Georgian Oil and Gas Corporation JSC

Consolidated Financial Statements for 2017

Contents

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Independent Auditors' Report

To the Board of Directors of Georgian Oil and Gas Corporation JSC

Opinion

We have audited the consolidated financial statements of Georgian Oil and Gas Corporation JSC (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

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 *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

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

Valuation of Unguaranteed residual value of Finance Lease Receivable

Please refer to Note 14 in the consolidated financial statements.

The Key audit matter	How the matter was addressed in our audit
During 2017, the Group revised the estimated unguaranteed residual value of the finance lease receivable amounting to 62,873 GEL thousand at 31 December 2017. This revision involved certain critical judgements in respect of the assumptions made which are inherently uncertain. Due to the above and the significance of the Finance lease receivable balance, the carrying value of the Finance Lease Receivable is a Key Audit Matter.	We have analysed the Pipeline construction and operating agreement, dated 8 March, 1996 that stipulates the main terms of the finance lease and reconciled the assumptions and inputs used in the calculation of the unguaranteed residual value of the finance lease receivable with respective contractual provisions. Namely, we checked that the nature of assets leased out to the lessees, lease commencement and termination dates were correctly reflected in the calculation of the residual value of the finance lease receivable. We have also compared the date of transfer of the leased assets to the Group detailed in the calculation of the unguaranteed residual value with respective orders of the relevant Government agency, LEPL Enterprise Management Agency.
Changes to the key assumptions included a decrease in the discount rate used to calculate the present value of the unguaranteed residual value of the finance lease receivable and a decrease in projected cash flows from transit fees produced by these assets.	We assessed the reasonableness of the revised assumptions made by the Group as follows: we agreed the recalculated the incremental borrowing rate used by the Group to calculate the present value of the unguaranteed residual value of the finance lease receivable. We have involved our valuation specialists to assess whether the discount rate applied in the cash flow forecast was in line with international valuation standards and accepted market practice. In addition, we evaluated management's cash flow forecast by comparing projected cash flows from transit fees to actual cash flows from transit fees in 2010-2017.

Property, plant and equipment (PPE) register accuracy

Please refer to Note 12 in the consolidated financial statements

The Key audit matter	How the matter was addressed in our audit
The Group has a significant number of items of PPE (approximately 6 thousand items) spread across Georgia that are not always under the physical control of the Group due to the nature and location of the assets. The Group acquires a significant amount of assets on a recurring basis for various capital projects. The Group has a significant amount of assets under construction and as uninstalled equipment. The PPE register is an Excel-based application that is not	Our audit procedures to address the Key Audit matter included the following: — Assessing the Group's capitalization policy for expenditure relating to PPE with reference to the requirements of IFRS; — Assessing, on a sample basis costs capitalized during the year by comparing the costs capitalized with the relevant underlying documentation, which included purchase agreements and invoices, and assessing whether the costs capitalized met the relevant criteria for capitalization; — Challenging the date of transferring construction in progress to PPE by examining the inspection reports, on a sample basis; — Evaluating management's estimation of the carrying value of PPE uninstalled for longer than 24 months by

integrated with the Group's accounting software. The Group does not have formalized controls over the accuracy of the register and over the reconciliation between the register and the accounting software. The PPE register contained errors in respect of additions, disposals and depreciation. Due to the above and the significance of the PPE balance, the accuracy of PPE is a Key Audit Matter.	collecting corroborative evidence from Group's technical personnel and considering our knowledge of the business; — Evaluating management's estimation of useful economic lives by considering our knowledge of the business and practices adopted in the wider oil transportation industry; — Testing the accuracy of the opening balances of the PPE register items by means of reconciling them with the financial records of prior periods; — Checking the completeness and accuracy of additions and disposals of PPE, by tracing respective contracts, underlying invoices and cash payments to significant changes in the PPE register and vouching significant changes to respective source documents; — Reconciliation of the information from the PPE register with the respective disclosures in the financial statements;

Management Report

Management is responsible for the Management Report. The Management report will not include the consolidated financial statements nor our auditors' report thereon. The Management Report is expected to be made available to us after the date of this auditors' report.

Our opinion on the consolidated financial statements does not cover the Management Report and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the Management Report when it becomes available and, in doing so, consider whether the Management Report is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated and whether it contains all information required by and is compliant with the Law of Georgia on Accounting, Reporting and Auditing.

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

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

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

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

The engagement partner on the audit resulting in this independent auditors' report is:

Andrew Coxshall

KPMG Georgia LLC
Tbilisi, Georgia
26 June 2018

’000 GEL	Note	2017	2016
Assets			
Property, plant and equipment	12	778,419	775,511
Prepayments for non-current assets	13	59,535	-
Intangible assets		1,136	1,129
Finance lease receivable	14	62,873	59,037
Loans given	15	12,041	-
Trade and other receivables	16	21,169	20,721
Equity accounted investees	7	15,480	12,640
Non-current assets		**950,653**	**869,038**
Loans given	15	-	2,651
Inventories		12,412	10,928
Taxes other than on income		-	3,659
Prepayments	13	50,791	48,521
Trade and other receivables	16	147,026	179,735
Term deposits		-	75,129
Cash and cash equivalents	17	498,960	391,609
Current assets		**709,189**	**712,232**
Total assets		**1,659,842**	**1,581,270**
Equity	18		
Share capital		624,916	617,093
Additional paid in capital		71,718	71,718
Fair value reserve for non-cash owner contributions		(282,181)	(282,181)
Retained earnings		428,994	264,778
Equity attributable to owners of the Company		**843,447**	**671,408**
Non-controlling interests	23	69,063	40,186
Total equity		**912,510**	**711,594**
Liabilities			
Loans and borrowings	20	637,381	650,806
Non-current liabilities		**637,381**	**650,806**
Loans and borrowings	20	78,519	151,593
Trade and other payables	21	29,254	64,410
Current tax liabilities		113	802
Provisions		2,065	2,065
Current liabilities		**109,951**	**218,870**
Total liabilities		**747,332**	**869,676**
Total equity and liabilities		**1,659,842**	**1,581,270**

The consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 44.

