Revenue recognition

Revenue comprises the fair value of consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of VAT, returns, discounts, and other sales-based taxes, if any, after eliminating sales within the Group.

Revenue from sales of water and sewerage services are recorded on the basis of regular water meter readings (monitored on a monthly basis) and estimates of customer usage from the last meter reading to the end of the reporting period. Water prices and waste water treatment tariffs to the final consumers in the Republic of Azerbaijan are regulated by the Tariff Council of the Republic of Azerbaijan.

Sales of services are recognized in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Expenses

Expenses are presented by function in consolidated statement of profit or loss and other comprehensive income. Categorization of the nature of expenses is based on operational functions of the Group's departments and subsidiaries.

Employee benefits

Wages, salaries, contributions to the Social Protection Fund of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits (e.g. health services) are accrued in the year in which the associated services are rendered by the employees of the Group.

Related parties

Related parties are disclosed in accordance with IAS 24 *Related Party Disclosures*.

Governmental economic and social policies affect the Group's financial position, results of operations and cash flows. The Government imposed an obligation on the Group to provide an uninterrupted supply of water to customers in the Republic of Azerbaijan at government controlled prices.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arms-length basis.

Correction of error

During the preparation of the consolidated financial statements for the year ended 31 December 2017 the Group identified that, due to incorrect accounting in previous years government investments and accumulated losses were not properly calculated in consolidated statement of financial position.

To correct this error the Group restated comparative information as of and for the year ended 31 December 2016 as follows:

Impact on the consolidated statement of financial position as of 31 December 2016 (increase/ (decrease) in each line)

	As previously reported	Correction of error	As restated
Government investments	3,270,632	(204,327)	**3,066,305**
Accumulated losses	(5,600,479)	204,327	**(5,396,152)**
Total equity	(361,780)	–	**(361,780)**

The change did not have an impact the Group's the consolidated statement of profit or loss and other comprehensive income and consolidated statement of cash flows. All the disclosure amounts within the comparative information were changed respectively.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Reclassifications

Certain reclassification has been made to the prior year's consolidated statement of financial position and corresponding note to conform to the current year's presentation. There was no material impact on the Group's consolidated statement of profit or loss and other comprehensive income, consolidated statement of cash flows, results of operations and equity as a result of this reclassification.

	Prior to reclassifications	Reclassifications	After reclassifications
Consolidated statement of financial position for the year ended 31 December 2016			
Trade and other payables (long-term)	–	79,440	79,440
Trade and other payables (short-term)	496,790	(79,440)	417,350

3. Adoption of new or revised standards and interpretations

The Group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2017. Although these new standards and amendments applied for the first time in 2017, they did not have a material impact on the consolidated financial statements of the Group. The nature and the impact of each new standard and amendment is described below:

IAS 7 Disclosure Initiative – Amendments to IAS 7

The amendments to IAS 7 Statement of Cash Flows are part of the IASB's Disclosure Initiative and require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. On initial application of the amendment, entities are not required to provide comparative information for preceding periods. These amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted. Application of the amendments will result in additional disclosures provided by the Group.

IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses − Amendments to IAS 12

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in the opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact. These amendments are effective for annual periods beginning on or after 1 January 2017 with early application permitted. If an entity applies the amendments for an earlier period, it must disclose that fact. These amendments are not expected to have any impact on the Group.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Adoption of new or revised standards and interpretations (continued)

Amendments to IFRS 12 (Annual Improvements to IFRS Standards 2014–2016 Cycle, issued in December 2016)

The amendments clarify that the disclosure requirements of the Standard apply to interests in entities within the scope of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations except for summarised financial information for those interests (ie paragraphs B10–B16 of IFRS 12). The amendments had no effect on the Group's consolidated financial statements.

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. This list includes standards and interpretations that the Group expects to be applied in future periods. The Group intends to adopt these standards, if applicable, when they become effective.

Amendments to existing Standards

Amendments to IAS 28 (Annual Improvements to IFRS Standards 2014–2016 Cycle, issued in December 2016)

The amendments, applicable to annual periods beginning on or after 1 January 2018 (earlier application permitted), 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 organisation, mutual fund, unit trust 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 are not expected to have an effect on the Group's consolidated financial statements.

Amendments to IAS 40 titled Transfers of Investment Property (issued in December 2016)

The amendments, applicable to annual periods beginning on or after 1 January 2018 (earlier application permitted), clarify that transfers to, or from, investment property (including assets under construction and development) should be made when, and only when, there is evidence that a change in use of a property has occurred. The amendments are not expected to have a material effect on the Group's consolidated financial statements.

Amendments to IFRS 2 titled Classification and Measurement of Share-based Payment Transactions (issued in June 2016)

The amendments, applicable to annual periods beginning on or after 1 January 2018 (earlier application permitted), clarify the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payment (SBP) transactions, the accounting for SBP transactions with a net settlement feature for withholding tax obligations, and the effect of a modification to the terms and conditions of a SBP that changes the classification of the transaction from cash-settled to equity-settled. The amendments are not expected to have a material effect on the Group's consolidated financial statements.

Amendments to IFRS 4 titled Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (issued in September 2016)

The amendments, applicable to annual periods beginning on or after 1 January 2018, give all insurers the option to recognise in other comprehensive income, rather than in profit or loss, the volatility that could arise when IFRS 9 is applied before implementing IFRS 17 ('the overlay approach').

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Adoption of new or revised standards and interpretations (continued)

Standards issued but not yet effective (continued)

Also, entities whose activities are predominantly connected with insurance are given an optional temporary exemption (until 2021) from applying IFRS 9, thus continuing to apply IAS 39 instead ('the deferral approach'). As the Group has not issued insurance contracts, the amendments are not expected to have an effect on its consolidated financial statements.