'000 GEL	Note	2017	2016
Revenue	6	671,586	633,638
Cost of gas and oil		(392,649)	(391,141)
Depreciation		(37,322)	(39,864)
Personnel costs		(17,703)	(15,722)
Taxes, other than on income		(9,650)	(10,195)
Other expenses	8	(16,468)	(28,190)
Other income	9	8,028	1,068
Results from operating activities		**205,822**	**149,594**
Finance income	10	68,432	61,305
Finance costs	10	(53,889)	(111,517)
Net finance income/(costs)		**14,543**	**(50,212)**
Share of profit/(loss) of equity accounted investees	7	2,100	(1,964)
Profit before income tax		**222,465**	**97,418**
Income tax expense	11	(2,059)	(19,381)
Profit and total comprehensive income for the year		**220,406**	**78,037**
Profit and total comprehensive income attributable to:			
Owners of the Company		191,529	81,364
Non-controlling interests		28,877	(3,327)
		220,406	**78,037**

These consolidated financial statements were approved by management on 26 June 2018 and were signed on its behalf by:

David Tvalabeishvili
General Director

David Vardiashvili
Financial Director

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 44.

	Attributable to owners of the Company						
’000 GEL	**Share capital**	**Additional paid in capital**	**Fair value reserve for non-cash owner contributions**	**Retained earnings**	**Total**	**Non-controlling interests**	**Total equity**
Balance at 1 January 2016	**610,901**	**71,718**	**(282,181)**	**270,908**	**671,346**	**43,513**	**714,859**
Profit and total comprehensive income for the year	**-**	**-**	**-**	**81,364**	**81,364**	**(3,327)**	**78,037**
Transactions with owners of the Company							
Contributions and distributions							
Dividends (see note 18(c))	-	-	-	(12,676)	(12,676)	-	(12,676)
Distribution of non-cash assets, net of tax	-	-	-	(74,818)	(74,818)	-	(74,818)
Increase in share capital (see note 18 (a))	6,192	-	-	-	6,192	-	6,192
Total contributions and distributions	**6,192**	**-**	**-**	**(87,494)**	**(81,302)**	**-**	**(81,302)**
Balance at 31 December 2016	**617,093**	**71,718**	**(282,181)**	**264,778**	**671,408**	**40,186**	**711,594**
Balance at 1 January 2017	**617,093**	**71,718**	**(282,181)**	**264,778**	**671,408**	**40,186**	**711,594**
Profit and total comprehensive income for the year	**-**	**-**	**-**	**191,529**	**191,529**	**28,877**	**220,406**
Transactions with owners of the Company							
Contributions and distributions							
Dividends (see note 18(c))	-	-	-	(27,313)	(27,313)	-	(27,313)
Increase in share capital (see note 18 (a))	7,823	-	-	-	7,823	-	7,823
Total contributions and distributions	7,823	**-**	**-**	**(27,313)**	**(19,490)**	**-**	**(19,490)**
Balance at 31 December 2017	**624,916**	**71,718**	**(282,181)**	**428,994**	**843,447**	**69,063**	**912,510**

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 44.

'000 GEL	Note	2017	2016
Cash flows from operating activities			
Cash receipts from customers		759,289	678,142
Cash paid to suppliers and employees		(513,090)	(490,150)
Value added tax refund from the State		-	3,500
Cash from operations before income taxes and interest		**246,199**	**191,492**
		-	(12,341)
Interest paid		(46,073)	(42,913)
Interest received		31,774	22,848
Net cash from operating activities		**231,900**	**159,086**
Cash flows from investing activities			
Acquisition of property, plant and equipment, including advances paid		(82,889)	(53,115)
Decrease in term deposit		69,129	-
Repayment of loans given		2,442	41,015
Loans given		(10,883)	(39,858)
Acquisition of equity accounted investee		(740)	(8,942)
Net cash used in investing activities		**(22,941)**	**(60,900)**
Cash flows from financing activities	20		
Dividends paid		(27,313)	(12,676)
Proceeds from borrowings		69,914	550,431
Repayment of borrowings		(130,227)	(450,154)
Net cash (used in)/from financing activities		**(87,626)**	**87,601**
Net increase in cash and cash equivalents		**121,333**	**185,787**
Cash and cash equivalents at 1 January		391,609	191,088
Effect of exchange rate fluctuations on cash and cash equivalents		(13,982)	14,734
Cash and cash equivalents at 31 December	17	**498,960**	**391,609**

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 44.

1. Reporting entity

(a) Organisation and operations

Georgian Oil and Gas Corporation JSC (the "Company") and its subsidiaries (the "Group") comprise Georgian Joint Stock and Limited Liability Companies as defined in the Law of Georgia on Entrepreneurs. The Company was established as a 100% state-owned enterprise by the order of the Ministry of Economy of Georgia on 21 March 2006, on the basis of three Georgian state-owned companies: Georgian International Oil Corporation JSC, Georgian Gas International Corporation JSC and Teleti Oil Company JSC.

The Company's registered office is 21 Kakheti Highway, Tbilisi 0190, Georgia. The Company has been registered by Tbilisi Tax Inspection and the registration number is # 4346/007.

The Group's principal activities are natural gas import, electricity generation and supply, rent of gas pipelines and oil and gas exploration and extraction in Georgia. Following the completion of the Gardabani Combined Cycle Power Plant (CCPP) construction in July 2015, electricity generation was added to the Group's principal activities. On 7 September 2015, Gardabani CCPP obtained the licence on operation for an unlimited period from the Georgian National Energy and Water Supply Regulatory Commission (GNERC) and commenced generating revenue in accordance with the deregulated tariffs on the electricity market in Georgia. In accordance with the Government of Georgia order # 475 dated 14 September 2015 Gardabani CCPP was granted the status of guaranteed capacity operator until 1 October 2040.

In 2016 the Group acted as an agent for crude oil delivery from Azerbaijan to Batumi sea port in Georgia. In 2017 the Group ceased these operations.

Since December 2006, when the Company has been granted the status of National Oil Company on behalf of the State of Georgia, the Company receives and sells the State's share of extracted oil and gas in Georgia in accordance with Production Sharing Agreements signed between the State and investors.

(b) Business environment

The Group's operations are located in Georgia, consequently, the Group is exposed to the economic and financial markets of Georgia, which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The consolidated financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2. Basis of accounting

(a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

3. Functional and presentation currency

The national currency of Georgia is the Georgian Lari ("GEL"), which is the Company's functional currency and the currency in which these consolidated financial statements are presented. All financial information presented in GEL has been rounded to the nearest thousand.

4. Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

– Note 14 Finance lease receivable – determination of whether the initial arrangement contains a finance lease and the present value of the unguaranteed residual value at the end of the lease term;
– Note 16 Trade and other receivables– determination of payment schedules for receivables from GGTC.
– Note 17 Cash and cash equivalents – classification of term deposits with original maturities of more than three months as cash and cash equivalents;
– Note 23 Significant subsidiaries – determination of control over subsidiaries;
– Note 24 Capital and other commitments – assessment of the commitment related to the purchase and sale of gas.

Measurement of fair values

Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

– *Level 1*: quoted prices (unadjusted) in active markets for identical assets or liabilities.
– *Level 2*: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
– *Level 3*: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

The information about the assumptions made in measuring fair values is included in note 22.

Further information about the assumptions made in measuring fair values is included in note 22 (a) – accounting classifications and fair values.

5. Operating segments

The Group has five reportable segments (six in 2016), as described below, which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately. For each of the strategic business units, the Company's General Director reviews internal management reports on at least a quarterly basis. The following summary describes the operations in each of the Group's reportable segments:

— *Gas supply:* Includes purchase and sale of natural gas.
— *Electricity generation and supply*: Includes electricity sales and guaranteed capacity fees.
— *Pipeline rental*: Includes rental income earned by the Group from the lease of gas pipelines to a related party, Georgian Gas Transportation Company LLC (see note 26).
— *Oil transportation*: Includes income from transportation of oil through the territory of Georgia.
— *Upstream activities*: Includes sale of oil from production-sharing arrangements.
— *Oil trading*: Includes agency fees from crude oil delivery from Azerbaijan to Black Sea ports in Georgia. The Group ceased this activity in 2017.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before depreciation, personnel costs, net finance costs, other income/expenses and income and other taxes, as included in the internal management reports that are reviewed by the Company's General Director. The management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. The Company's General Director does not monitor segment assets or liabilities.

(i) Information about reportable segments:

	Gas supply		**Electricity generation and supply**		**Pipeline rental**		**Oil transportation**		**Upstream activities**		**Agency fee from oil trading**		**Total**	
'000 GEL	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Revenue	379,560	348,226	199,711	184,377	59,847	68,487	18,315	18,047	14,153	10,478	-	4,023	671,586	633,638
Cost of gas and oil	(304,576)	(308,875)	(88,073)	(82,266)	-	-	-	-	-	-	-	-	(392,649)	(391,141)
Reportable segment profit before unallocated costs and income tax	**74,984**	**39,351**	**111,638**	**102,111**	**59,847**	**68,487**	**18,315**	**18,047**	**14,153**	**10,478**	**-**	**4,023**	**278,937**	**242,497**

'000 GEL	**2017**	**2016**
Revenues		
Total revenue for reportable segments	671,586	633,638
Profit or loss		
Reportable segments profit	278,937	242,497
Unallocated amounts:		
Depreciation	(37,322)	(39,864)
Personnel costs	(17,703)	(15,722)
Net finance income/(costs)	14,543	(50,212)
Taxes, other than on income	(9,650)	(10,195)
Other expenses	(16,468)	(28,190)
Other income	8,028	1,068
Share of income/(loss) of equity accounted investees	2,100	(1,964)
Consolidated profit before income tax	**222,465**	**97,418**

(ii) Geographical information

Majority of the Group's revenues are generated in Georgia and all non-current assets are located in Georgia.

(iii) Major customer

In 2017 sales to one customer in the gas supply segment represented GEL 376,671 thousand which represents approximately 56 % of the Group's total revenue (2016: GEL 345,874 thousand, 55%).
In 2017 sales to one customer in electricity generation and supply segment represented GEL 109,125 thousand which represents approximately 16% of the Group's total revenue (2016: GEL 115,993 thousand, 18%).

6. Revenue

'000 GEL	**2017**	**2016**
Sale of natural gas	379,560	348,226
Income from electricity generation and supply	199,711	184,377
Income from rent of gas pipelines	59,847	68,487
Oil transportation fee	18,315	18,047
Income from crude oil sales	14,153	10,478
Agency fees from oil trading	-	4,023
Total revenues	**671,586**	**633,638**

Income from electricity generation and supply includes the income from guaranteed capacity fees of GEL 103,166 thousand (2016: GEL 109,852 thousand) and income from electricity generation of GEL 96,545 thousand (2016: GEL 74,525 thousand).

The Company rents its gas pipeline and related infrastructure to Georgian Gas Transportation Company LLC (GGTC). The rent agreement is non-cancellable and is valid until 1 January 2020. From September 2011 till 1 September 2017 the lease payments were calculated based on the volume of gas transported through the leased gas pipeline at a rate of $6.80 per 1,000 cubic metres. Since 1 September 2017 the rent fee is fixed at GEL 3,500 thousand per month. GGTC is responsible for all costs related to the repair, maintenance, operation and security of the main gas pipeline system. The Company is responsible for capital expenditures only.
Transactions with related parties are disclosed in note 26.

Oil transportation fee is received for the oil transit from Azerbaijan to Turkey through the Baku-Supsa pipeline.

7. Equity accounted investees

During the year ended 31 December 2017 Georgian Energy Development Fund JSC decreased the charter capital of its subsidiary Kartli Wind Power Station LLC from 57.15% to 50.1%, which in turn resulted in an increase in the Group's share to 49.99% and amounted to GEL 14,435 thousand (2016: GEL 14,322 thousand, 42.85%).

Kartli Wind Power Station LLC constructed the first wind power station in Georgia with a capacity of 20.7 MW. The construction of the station was completed in September 2016 and started operation from November 2016.

'000 GEL	**2017**	**2016**
Balance at 1 January	12,640	5,663
Contributions made	740	8,941
The Group's share of profit/(loss), net of income tax	2,100	(1,964)
Balance at 31 December	**15,480**	**12,640**

'000 GEL	**2017**	**2016**
Percentage ownership interest	**49.99%**	**42.85%**
Non-current assets	66,212	68,563
Current assets	17,796	22,767
Non-current liabilities	(48,478)	(47,863)
Current liabilities	(7,589)	(15,786)
Net assets (100%)	27,941	27,681
Group's share of net assets	**13,968**	**11,861**
Revenue	14,106	-
Profit/(loss) and total comprehensive income/(loss) (100%)	4,200	(4,584)
Group's share of profit/(loss) and total comprehensive income/(loss)	**2,100**	**(1,964)**

Additionally, Georgian Oil and Gas Corporation JSC owns an interest in International Pipeline Company Samartia LLC and an interest in AGRI LNG Project Company LLC, both constituting significant influence.