Amendments to IFRS 10 and IAS 28 titled Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued in September 2014)

The amendments address a current conflict between the two Standards and clarify that a gain or loss should be recognised fully when the transaction involves a business, and partially if it involves assets that do not constitute a business. The effective date of the amendments, initially set for annual periods beginning on or after 1 January 2016, was deferred indefinitely in December 2015 but earlier application is still permitted. This is not expected to have an effect on the Group's consolidated financial statements.

New standards

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for the financial instruments project: classification and measurement; impairment; and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required, but providing comparative information is not compulsory. The Group is currently assessing the impact of IFRS 9 and plans to adopt the new standard on the required effective date.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

IFRS 17 Insurance Contracts (issued in May 2017)

The Standard that replaces IFRS 4, effective for annual periods beginning on or after 1 January 2021 (earlier application permitted only if IFRS 9 and IFRS 15 also applied), requires insurance liabilities to be measured at a current fulfilment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of consistent, principle-based accounting for insurance contracts, giving a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued. As the Group has neither issued insurance contracts nor held reinsurance contracts, the Standard is not expected to have an effect on its consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

4. Critical accounting estimates and judgments

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities. Uncertainty about these assumption and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Estimates and judgments are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group based its assumptions and estimates on parameters available when 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. Management also makes certain judgments, apart from those involving estimations, in the process of applying the accounting policies.

Judgments that have the most significant effect on the amounts recognized in this consolidated financial statements and estimates that can cause a material adjustment to the carrying amount of assets and liabilities at reporting date include:

Environmental obligations

The Group records a provision in respect of estimated costs of remediation of the damage historically caused to the natural environment by the activities of the Group. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the respective consolidated statement of financial position date based on requirements of the Code of Administrative Offences of the Republic of Azerbaijan in effect and is also subject to changes because of modifications and revisions. Governmental authorities continuously consider applicable regulations and their enforcement. Estimated liability for environmental remediation as of 31 December 2017 and 31 December 2016 amounted nil. Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

Useful lives of property, plant and equipment and intangible assets

Management determines the estimated useful lives and related depreciation and amortization charges for its property, plant and equipment and intangible assets. This estimate is based on projected period over which the Group expects to consume economic benefits from the asset. Management will increase the depreciation charge where useful lives are less than previously estimated lives, or it will write-off or write-down technically obsolete assets that have been abandoned or sold. The useful lives are reviewed at least at each reporting date. Changes in any of the above conditions or estimates may result in adjustments to future depreciation rates.

Deferred income tax asset recognition

The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded on the consolidated statement of financial position. Deferred income tax assets are recorded to the extent that realization of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments and applies estimation based on last three years results and expectations of future income that are believed to be reasonable under the circumstances.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

4. Critical accounting estimates and judgments (continued)

Current taxes

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

The 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 31 December 2017 and 2016 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.

Impairment of non-financial assets

Management assesses whether there are any indicators of possible impairment of all non-financial assets at each reporting date based on events or circumstances that indicate the carrying value of assets may not be recoverable. Goodwill and other indefinite life intangibles are tested for impairment annually and at other times when impairment indicators exist. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

Given the nature of the Group's activities, information on the fair value of an asset is usually difficult to obtain unless negotiations with potential purchasers are taking place. Consequently, unless indicated otherwise, the recoverable amount used in assessing the impairment charges described below is value-in-use.

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows. The Group has been considered as one CGU and impairment was determined on the level of the whole Group. The value of the CGU was calculated by discounting the future cash flows at the rate of 13.26% (31 December 2016: 12.8%) on pre-tax base and impairment charge of AZN 567,416 (31 December 2016: AZN 543,282) has been recognized in consolidated statement of profit or loss and other 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/ lower than management's estimate, the aggregate amount of impairment loss would have been AZN 68,715 higher /AZN 53,865 lower (31 December 2016: AZN 41,450 / AZN 50,860, respectively).

Impairment provision for trade receivables

The impairment provision for trade receivables is based on management's assessment of the probability of collection of major individual consumers' accounts receivable. Significant financial difficulties of the consumers, probability that the contract parties will suffer bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the receivable is potentially impaired. Actual results could differ from these estimates if there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

4. Critical accounting estimates and judgments (continued)

Impairment provision for trade receivables (continued)

Additionally, a large number of minor receivables are grouped into homogenous groups and assessed for impairment collectively. Trade receivables outstanding more than 12 months are generally written off against respective impairment provision.

When there is no expectation of recovering additional cash for an amount receivable, amount receivable is written off against associated provision.

Future cash flows of trade receivables that are evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

Provision for unused vacation

The Group has a policy to settle total amount of payable to individual employee accrued for several years for unused vacations only when the vacation option is utilized by the employee and no reliable basis for estimation of timing of payment is available.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

5. Property, plant and equipment

Movements in the carrying amount of property, plant and equipment ("PPE") were as follows:

	Land	Buildings and constructions	Facilities	Transmission devices	Machinery and equipment	Vehicles	Stationary and office equipment	Construction in progress	Total
Cost									
At 1 January 2016	**21,660**	**21,083**	**28,309**	**166,122**	**44,875**	**32,929**	**4,626**	**2,951,725**	**3,271,329**
Additions	–	–	2	61	1,052	228	49	519,944	**521,336**
Granted assets	–	67	349	300	115	–	–	–	**831**
Transfers	–	2,445	1,981	55,236	4,246	16	64	(63,988)	**–**
At 31 December 2016	**21,660**	**23,595**	**30,641**	**221,719**	**50,288**	**33,173**	**4,739**	**3,407,681**	**3,793,496**
Additions	–	–	23	23	476	308	131	622,780	**623,741**
Granted assets	3	6,502	18	775	6	84	1	–	**7,389**
Transfers	–	1,698	3,314	20,766	4,512	34	25	(30,349)	–
Disposals	–	–	(5)	(234)	(12)	–	(6)	–	**(257)**
At 31 December 2017	**21,663**	**31,795**	**33,991**	**243,049**	**55,270**	**33,599**	**4,890**	**4,000,112**	**4,424,369**
Depreciation and impairment									
At 1 January 2016	**(10,658)**	**(19,688)**	**(26,547)**	**(150,414)**	**(43,909)**	**(32,367)**	**(4,209)**	**(2,381,909)**	**(2,669,701)**
Depreciation charge	–	(465)	(816)	(11,615)	(5,080)	(634)	(290)	–	**(18,900)**
Impairment charge	(4,866)	(1,731)	(1,683)	(30,637)	(668)	(8)	(101)	(503,518)	**(543,212)**
At 31 December 2016	**(15,524)**	**(21,884)**	**(29,046)**	**(192,666)**	**(49,657)**	**(33,009)**	**(4,600)**	**(2,885,427)**	**(3,231,813)**
Depreciation charge	–	(374)	(627)	(6,378)	(3,261)	(453)	(103)	–	**(11,196)**
Impairment charge	–	(1,551)	(2,171)	(22,127)	(1,174)	(2)	(50)	(540,297)	**(567,372)**
At 31 December 2017	**(15,524)**	**(23,809)**	**(31,844)**	**(221,171)**	**(54,092)**	**(33,464)**	**(4,753)**	**(3,425,724)**	**(3,810,381)**
Net book value									
At 31 December 2016	**6,136**	**1,711**	**1,595**	**29,053**	**631**	**164**	**139**	**522,254**	**561,683**
At 31 December 2017	**6,139**	**7,986**	**2,147**	**21,878**	**1,178**	**135**	**137**	**574,388**	**613,988**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

5. Property, plant and equipment (continued)

Granted assets

During the years ended 31 December 2017 and 2016 certain assets (transmission devices and other infrastructures, land, buildings, etc.) were contributed to the Group by various governmental organizations. The Group engaged an independent appraiser to determine the fair value of granted assets as of 31 December 2017 and 2016. Fair value of granted assets was determined in the amount of AZN 7,389 for the year ended 31 December 2017 (31 December 2016: AZN 831). Assets received from governmental organizations were recognized as Government investments in the consolidated financial statements (see Note 11).

Prepayments

Included in construction in progress are prepayments made for construction activities and services that have not been provided yet. The net amounts of such prepayments are AZN 40,219 and AZN 31,463 as at 31 December 2017 and 31 December 2016, respectively.

Capitalization of borrowings costs

Since 2005, the Group incepted several construction projects for building of new water pipelines and reservoirs as well as waste management and sewerage system in Baku city and other regions of the Republic of Azerbaijan. The projects are financed through government investments and loans from international financial organizations. The total amount of borrowing costs capitalized during 2017, by the Group on construction property was AZN 3,373 (31 December 2016: AZN 3,740).

6. Taxes receivable

In 31 December 2017 and 31 December 2016 taxes receivable mainly comprised VAT recoverable in the amount of AZN 23,449 (31 December 2016: AZN 25,850) related to purchases which have not been settled at the end of the year, and thus not claimed in tax declarations and prepayment on construction works which can be claimed only after the vendor performs the associated services.

Taxes receivable is recoverable by means of an offset against tax liabilities or as a direct cash refund from the tax authorities.

7. Inventories

Inventories comprised the following as at:

	31 December 2017	**31 December 2016**
Materials	19,129	2,664
Goods	7,630	1,368
Goods for sale	2,482	1,149
Spare parts	605	533
Raw materials	582	193
Fuel and lubricants	22	29
Total inventories	**30,450**	**5,936**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

8. Trade and other receivables

Trade and other receivables comprised the following as at:

	31 December 2017	31 December 2016
Receivables from sale of water	73,258	75,037
Less impairment loss provision	(58,063)	(65,944)
Total trade receivables	**15,195**	**9,093**
Other receivables	3,160	1,544
Total trade and other receivables	**18,355**	**10,637**

As of 31 December 2017 trade receivables are mainly represented by receivables for sale of water to non-population and population in the amount of AZN 37,210 and AZN 36,048, respectively (31 December 2016: AZN 52,956 and AZN 22,081, respectively). General credit terms on sales of water include 30 days settlement requirement after the billing date. Tariffs on sales of water are subject to state regulations and are governed by the Tariff Council of the Republic of Azerbaijan.

Movements on the provision for impairment of trade receivables were as follows:

	2017	2016
At 1 January	**65,944**	**50,065**
Receivables written off during the year as uncollectible net of recovery	–	(689)
Net change in provision (Note 19)	(7,881)	16,568
At 31 December	**58,063**	**65,944**

As at 31 December the ageing analysis of trade and other receivables is as follows:

	Total	<30 days	Past due but not impaired	Individually and collectively impaired
31 December 2016	**76,581**	10,637	–	65,944
31 December 2017	**76,418**	18,355	–	58,063

9. Cash and cash equivalents and restricted cash

Cash and cash equivalents comprised the following as at:

	31 December 2017	31 December 2016
Cash in transit	1,124	719
Correspondent and settlement accounts	3,458	990
Cash on hand	10	12
Other cash equivalents	2	2
Total cash and cash equivalents	**4,594**	**1,723**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Cash and cash equivalents and restricted cash (continued)

Cash and cash equivalents in original currency comprised the following as at:

	31 December 2017	31 December 2016
AZN dominated bank balances	4,462	1,592
USD dominated bank balances	91	94
EUR dominated bank balances	31	25
Cash on hand	10	12
Total cash and cash equivalents	**4,594**	**1,723**

Restricted cash comprised the following as at:

	31 December 2017	31 December 2016
VAT deposit account	315	493
Account at the State Treasury	1,862	–
Designated accounts	–	932
Total restricted cash	**2,177**	**1,425**

Account at the State Treasury was originated based on signed order by the Government and is held at the State Treasury of the Republic of Azerbaijan. The Group has no direct control over the account which is mainly used for financing of the Group's construction projects and funded by the Government based on authorized requests placed at the State Treasury. Subject to the State Treasury approval appropriated funds are directly transferred to the vendor's account. The Group treats these contributions as a Government Investment within the Group's equity.