Based on the order # 775 of the Government of Georgia on 13 April 2017, Georgian Oil and Gas Corporation JSC can participate in the implementation of White Stream and Trans-Caspian Gas Pipeline projects. Based on the annual Partnership Meeting held on 9 July 2017, Partners of Samartia made the decision to increase the charter capital of Samartia LLC. Based on the above-mentioned decision, cash paid for the acquisition of equity accounted investees equalled to GEL 740 thousand.

None of the Group's equity accounted investees are publicly listed entities and consequently do not have published price quotation for shares.

8. Other expenses

’000 GEL	**2017**	**2016**
Transportation, materials, repair and maintenance	6,434	9,822
Regulatory fees	2,091	2,595
Legal fees	1,737	11
Office expenses	1,231	1,649
Representative and business trip expenses	650	504
Benefits to employees	597	537
Professional services *	227	266
Write off and disposal of assets	97	-
Impairment loss on trade receivables	-	8,818
Pre-feasibility study cost	-	1,428
Other	3,404	2,560
	16,468	**28,190**

*****The professional services above include fees paid to the audit firm of about GEL 62 thousand, for the provision of audit and other professional services.

9. Other income

’000 GEL	**2017**	**2016**
Reversal of impairment loss on trade receivables	1,340	-
Excess inventory identified through stock count	1,176	-
Oil processing	229	464
Other	5,283	604
	8,028	**1,068**

10. Finance income and finance costs

’000 GEL	**2017**	**2016**
Recognised in profit or loss		
Interest income on bank deposits	36,453	24,037
Interest income on loans given	495	5,904
Customer late payment penalty interest	20,851	27,751
Net foreign exchange gain	6,797	-
Unwinding of discount on finance lease receivable (note 14)	3,836	3,613
Finance income	**68,432**	**61,305**
Interest expense on loans and borrowings	(48,695)	(48,049)
Loss on derecogntion of financial asset (see note 16)	(5,194)	-
Net foreign exchange loss	-	(50,413)
Early redemption fees	-	(13,055)
Finance costs	**(53,889)**	**(111,517)**
Net finance income (costs) recognised in profit or loss	**14,543**	**(50,212)**

11. Income tax expense

(a) Amounts recognized in profit or loss

The Groups applicable tax rate is the income tax rate of 17.64% (2016: 15%) applicable to Georgian companies.

’000 GEL	2017	2016
Current tax expense		
Current year	391	18,333
Under provided in prior years	1,668	726
	2,059	**19,059**
Deferred tax benefit		
Origination and reversal of temporary differences	-	322
Total tax expense	**2,059**	**19,381**

(b) Reconciliation of effective tax rate:

	2017		2016	
	’000 GEL	%	’000 GEL	%
Dividend declared / Profit before tax	27,313	100	97,418	100
Income tax expenses at applicable tax rate	4,820	18	14,613	15
Set off of the tax payable on dividends *	(4,429)	(16)		
Under provided in prior years	1,668	6	726	1
Change in recognised deductible temporary differences due to change in the legislation **	-	-	322	0
Differences' between tax and IFRS bases of income and expenses	-	-	3,720	4
	2,059	**8**	**19,381**	**20**

* Set off of the tax payable on dividends relates to corporate income tax paid on the undistributed earnings in the years 2008 to 2016.

** Reversal of previously recognized deferred tax asset and liabilities of GEL 322 thousand is attributable to changes in Georgian tax legislation. On 13 May 2016 the Parliament of Georgia passed a bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed. The law is effective for tax periods starting after 1 January 2017. Considering that the change in the Georgian Tax Code was enacted before the reporting date, the Company has recognized the full effect of the change by derecognizing previously recognized deferred tax asset through the previous period statement of profit or loss as an income tax expense.

12. Property, plant and equipment

’000 GEL	Gas and oil pipelines	Land and buildings	Electricity Generating unit	Oil wells	Plant and equipment	Other	Under construction and uninstalled equipment	Total
Cost								
Balance at 1 January 2016	**402,482**	**37,585**	**391,563**	**29,864**	**18,479**	**7,589**	**39,506**	**927,068**
Additions	174	5,576	-	-	363	1,796	55,253	63,162
Transfers	-	636	2,896	5,540	749	373	(10,194)	-
Disposals	(335)	(117)	(3,555)	-	(581)	-	(1,680)	(6,268)
Reclassification	(10,672)	-	-	-	-	-	10,672	-
Balance at 31 December 2016	**391,649**	**43,680**	**390,904**	**35,404**	**19,010**	**9,758**	**93,557**	**983,962**
Balance at 1 January 2017	**391,649**	**43,680**	**390,904**	**35,404**	**19,010**	**9,758**	**93,557**	**983,962**
Additions	8,380	865	-	-	457	848	31,229	41,779
Transfers	13,054	(352)	525	-	384	249	(13,860)	-
Disposals	(683)	(118)	-	-	(73)	(11)	(695)	(1,580)
Reclassification	(603)	-	-	-	-	-	603	-
Balance at 31 December 2017	**411,797**	**44,075**	**391,429**	**35,404**	**19,778**	**10,844**	**110,834**	**1,024,161**
Depreciation and impairment losses								
Balance at 1 January 2016	122,990	5,752	7,065	22,540	6,769	3,688	-	168,804
Depreciation for the year	19,244	744	15,152	1,683	2,340	595	-	39,758
Disposals	-	-	(111)	-	-	-	-	(111)
Transfers to uninstalled equipment	(6,270)	-	-	-	-	-	6,270	-
Balance at 31 December 2016	**135,964**	**6,496**	**22,106**	**24,223**	**9,109**	**4,283**	**6,270**	**208,451**
Balance at 1 January 2017	**135,964**	**6,496**	**22,106**	**24,223**	**9,109**	**4,283**	**6,270**	**208,451**
Depreciation for the year	17,674	776	15,291	1,207	1,805	1,115	-	37,868
Disposals	(529)	(26)	-	-	(11)	(11)	-	(577)
Transfers to uninstalled equipment	5	-	-	-	-	-	(5)	-
Balance at 31 December 2017	**153,114**	**7,246**	**37,397**	**25,430**	**10,903**	**5,387**	**6,265**	**245,742**
Carrying amounts								
At 1 January 2016	**279,492**	**31,833**	**384,498**	**7,324**	**11,710**	**3,901**	**39,506**	**758,264**
At 31 December 2016	**255,685**	**37,184**	**368,798**	**11,181**	**9,901**	**5,475**	**87,287**	**775,511**
At 31 December 2017	**258,683**	**36,829**	**354,032**	**9,974**	**8,875**	**5,457**	**104,569**	**778,419**