The Government has also established Designated Accounts at commercial banks acceptable to the international financing institutions in accordance with the terms of respective loan agreements for use of funds provided under these loan agreements. Designated Accounts are established, managed, replenished and liquidated in accordance with manuals introduced by the international financing institutions. The Designated Accounts are maintained in foreign currencies and the Group has no direct control over these accounts.

Effective 1 January 2008 the state tax authorities introduced VAT deposit accounts and enforced payments of input and output VAT via these accounts. In order to comply with new tax regulation, the Group has opened a VAT deposit account. In accordance with this regulation, the balance on VAT deposit account may only be withdrawn with a 45 day notice to the tax authorities.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

10. Share capital

Share capital of the Group comprised the following as at:

	31 December 2017		31 December 2016	
	Number of shares	**Share capital**	**Number of shares**	**Share capital**
"Azersu" OJSC	20,000,000	400,000	20,000,000	400,000
Subsidiaries				
"Sutikinti" Division	100	1,423	100	1,423
"Sukanal" Scientific Research and Design Institute	–	131	–	131
"Ganja Sukanal" SJSC	383,640	7,673	383,640	7,673
"Aghdash Sukanal" SJSC	53,568	1,071	53,568	1,071
"Goychay Sukanal" SJSC	53,568	1,071	53,568	1,071
"Sheki Sukanal" SJSC	95,663	1,914	95,663	1,914
"Birleshmish Sukanal" LLC	4,063,722	81,274	4,063,722	81,274

Parent company of the Group, Azersu OJSC, has a legal status of a state enterprise. The Group includes 8 separate legal entities each possessing their own share capital. As at 31 December 2017 and 31 December 2016 Azersu OJSC had authorized and issued 20,000,000 shares at par AZN 0.02. Azersu OJSC has ultimate control and 100% interest in all of its subsidiaries.

During 2017 the Group recorded additional paid-in capital in the amount of AZN 665 (31 December 2016: AZN 1,416,155) based on value of the completed investment projects accepted by the Government.

11. Government investments

Government investments comprised the following as at:

	31 December 2017	**31 December 2016 (restated*)**
Non-financial asset investments	47,819	38,205
Investments financed from the State Budget of the Republic of Azerbaijan	2,765,200	2,238,857
Investments financed from international financial organizations under the state guarantee	1,061,391	789,243
Total government investments	**3,874,410**	**3,066,305**

The balance of Government investments comprised funding made from the State Budget to finance various capital and other expenditures of the Group, Government borrowings from international financial institutions and non-financial assets granted to the Group by the Government.

As discussed in Note 5, fair value of non-financial assets granted from the various budget organizations at the date of transition amounted to AZN 7,389 during 2017 (31 December 2016: AZN 831).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

12. Interest-bearing loans and borrowings

Interest-bearing loans and borrowings comprised the following:

	31 December 2017	31 December 2016
Government loans financed by international financial institutions	167,268	167,434
Loans from the Ministry of Finance of the Republic of Azerbaijan	71,466	38,939
Loans from local banks	71	215,556
Total interest-bearing loans and borrowings	**238,805**	**421,929**

Current portion of loans of the Group were represented by the following financial institutions:

Financial institution	Contractual interest rate	Original currency	Maturity date	31 December 2017	31 December 2016
World Bank (IDA)	0.75%	SDR	May 2030	8,434	9,207
World Bank (IDA)	0.75%	SDR	November 2037	1,075	1,148
KfW	0.75%	EUR	June 2040	979	899
KfW	0.75%	EUR	December 2045	1,163	880
Natixis	2.45%	EUR	September 2030	4,442	4,078
ADB	2.5%	SDR	November 2036	3,068	2,631
International Bank of Azerbaijan	1%	AZN	July 2025	71	23,972
Total short-term loans and current portion of long-term loans				**19,232**	**42,815**

Non-current portion of loans of the Group were represented by the following financial institutions:

Financial institution	Contractual interest rate	Original currency	Maturity date	31 December 2017	31 December 2016
World Bank (IDA)	0.75%	SDR	May 2030	32,538	40,232
World Bank (IDA)	0.75%	SDR	November 2037	4,154	5,133
KfW	0.75%	EUR	June 2040	21,217	20,268
KfW	0.75%	EUR	December 2045	31,391	24,651
Natixis	2.45%	EUR	September 2030	46,633	47,700
ADB	2.5%	SDR	November 2036	12,174	10,607
International Bank of Azerbaijan	1%	AZN	July 2025	–	191,584
The Ministry of Finance	0%	AZN	December 2027	11,006	10,898
The Ministry of Finance	0%	USD	December 2027	26,948	28,041
The Ministry of Finance	0%	USD	August 2028	16,284	–
The Ministry of Finance	0%	USD	August 2030	17,228	–
Total long-term loans				**219,573**	**379,114**

Reconciliation of loans of the Group were represented as the following:

			Non-cash reconciliation		
	31 december 2016	Cash reconciliation	Paid by Government	Forex diffreneces and others	31 december 2017
Interest-bearing loans and borrowings	421,929	–	(235,657)	52,533	238,805
Total loans	**421,929**	–	**(235,657)**	**52,533**	**238,805**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

12. Interest-bearing loans and borrowings (continued)

Government loans financed by international financial institutions

Loans from international financial institutions represent lending for the financing of projects related to development and improvement of water supply system of the Republic of Azerbaijan lent directly to the Government. The Government in its turn transferred related rights and obligations on these loans to the Group by means of re-financing agreement between the Government and the Group under the similar terms and conditions.

Loans from World Bank (IDA)

On 6 July 1995 the Government entered into loan agreement with International Development Association ("IDA") that is included in the World Bank group, for the amount of SDR 38,800 thousand (AZN 93,714). On 30 June 2003 the Government signed another loan agreement with IDA for the amount of SDR 9,673 thousand (AZN 23,363). The annual effective interest rate under these loan agreements is 0.75% and they are repayable until 2030 and 2037, respectively. These loans were lent for the financing of the project "Greater Baku Water Supply Rehabilitation Project".

Loans from KfW

On 25 September 2006 two loans were lent to the Government by Kreditanstalt für Wiederaufbau ("KfW") German government-owned development bank, in the amount of EUR 14,827 thousand (AZN 30,109) and EUR 26,350 thousand (AZN 53,509), at 0.75% and 0.75% annual effective interest rate and repayable until 2040 and 2045, respectively. The loans were lent for the financing of the project "Open Program Municipal infrastructure". As at 31 December 2017 total drawn amount under the loans amounted EUR 14,827 thousand (AZN 30,109) and EUR 17,756 thousand (AZN 36,057), respectively (31 December 2016: EUR 14,731 thousand (AZN 27,464) and EUR 14,556 thousand (AZN 27,138), respectively).

Loan from Natixis

On 30 September 2006 the loan was lent to the Government by the Natixis, a French corporate and investment bank on behalf of the Government of the Republic of France, in the amount of EUR 35,000 thousand (AZN 71,075) at 2.45% annual effective interest rate and repayable until 2030. The loan was lent for the financing of the project "Reconstruction of Hovsan waste management system, Zygh pump station".

Loan from Asian Development Bank

On 29 November 2005 the loan was lent to the Government by the Asian Development Bank ("ADB"), in the amount of SDR 5,428 thousand (AZN 13,110) at 2.5% annual effective interest rate and repayable until 2036. The loan was lent for the financing of the project "Urban Water Supply and Sanitation Project".

Loans from the Ministry of Finance of the Republic of Azerbaijan

On November 29, 2016 the Group received two interest free loans from the Ministry of Finance in amount of USD 17,382 thousand (AZN 29,551) and AZN 11,943. According to the contracts repayment of loans will start in 2024 in 8 equal instalments twice a year till December 2027. Additionally, on June 7, 2017 the Group received interest free loan from the Ministry of Finance in amount of USD 11,183 thousand (AZN 19,012). According to the contract repayment of loans will start in 2025 in 8 equal instalments twice a year till August 2028.
In addition, at the end of 2017 the Ministry of Finance has granted interest free loan to the Group in amount of USD 11,280 (AZN 19,177).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

12. Interest-bearing loans and borrowings (continued)

Loan from International Bank of Azerbaijan

On July, 2016 the Group has signed a loan agreement with International Bank of Azerbaijan under the government guarantee in the amount of AZN 239,720. As of 31 December 2016, the Group utilized full loan amount for financing of the ongoing infrastructure projects. The interest rate under the loan agreement was 1% per annum. In accordance with the order of the Cabinet of Ministers dated March 14, 2017 № 201S the loan has been paid by the Guarantee Fund. As at 31 December 2017 an unpaid accrued interest on the loan is AZN 71.

13. Provisions

Provisions comprised the following as at:

	31 December 2017	31 December 2016
Unused vacation	6,367	6,111
Provision for court cases	3,627	1,473
Other	120	119
Total provisions	**10,114**	**7,703**

Provision for court cases

Provision for court cases represents factual and probable estimated claims against the Group which were given rise due to ongoing construction projects mainly.

14. Taxes and penalties payable other than income tax

Taxes and penalties payable other than income tax comprised the following as at:

	31 December 2017	31 December 2016
VAT	(11,378)	1,035
Economic and financial sanctions	8,307	23,130
Property tax	5,428	7,604
Withholding tax	221	1,266
Land tax	2,364	4,343
Personal Income tax	(1,185)	(3,435)
Road tax	138	215
Total taxes and penalties other than income tax	**3,895**	**34,158**

Economic and financial sanctions comprised fines and penalties for delayed submission of statutory financial reports, mistakes during statutory reporting and other sanctions.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

15. Trade and other payables

Trade and other payables comprised the following as at:

	31 December 2017	31 December 2016
Construction related payables	314,424	297,208
Trade payables	98,090	118,370
Accrued liabilities	42,436	44,083
Other payables	1,443	1,210
Total financial payables	**456,393**	**460,871**
Payable to Social Security Fund	32,824	31,413
Payable to employees	4,778	4,506
Total trade and other payables	**493,995**	**496,790**

The Group's total payables mainly represented by payables for construction services and payables for material, transportation, water-supply, energy and utilities provided by vendors to the Group.

16. Balances and transactions with related parties

Key management compensation

Key management of the Group includes the Chairman of the Group and its six deputies. The Chairman is appointed by the President of the Republic of Azerbaijan, deputies are appointed by the Chairman and approved by Deputy Prime Minister of the Republic of Azerbaijan. Key management individuals are entitled to salaries and benefits provided by the Group in accordance with the approved payroll matrix. During 2017 compensation of key management personnel totaled to AZN 269 (31 December 2016: AZN 132).

Significant Transactions

All transactions with the Government are disclosed in Note 10, Note 11, Note 12 and Note 24.

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding are detailed below.