Uninstalled equipment represents GEL 61,635 thousand from the balance (2016: GEL 37,074 thousand) of GEL 104,569 thousand, assets under construction and uninstalled equipment. Uninstalled equipment consists of gas pipelines and turbines not yet put into use. Since the Georgian market is not developed, it is almost impossible to buy parts for thermal power plants quickly in urgent situations, hence the Company has to keep additional stock. Assets under construction mostly contains the construction / rehabilitation works related to the gas pipelines.

During 2017 the Government of Georgia contributed gas pipelines of GEL 7,421 thousand, land plots of GEL 313 thousand and inventories of GEL 89 thousand (2016: gas pipelines of GEL 174 thousand, land plots of GEL 4,611 thousand, plant and equipment of GEL 363 thousand and intangible assets of GEL 1,044 thousand) in the form of an increase in share capital. The nominal value of these assets approximates their fair value.

13. Prepayments

'000 GEL	**2017**	**2016**
Non-current assets		
Prepayments	59,535	-
Total non-current	**59,535**	**-**
Current assets		
Prepayments	50,791	48,521
Total current	**50,791**	**48,521**
	110,326	**48,521**

On 28 September 2016 the agreement was signed on engineering, procurement and construction of Gardabani II combined cycle thermal power plant, between Gardabani II LLC and China Tianchen Engineering Corporation. The completion period is 24 months from the commencement date. GEL 59,535 thousand was paid as an advance payment in accordance with the above agreement and is classified as a non-current asset.

Short term prepayments are made mainly to South Caucasus Pipeline Option Gas Company Limited GEL 31,136 thousand (GEL 29,271 thousand in 2016) and to Azerbaijan Gas Supply Company Limited (AGSC), GEL 11,636 thousand, (GEL 12,216 thousand in 2016) for the supply of gas.

14. Finance lease receivable

In 1996, the Government of Georgia entered into a 30 year arrangement with a consortium of oil companies that undertook the construction and development of an oil pipeline system from the Georgian-Azerbaijan state border to the Supsa oil terminal on the Georgian Black Sea coast. The arrangement granted the oil companies the right to transport oil across the territory of Georgia through that pipeline system that became the property of the Government of Georgia. The ownership of this pipeline was transferred to the Company in June-July 2010 as a contribution to the charter capital of the Company at a nominal value of GEL 269,299 thousand. In exchange for the oil companies using the pipeline, the Group receives a transit fee for each barrel of oil transported. Management has determined that the initial arrangement contained a finance lease at inception date, as the lease agreement transferred substantially all of the risks and rewards incidental to ownership to the lessee.

The Group has recognized the finance lease receivable of GEL 39,229 thousand at the date when the title of the pipelines was transferred to the Group. The finance lease receivable is the present value of the net investment in the lease comprising the present value of the assets' unguaranteed residual value at the end of the lease term discounted at the interest rate implicit in the lease. The difference of GEL 230,070 thousand between the nominal and the present value of the net investment in the lease has been recognised in equity as a fair value adjustment for non-cash owner contributions.

’000 GEL	**2017**	**2016**
Finance lease receivable at 1 January	59,037	55,424
Unwinding of discount on finance lease receivable	3,836	3,613
Finance lease receivable at 31 December	**62,873**	**59,037**

Contingent rent related to oil transportation recognized in the consolidated statement of profit or loss and other comprehensive income during 2017 amounted to GEL 18,315 thousand (2016: GEL 18,047 thousand).

15. Loans given

’000 GEL	**2017**	**2016**
Non-current assets		
Loan given to shareholder	12,041	-
Total non-current	**12,041**	**-**
Current assets		
Loan given to third party	-	2,651
Total current	**-**	**2,651**
	12,041	**2,651**

The loan outstanding as at 31 December 2016 was fully repaid during 2017.

The loan given to the shareholder, JSC Partnership Fund, is unsecured subordinated loan and denominated in USD, bears the contractual interest rate of 9.5% per annum and matures within 4 years.

Based on the agreement between JSC Partnership Fund and the Company, the loan given by the Company will be repaid a) no later than 31 May 2021 or b) the date falling 6 months after JSC Partnership Fund pays its debt to a third party in full – the later of (a) and (b) is considered as the repayment date. The Group’s exposure to credit risks and impairment losses related to loans are disclosed in note 22.

16. Trade and other receivables

’000 GEL	**2017**	**2016**
Non-current assets		
Trade receivables	21,169	20,721
Total non-current	**21,169**	**20,721**
Current assets		
Trade receivables	144,458	179,345
Other receivables	2,568	390
Total current	**147,026**	**179,735**
	168,195	**200,456**

On 16 November 2017, the Company and Georgian Gas Transportation Company LLC signed an agreement on restructuring the receivable related to the rent of the main gas pipeline. The counterparties agreed a payment schedule, based on which the total amount will be repaid by the end of 2025. The restructuring of the receivable signifies a substantial modification of terms, therefore, at the date of the restructuring, the Company derecognized the existing receivable and recognised a new asset according to the new terms, the difference of GEL 5,194 thousand being recognized as a

loss on derecogntion of a financial asset in the statement of profit or loss and other comprehensive income. The fair value of the balance is calculated based on the present value of future payments at the market interest rate of 10.86 % (Note 10).

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 22.

17. Cash and cash equivalents

'000 GEL	**2017**	**2016**
Cash and cash equivalents	203,711	219,902
Call deposits	295,249	171,543
Restricted cash	-	164
Cash and cash equivalents in the consolidated statement of cash flows and in the consolidated statement of financial position	**498,960**	**391,609**

Call deposits represent term deposits with banks with maturities greater than three months from the acquisition date but for which the Group has the unilateral right to withdraw the deposits within a few days of providing notification without incurring significant penalties or loss of interest. Consequently, these term deposits have been classified in accordance with their nature which is that of a call deposit.