The Group had the following outstanding balances with related parties:

		Government and entities under government control	
	Note	31 December 2017	31 December 2016
Gross amounts of trade receivables		30,647	42,744
Impairment provisions for trade receivables		(22,086)	(37,565)
Other receivables		1,809	1,526
Taxes receivables		34,827	25,850
Cash and cash equivalents		302	820
Restricted cash	9	2,179	1,425
Long-term borrowings	12	(219,573)	(379,114)
Short-term borrowings		(19,232)	(42,815)
Trade and other payables		(143,097)	(86,054)
Taxes payables		(15,525)	(36,275)
Advances received		(1,487)	(589)
Deferred revenue		(70)	(133)

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

16. Balances and transactions with related parties (continued)

Significant Transactions (continued)

The transactions with related parties for the year ended 31 December 2017 and 2016 were as follows:

		Government and entities under government control	
	Note	**2017**	**2016**
Sales revenue		45,847	45,920
Energy costs	19	(44,807)	(33,641)
Security costs		(3,858)	(3,771)
Water purchase		(50)	(4,181)
Other expenses		(31,134)	(24,828)
Communication expenses		(143)	(378)

The sales to and purchases from related parties are made at terms equivalent to those that prevail in arm's length transactions except for Government loans lent at a below market rate. Outstanding balances at the yearend are unsecured and interest free except for borrowings. There have been no guarantees provided or received for any related party receivables or payables.

17. Financial risk management

Financial risk factors

In the ordinary course of business, the Group is exposed to credit, liquidity and market risks. Market risks arise from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial position. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position. Although there are no structured formal management procedures, management of the Group identifies and evaluates financial risks with reference to the current market position.

Currency risk

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business. Foreign exchange risk arises primarily from future commercial transactions, recognized assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

The following tables demonstrates the sensitivity to a reasonably possible change in the USD, EUR, SDR exchange rates, with all other variables held constant, of the Group's post-tax profit. There is no material impact on the Group's equity:

31 December 2017	**Change in rates**	**Effect on post-tax profit**
USD/AZN	10%(-10%)	(17,399)/17,399
EUR/AZN	10%(-10%)	(13,168)/13,168
SDR/AZN	1%(-1%)	(614)/614

31 December 2016	**Change in rates**	**Effect on post-tax profit**
USD/AZN	20%/(-20%)	(18,737)/18,737
EUR/AZN	20%/(-20%)	(20,368)/20,368
SDR/AZN	1%/(-1%)	(552)/552

The Group's exposure to foreign currency changes for all other currencies is not material.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

17. Financial risk management (continued)

Credit risk and concentration of credit risk

Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if counterparty defaults on its contractual obligations.

The Group's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and trade and other receivables.

The Group's maximum exposure to credit risk is represented by carrying amounts of financial assets and is presented by class of assets as shown in the table below:

	31 December 2017	**31 December 2016**
Cash and cash equivalents	4,584	1,711
Trade and other receivables	18,355	10,637
Total maximum exposure to credit risk	**22,939**	**12,348**

The Group places its cash with reputable financial institutions in the Republic of Azerbaijan. The Group continually monitors the status of the banks where its accounts are maintained. The Group's credit risk arising from its trade receivables balance with private sector and other third-party unrelated customers is mitigated by continuous monitoring of their creditworthiness. The requirement for an impairment is analyzed at each reporting date on an individual basis for major clients. Additionally, a large number of minor receivables are grouped into homogenous groups and assessed for impairment collectively. The calculation is based on actual incurred historical data. The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets. The Group does not hold collateral as security. Management of the Group believes that the Group is not exposed to high credit risk as the impairment provision has already been accrued in the accompanying consolidated financial statements for all debtors which are not expected to be recovered in a future.

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, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing liquidity risk, the Group should maintain adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows.

Prudent liquidity risk management includes maintaining sufficient working capital and the ability to close out market positions. As discussed in Note 2 the Group continues to remain dependent on its ability to obtain sufficient funding from the Government to sustain operations and complete its current investment projects. Refer to the respective note for management's action points.

All of the Group's financial liabilities represent non-derivative financial instruments. The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period from the statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

17. Financial risk management (continued)

Liquidity risk (continued)

The maturity analysis of financial liabilities is as follows:

At 31 December 2017	Less than 3 months	3-12 months	1-5 years	More than 5 years	Total
Trade and other financial payables	380,105	–	76,288	–	**456,393**
Interest-bearing loans and borrowings	938	14,267	73,833	160,696	**249,734**
Total undiscounted financial liabilities	**381,043**	**14,267**	**150,121**	**160,696**	**706,127**

At 31 December 2016	Less than 3 months	3-12 months	1-5 years	More than 5 years	Total
Trade and other financial payables	381,431	–	79,440	–	**460,871**
Interest-bearing loans and borrowings	12,877	32,127	178,777	230,474	**454,255**
Total undiscounted financial liabilities	**394,308**	**32,127**	**258,217**	**230,474**	**915,126**

Capital management

The primary objective of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain government, investor and creditor confidence to support its business activities.

The Group is 100% owned by the Government of Azerbaijan Republic and periodically receives funds in form of Government investment for implementation of construction projects. Having considered that contributions and additions in capital depend on government decisions and there are no requirements and limits set on level of the capital, no specific capital risk management policies were developed by the Group.

Fair value of financial instruments

The fair value of the financial assets and liabilities is included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of the financial instruments.

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements.

As at 31 December 2017	Carrying value	Fair value
Cash and cash equivalents	4,584	4,584
Trade and other financial receivables	18,355	18,355
Long-term trade and other financial payables	(76,288)	(76,288)
Short-term trade and other financial payables	(417,707)	(417,707)
Long-term bank loans	(219,573)	(159,640)
Short-term bank loans	(19,232)	(19,232)

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

17. Financial risk management (continued)

Fair value of financial instruments (continued)

As at 31 December 2016	Carrying value	Fair value
Cash and cash equivalents	1,711	1,711
Trade and other financial receivables	10,637	10,637
Long-term trade and other financial payables	(79,440)	(79,440)
Short-term trade and other financial payables	(417,350)	(417,350)
Long-term bank loans	(379,114)	(280,740)
Short-term bank loans	(42,815)	(42,815)

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

i. Short-term financial assets and liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

ii. Long-term borrowings are evaluated by the Group based on parameters such as interest rates, specific country risk factors, individual creditworthiness of customers and the risk characteristics of the financed project.

18. Sales revenue and deferred revenue

Sales revenue comprised the following:

	Year ended 31 December 2017	Year ended 31 December 2016
Sales of water	110,621	115,545
Sewerage services	51,449	41,183
Other sales revenue	3,675	3,109
Total sales revenue	**165,745**	**159,837**

Revenue from other sales mainly comprised the sales of water-meters and scientific research and design projects.

Deferred revenue is mainly comprised of advances received from customers for provision of water and sewerage services in the amount of AZN 7,664 as of 31 December 2017 (31 December 2016: 6,288). Moreover, this deferred revenue balance includes advance payments received for technical terms to be provided to the customers and amounted to AZN 1,074 as at 31 December 2017 (31 December 2016: 1,140).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

19. Expenses

For the year ended 31 December 2017 and 2016, cost of sales, administrative expenses, selling and distribution expenses and other operating expenses comprised the following:

2017	Cost of sales	Administrative expenses	Selling and distribution expenses	Other operating expenses	Total
Impairment of property, plant and equipment (Note 5)	–	–	–	567,372	**567,372**
Impairment of intangible assets	–	–	–	44	**44**
Wages, salaries and social security costs	28,749	7,803	41,697	–	**78,249**
Depreciation of property, plant and equipment	5,166	315	5,715	–	**11,196**
Amortization cost	–	73	–	–	**73**
Energy expenses	35,713	215	8,880	–	**44,808**
Raw materials and consumables used	2,827	391	1,475	–	**4,693**
Repairs and maintenance expenses	1,232	86	2,295	–	**3,613**
Training, education and business development costs	–	179	–	–	**179**
Economic sanctions and other penalties	259	10,752	1,213	–	**12,224**
Security expenses	3,633	180	9	–	**3,822**
Fuel expenses	1,543	–	571	–	**2,114**
Taxes other than income tax	4,295	451	1,964	–	**6,710**
Change in other provisions and liabilities	7	2,445	–	–	**2,452**
Bank and collecting expenses	130	1,988	372	–	**2,490**
Business trip expenses	307	291	137	–	**735**
Rent expenses	181	177	913	–	**1,271**
Communication expenses	36	245	342	–	**623**
Insurance expenses	1,036	221	1,093	–	**2,350**
Loss on disposal of non-current assets	245	2	10	–	**257**
Other expenses	368	5,402	51	–	**5,821**
	85,727	**31,216**	**66,737**	**567,416**	**751,096**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

19. Expenses (continued)

2016	Cost of sales	Administrative expenses	Selling and distribution expenses	Other operating expenses	Total
Impairment of property, plant and equipment (Note 5)	–	–	–	543,212	**543,212**
Impairment of intangible assets	–	–	–	70	**70**
Wages, salaries and social security costs	29,148	6,386	44,183	–	**79,717**
Depreciation of property, plant and equipment	10,653	1,905	6,342	–	**18,900**
Amortization costs	–	105	–	–	**105**
Energy expenses	26,732	49	6,860	–	**33,641**
Raw materials and consumables used	6,704	144	3,729	–	**10,577**
Repairs and maintenance expenses	290	135	3,213	–	**3,638**
Training, education and business development costs	–	7,107	–	–	**7,107**
Economic sanctions and other penalties	61	–	1,458	–	**1,519**
Security expenses	3,536	199	41	–	**3,776**
Fuel expenses	1,622	–	594	–	**2,216**
Taxes other than income tax	3,511	222	1,397	–	**5,130**
Change in other provisions and liabilities	–	185	–	–	**185**
Impairment of trade and other receivables	–	–	16,568	–	**16,568**
Bank and collecting expenses	227	1,579	426	–	**2,232**
Business trip expenses	193	213	120	–	**526**
Rent expenses	108	840	787	–	**1,735**
Communication expenses	55	253	350	–	**658**
Insurance expenses	214	561	115	–	**890**
Other expenses	1,524	–	3,755	–	**5,279**
	84,578	**19,883**	**89,938**	**543,282**	**737,681**

During 2017 the Group incurred net foreign exchange loss in the amount of AZN 3,129 (2016 net foreign exchange loss in the amount of AZN 39,800) due to devaluation of Azerbaijani manat against US dollar and other major currencies (see Note 23).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

20. Other income

Other income comprised the following:

	Year ended 31 December 2017	Year ended 31 December 2016
Grants received from KFW	7,242	–
Recovery of trade receivables written off in the previous years	33,770	–
Gain on decrease of allowance for trade receivables in the previous years	7,881	–
Gain on decrease of allowance for advance payments	555	–
Gain on reversal of provision for court cases and unused vacations	–	2,691
Investment from Balakhany Social Development Fund	–	1,947
Gain on written off tax debts	21,328	–
Other	13,090	1,202
Total other income	**83,866**	**5,840**

21. Income tax

Income tax expense comprised the following:

	Year ended 31 December 2017	Year ended 31 December 2016
Current income tax expense	(296)	(127)
Deferred income tax expense	134	(150)
Income tax expense for the year	**(162)**	**(277)**

Differences between IFRS and applicable domestic tax regulations give rise to the temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of these temporary differences is detailed below:

	31 December 2015	In the statement of profit or loss and other comprehensive income	31 December 2016	In the statement of profit or loss and other comprehensive income	31 December 2017
Deductible temporary differences					
Property, plant and equipment	395	(52)	343	350	693
Trade and other payables	149	68	217	(220)	(3)
Inventories	135	(121)	14	4	18
Provisions	49	(45)	4	1	5
Other	1	–	1	(1)	–
Deferred income tax asset	**729**	**(150)**	**579**	**134**	**713**