The Group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in note 22.

18. Equity

(a) Share capital

Number of shares unless otherwise stated	**Ordinary shares**	
	2017	**2016**
Par value	GEL 20	GEL 20
On issue at 1 January	30,854,651	30,545,028
Issue of shares in exchange for non-cash assets contributed	391,146	309,623
On issue at 31 December	**31,245,797**	**30,854,651**

Ordinary shares

The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of the Company.

(b) Additional paid in capital

Additional paid in capital represents benefits provided to the Group by the Government of Georgia acting in its role of the shareholder.

(c) Dividends and other distribution to shareholders

In 2017 dividends of GEL 27,313 thousand were declared and paid (2016: GEL 12,676 thousand were declared and paid).

Based on the Order # 531 issued by Government of Georgia on 27 March 2012, related to the distribution of net profit of the Company, from the net profit generated by the Company during 2012-2017, the maximum amount that can be distributed is 35% of net profit. From 2018 the intention of Management is to keep paying dividends up to 35% of consolidated net profit in future years.

(d) Non-controlling interests

Non-controlling interest represents the Partnership Fund JSC's contribution to the charter capital and its share of the cumulative retained earnings of Gardabani TPP LLC, a subsidiary of the Group (see note 23).

19. Capital management

The Group has no formal policy for capital management but management seeks to maintain a sufficient capital base for meeting the Group's operational and strategic needs, and to maintain confidence of market participants. This is achieved with efficient cash management, constant monitoring of the Group's revenues and profit, and long-term investment plans mainly financed by the Group's operating cash flows. With these measures the Group aims for steady profits growth.

There were no changes in the Group's approach to capital management during the year.

Neither the Company nor its subsidiary are subject to externally imposed capital requirements.

20. Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 22.

'000 GEL	**2017**	**2016**
Non-current liabilities		
Unsecured bond issue	637,381	650,806
	637,381	**650,806**
Current liabilities		
Unsecured loans	67,512	-
Current portion of unsecured bond issue	11,007	151,593
	78,519	**151,593**
	715,900	**802,399**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

				31 December 2017		**31 December 2016**	
'000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Loan from banks	USD	5.000%	2018	12,979	12,979	-	-
Loan from banks	USD	6.500%	2018	54,533	54,533	-	-
Unsecured bond issue	USD	6.750%	2021	648,050	648,388	661,700	659,968
Unsecured bond issue	USD	6.875%	2017	-	-	141,485	142,431
Total interest-bearing liabilities				**715,562**	**715,900**	**803,185**	**802,399**

In May 2017 the Group repaid in full the remaining part of the Eurobonds issued in May 2012.

In April 2016 the Group carried out the issuance, placement and registration (listing) on the London Stock Exchange of unsecured bonds of USD 250 million and the early part-redemption of the 2012 Bonds.

(b) Reconciliation of movements of assets and liabilities to cash flows arising from financing activities

	Retained earnings	**Liabilities**	
'000 GEL	**Retained earnings**	**Loans and borrowings**	**Total**
Balance at 1 January 2017	**264,778**	**802,399**	1,067,177
Proceeds from borrowings	-	69,914	69,914
Repayment of borrowings	-	(130,227)	(130,227)
Dividend paid	(27,313)	-	(27,313)
Total changes from financing cash flows	**(27,313)**	**(60,313)**	**(87,626)**
The effect of changes in foreign exchange rates	-	**(28,808)**	**(28,808)**
Interest expense	-	48,695	48,695
Interest paid	-	(46,073)	(46,073)
Total liability-related other changes	-	**(26,186)**	**(26,186)**
Total retained earnings-related other changes	**191,529**	-	**191,529**
Balance at 31 December 2017	**428,994**	**715,900**	**1,144,894**

21. Trade and other payables

'000 GEL	**2017**	**2016**
Trade payables	19,619	63,224
Payables for non-current assets	9,634	1,143
Other payables	1	43
	29,254	**64,410**

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 22.

22. Fair values and risk management

(a) Accounting classifications and fair values

The estimates of fair value are intended to approximate 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. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

The Group has determined fair values of financial assets and liabilities using valuation techniques. The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The valuation technique used is the discounted cash flow model. Fair value of all financial assets and liabilities is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

Management's estimate of the fair value of the unsecured bonds yielded a range of values from a fair value approximately equal to the carrying amount to a fair value approximately 8% higher than the carrying amount. Although unsecured bonds are listed in London Stock Exchange, the market is not considered as active, as the participants are mostly institutional investors and turnover on the market is not high.

The carrying values of other financial assets and liabilities of the Group are a reasonable approximation of their fair values.

(b) Financial risk management

The Group has exposure to the following risks from its use of financial instruments:

- credit risk (see (b)(ii));
- liquidity risk (see (b)(iii));
- market risk (see (b)(iv)).

(i) Risk management framework

The Supervisory Board has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

(ii) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers, loans given, term deposits and cash and cash equivalents.

The carrying amount of financial assets and prepayments represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was as follows:

	Carrying amount	
'000 GEL	**2017**	**2016**
Trade and other receivables *	168,195	200,456
Prepayments	110,326	48,521
Loans given	12,041	2,651
Term deposits	-	75,129
Cash and cash equivalents	498,960	391,609
	789,522	**718,366**

*The balance contains long term receivable from GGTC of GEL 21,169 thousand (see note 16).

Trade and other receivables

Credit risk is managed by requesting prepayments from customers or assessing their creditworthiness prior to extending credit. No collateral in respect of trade and other receivables is generally required.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables.

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

	Carrying amount	
'000 GEL	**2017**	**2016**
Domestic *	161,348	176,749
OECD countries	4,954	22,172
CIS countries	1,893	1,535
	168,195	**200,456**

The maximum exposure to credit risk for trade receivables at the reporting date by type of customer was:

	Carrying amount	
'000 GEL	**2017**	**2016**
Gas distributors	117,133	129,777
Electricity distributors	12,677	25,476
Gas pipeline rentals *	29,829	20,721
Oil trading	4,954	22,172
Others	3,602	2,310
	168,195	**200,456**

As at 31 December 2017 the Group had two customers whose balance exceeded 10% of total trade receivables (31 December 2016: one customer). The carrying value of this balances as at 31 December 2017 was GEL 116,749 thousand (31 December 2016: GEL 129,631 thousand) and GEL 43,746 thousand (31 December 2016: 20,721 thousand).

*The balance contains long term receivable from GGTC of GEL 21,169 thousand (see note 16).

Impairment losses

The ageing of trade and other receivables at the reporting date was as follows:

'000 GEL	**Gross 2017**	**Impairment 2017**	**Gross 2016**	**Impairment 2016**
Not past due	38,690	-	79,041	-
Past due 0-30 days	35,892	-	49,728	779
Past due 31-365 days	87,539	-	79,903	7,943
Past due more than one year	6,074	-	4,071	3,565
	168,195	**-**	**212,743**	**12,287**

The Group believes that the amounts that are past due are still collectible, based on historic payment behaviour and analysis of customer credit risk.

Prepayments

As at 31 December 2017, the Group's long-term prepayments consist of amounts transferred to foreign company to deliver engineering, procurement and construction services for Gardabani II combined cycle thermal power plant. The group obtained guarantees from A Fitch rated bank to cover credit risk associated with the prepayment.

As at 31 December 2017 and 2016, short term prepayments were mainly made to gas vendors, which whom the Group has long term uninterrupted history of gas supply.

Loans given

In 2017 the Group provided a loan to its shareholder. The loan provided to the third party in 2016 was fully repaid in 2017. Partnership Fund JSC is the largest government owned Company, with Fitch credit rating of BB-, thus per management's assessment there is no credit risk associated with loan issued.

Term deposits and cash and cash equivalents

As at 31 December 2017 the Group had placements with 3 banks whose balances exceeded 10% of total cash and cash equivalents (31 December 2016: 4 banks). The carrying value of these balances as at 31 December 2017 was GEL 410,469 thousand (31 December 2016: GEL 334,413 thousand). As at 31 December 2017 approximately 85% of bank balances are held with 3 Georgian banks, out of which 2 banks have long-term Fitch credit rating of BB- and one is the Georgian subsidiary of a Russian bank with long-term Fitch rating of BB+. 13% of bank balances are held with 2 Georgian banks with long-term Fitch credit rating of B+ and B.

(iii) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, 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. The Group's liquidity management also involves monitoring the covenants embedded in the bond issue agreements.

Typically the Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 60 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters.

Exposure to liquidity risk

The following are the contractual maturities of financial liabilities at the reporting date. The amounts include estimated interest payments. It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

'000 GEL 2017	**Carrying amount**	**Contractual cash flows**	**0-6 mths**	**6-12 mths**	**1-3 yrs**	**3-5 yrs**
Non-derivative financial liabilities						
Unsecured bond issue	648,388	801,153	21,872	21,872	87,487	669,922
Unsecured loans	67,512	70,070	1,973	68,097	-	-
Trade and other payables	29,254	29,256	29,256	-	-	-
	745,154	**900,479**	**53,101**	**89,969**	**87,487**	**669,922**

'000 GEL 2016	**Carrying amount**	**Contractual cash flows**	**0-6 mths**	**6-12 mths**	**1-3 yrs**	**3-5 yrs**
Non-derivative financial liabilities						
Unsecured bond issues	802,399	1,031,371	168,681	22,332	89,328	751,030
Trade and other payables	64,410	64,410	64,410	-	-	-
	866,809	**1,095,781**	**233,091**	**22,332**	**89,328**	**751,030**

(iv) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Currency risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of Group entities. The currency in which these transactions primarily are denominated is USD. Generally, the Group's borrowings are denominated in currencies that match the cash flows generated by the underlying operations of the Group. This provides an economic hedge without a need to enter into derivatives contracts.

The Group's exposure to foreign currency risk was as follows:

Exposure to currency risk

'000 GEL	**USD-denominated 2017**	**USD-denominated 2016**
Trade and other receivables	6,793	23,814
Loans given	12,041	2,651
Term deposits	-	75,129
Cash and cash equivalents	88,761	171,113
Trade and other payables	(6,640)	(22,125)
Loans and borrowings	(715,900)	(802,399)
Net exposure	**(614,945)**	**(551,817)**

The following significant exchange rates have been applied during the year:

in GEL	**Average rate**		**Reporting date spot rate**	
	2017	**2016**	**2017**	**2016**
USD	2.5086	2.3667	2.5922	2.6468

Sensitivity analysis

A reasonably possible 10% strengthening (20% in 2016) of the GEL, as indicated below, against USD at 31 December would have affected the measurement of financial instruments denominated in a foreign currency and increased/(decreased) profit or loss by the amounts shown below. The analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases.

'000 GEL	**Profit or (loss)**
31 December 2017	61,494
31 December 2016	93,809

A weakening of the GEL against USD at 31 December would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant. There would be no impact directly in equity as a result of foreign currency fluctuations.

Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

Exposure to interest rate risk

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was as follows:

	Carrying amount	
'000 GEL	**2017**	**2016**
Fixed rate instruments		
Loans given	12,041	2,651
Term deposits	-	75,129
Cash and cash equivalents	498,960	391,609
Loans and borrowings	(715,900)	(802,399)
	(204,899)	**(333,010)**

Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed-rate financial instruments as fair value through profit or loss or as available-for-sale. Therefore a change in interest rates at the reporting date would not have an effect in profit or loss or in equity.

23. Significant subsidiaries and non-controlling interest

In October 2013 a new subsidiary, Gardabani TPP LLC, was created by the Company and Partnership Fund JSC with 51% and 49% interest, respectively. The charter capital was defined at USD 100,000 thousand. The paid in charter capital as at 31 December 2017 amounted to GEL 175,185 thousand (2016: GEL 171,370 thousand).

In accordance with the charter of the subsidiary, unanimous agreement is required for certain decisions. Management has concluded that the Group has control over the subsidiary because the Group is exposed to (has rights to) variable returns from its involvement with the subsidiary, and has the ability to affect those returns through its power over the subsidiary. The conclusion is based on the percentage of the ownership interest and the significance of decisions defined in the charter of the subsidiary for which only a simple majority of votes is required.

The subsidiary was created for the construction and operation of the Gardabani Combined Cycle Power Plant (CCPP). The construction works were completed in July 2015. The Gardabani CCPP began generating revenue from September 2015.