At 31 December 2017 cumulative balance of unrecognized deferred tax asset from carry forward losses and other temporary differences amounted AZN 1,080,566 (31 December 2016 : AZN 1,044,314).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

21. Income tax (continued)

A reconciliation between tax expense and the product of accounting loss multiplied by the Group's domestic tax rate for the year ended 31 December 2017 and 2016 is as follows:

	2017	2016
Loss before tax	**(508,188)**	**(612,644)**
Theoretical tax benefit at statutory rate of 20 per cent	**101,638**	**122,529**
Tax effect of non-deductible expenses	(125)	(1,115)
Unrecognized deferred tax asset	(101,675)	(121,691)
Income tax expense for the year	**(162)**	**(277)**

The Group does not file a consolidated tax return. In the context of the Group's current structure, tax losses and current tax assets of different Group companies may not be offset against current tax liabilities and taxable profits of other Group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity.

The Group's several subsidiaries have tax losses, which in accordance with Azerbaijani tax legislation, can be carried forward for five years. However, as these losses relate to subsidiaries that have a history of losses, deferred tax assets have not been recognized as these losses may not be used to offset taxable profits elsewhere in the Group. The Group evaluated and concluded that it is not probable that deferred tax assets on balances of loss-making subsidiaries will be recovered in foreseeable future and recognized full allowance for deferred tax asset on these entities.

22. Significant non-cash investing and financing activities

Investing and financing transactions that did not require the use of cash and cash equivalents and were excluded from the consolidated cash flows statement are as follows:

	2017	2016
Construction works financed by the Government	324,121	190,127
Repayment of Group's loans by the Ministry of Finance	235,657	43,835
Grant received from KfW	165	–
Property, plant and equipment granted to the Group by the Government (Note 5)	7,389	831

As discussed in Note 9 the Group's account at the State Treasury is restricted by financing of the Group's construction activities by the Government. The total amount of funds appropriated by the Government for the payment of the Group's construction activities during the years ended 31 December 2017 and 2016 amounted AZN 324,121 and AZN 190,127 respectively.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Contingences, commitments and operating risks

Operating environment

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.

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government.

From the mid of June 2014 the oil prices fell instantaneously and this sharp decline had a direct impact on the oil producing countries i.e. Azerbaijan and their effects robust resulted in decrease in revenue of oil industry, reduction in fiscal revenues, reduction in production of oil and shutting of their progressive operations.

For the Purposes of remaining competitive in international market the Central Bank of Azerbaijan change their foreign exchange policy by depreciating Manat against US Dollar by 34% through a press release on February 21, 2015 and 48% on December 21, 2015. The smooth depreciation of manat against US Dollar continued throughout 2016 and as a whole was approximately equal to 23% for the year.

During 2017, the rate of Manat to US dollar remained stable at the equilibrium point. Since January 12, 2017 Azerbaijan's central bank has dropped the 4% exchange rate corridor it imposed on commercial banks in order to allow the currency to float freely.

The President of the Republic of Azerbaijan signed a decree on "Strategic roadmaps of national economy and main sectors of economy" on 6 December 2016. Development of a sustainable and competitive non-oil sector in Azerbaijan is the main direction of economic policy of Government; The President approved strategic roadmaps in 12 directions including agriculture, oil and gas, consumer goods, heavy industry, tourism, etc.

On September 14, 2017, a new agreement on the development of the Azeri-Chirag-Gunashli oil and gas block was signed with the participation of the President of the Republic of Azerbaijan. The agreement envisages the extension of the term of the "Contract of the Century" (the PSA agreement on the development of the Azeri-Chirag-Gunashli field blocks) until 2050. Under the new agreement, the share of SOCAR has increased from 11.6% to 25%.

As a result of the political and economic processes taking place in oil producing countries, oil prices have increased by about 25% in 2017 in comprison with the end of the previous year.

The volatility in oil prices is significantly effecting the financial and liquidity position of companies in oil or energy sector and lending exposure to this sector may also be adversely affected by the financial and economic environment which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for customers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Group's future results and financial position and business prospects in a manner not currently determinable. Such adverse impacts could include increases in Group's non-recoverable receivables.

Azerbaijani Government announced plans to accelerate reforms and support to mainly, banking system and other industry sectors in response to current economic challenges.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Contingences, commitments and operating risks (continued)

Operating environment (continued)

The Group's Management is monitoring these developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Group's business in the foreseeable future.

While 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 a manner not currently determinable.

The accompanying financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the period when they become known and estimable.

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 internal 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 consolidated financial statements.

Tax legislation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which may occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities. Fiscal periods remain open to review by the tax authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances such reviews may cover longer periods.

The Group's management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained and potential tax liabilities of the Group will not exceed the amounts recorded in these consolidated financial statements.

Environmental matters

The enforcement of environmental regulation in the Azerbaijan Republic 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 liabilities for environmental damage.

24. Events after the reporting date

Following significant events took place subsequent to 31 December 2017:

- According to the Order of the President of the Republic of Azerbaijan dated 22 January 2018, the funds of AZN 184,720 from the budget are considered to be allocated to the Group for financing of construction of the ongoing infrastructure projects and improvement of water supply system.
- By the end of the first quarter of 2018, in accordance with the Law of the Republic of Azerbaijan on "The Regulation of Debts in Compulsory State Social Insurance" debts of AZN 16,595 for mandatory state social insurance premiums of the Group generated until January 1, 2006 and not paid until April 1, 2018 and for financial sanctions (calculated penalty) generated until January 1, 2015 and not paid until April 1, 2018 were written off.