The following table summarises the information relating to the Group's subsidiary Gardabani TPP LLC that has material non-controlling interest (NCI):

'000 GEL	**2017**	**2016**
NCI percentage	49%	49%
Non-current assets	415,952	431,144
Current assets	57,142	47,943
Non-current liabilities	(321,530)	(383,220)
Current liabilities	(10,620)	(13,856)
Net assets	**140,944**	**82,011**
Carrying amount of NCI	69,063	40,186
Revenue	199,711	184,377
Profit/(lloss)	58,934	(6,790)
Total comprehensive profit/loss	**58,934**	**(6,790)**
Profit/(loss) allocated to NCI	**28,878**	(3,327)
Cash flows from operating activities	108,590	64,482
Cash flows used in investment activities	(3,204)	(8,936)
Cash flows used in (dividends to NCI: nil)	(84,593)	(49,053)
Net increase in cash and cash equivalents	**20,793**	**6,493**

In August 2016 a new subsidiary Gardabani 2 TPP LLC, with charter capital of GEL 10,000 thousand, was founded in which the Company holds 100% interest. During 2017 the Group made additional investments in the capital of Gardabani 2 TPP LLC and as at December 2017 the capital of the new subsidiary amounts to GEL 188,458 thousand. As at 31 December 2017 and for the year then ended the subsidiary had material balance of prepayments for current assets of GEL 61,791 thousand, out of which GEL 59,535 thousand was made to China Tianchen Engineering Corporation regarding engineering, procurement and construction of Gardabani-II combined-cycle thermal power plant. Construction works had not started as at 31 December 2017 and thus the subsidiary is considered to be at the start-up phase. The construction of Gardabani 2 Combined Cycle Power Plant with installed capacity of 230 MW is expected to be completed by the end of 2020.

In August 2017 a new subsidiary GOGC Trading SA was incorporated with registered office situated in Geneva, Switzerland. The Company's purpose is to trade crude oil, petroleum products, petrochemicals and other commodities as well as logistics. GOGC holds a 100% interest in the Company with share capital fixed of 100,000 Swiss francs.

24. Capital and other commitments

The Group had entered into contracts for construction of pipelines and the Gardabani 2 Combined Cycle Power Plant with outstanding capital commitments as at 31 December 2017 of GEL 24,900 thousand and GEL 375,105 thousand respectively. (2016: GEL 35,138 thousand-pipelines only).

The Group is a party to a Supplemental Gas purchase agreement effective until 2026 in accordance with which the Group shall take and pay for or pay for, if not taken, certain quantities of gas and at predetermined prices, which are significantly below the current market price of natural gas.

As at 31 December 2017 the total remaining amount of Supplemental Gas to be purchased and paid for amounted to GEL 902,590 thousand (31 December 2016: GEL 1,014,071 thousand). The Group is also a party to a gas sale agreement based on which its customer must take and pay for or pay for, if not taken, the whole quantity of gas purchased by the Group including the whole amount of the Supplemental Gas. As a result the Group considers that their commitment in respect of the purchase of Supplemental Gas is set off by the commitment of the Group's customer to buy that amount of gas and represents an effective back-to-back contractual arrangement whereby the Group passes its obligations towards the customer of the Group.

25. Contingencies

(a) Insurance

The insurance industry in the Georgia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

(b) Litigation

In October 2017 the Company has filed a case against GGTC (the defendant) seeking compensation for the loss of approximately GEL 9,712 thousand incurred by the Company due to the defendant's failure to provide the Company with the contractually required quantity of Natural Gas. Additionally the Company seeks restitution amounting to GEL 706 thousand for the repair of damages incurred to the pipeline system, leased out to the defendant by the Company, during the period when it was operated by the latter. The lawsuit is currently pending at Tbilisi City Court, which is the court of first instance. Until the appointment of the main hearing, which marks the beginning of the substantive stage, the parties have the right to amend the claim or the response, increase or decrease the claimed amount, submit new evidence, modify the factual or legal basis of the lawsuit.

As at 31 December 2017 and subsequent to the reporting date the outcome of the litigation and the amount of damages that may be awarded cannot be predicted with any certainty, as a result the Company has not recorded any receivable in respect of the above.

(c) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

These circumstances may create tax risks in Georgia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

(d) Environmental matters

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

26. Related party transactions

(a) Control relationships

As at 31 December 2017 and 2016 Georgian Oil and Gas Corporation JSC is wholly owned by Partnership Fund JSC. The ultimate controlling party of the Group is the Government of Georgia. The Group's parent company produces publicly available financial statements.

(b) Transactions with key management personnel

(i) Key management remuneration

Key management received the following remuneration during the year, which is included in personnel costs:

'000 GEL	**2017**	**2016**
Salaries and bonuses	**916**	**1,038**

(c) Other related party transactions

The Group transacts in its daily operations with a number of entities that are either controlled, jointly controlled or under significant influence of the Government of Georgia. The Group has opted to apply the exemption in IAS 24 *Related Party Disclosures* that allows the presentation of reduced related party disclosures regarding transactions with government-related entities.

Management estimates that the aggregate amounts of other income and expenses and the related balances with Government-related entities, except as disclosed below are not significant.

The Group's related party transactions are disclosed below. Transactions with the Government of Georgia are disclosed in notes 6, 12, 14, 16 and 18 of these consolidated financial statements.

(i) Revenue

	Transaction value for the year ended 31 December		**Outstanding balance as at 31 December**	
'000 GEL	**2017**	**2016**	**2017**	**2016**
State controlled entities:				
Income from rent of gas pipelines*	59,847	68,487	29,800	20,721
Income from electricity generation and supply	180,420	184,377	11,268	25,426
	240,267	**252,864**	**41,068**	**46,147**

* Outstanding balance of the rent of pipeline represents the restructured receivable from GGTC (see note 16). Details are presented below:

'000 GEL	**2017**
Derecognition of financial asset (gross)	39,594
Derecognition of provision related to the financial asset	(8,722)
Recognition of new financial liability	25,678
Loss on derecognition of financial asset (Note 10)	**5,194**

Outstanding balances related to the income from electricity generation and supply are to be settled in cash within six months at the end of the reporting period.

None of the balances are secured.

(ii) Expenses

	Transaction value for the year ended 31 December		**Outstanding balance as at 31 December**	
'000 GEL	**2017**	**2016**	**2017**	**2016**
State controlled entities:				
Purchase of natural gas	31,516	14,394	30	4,215
	31,516	**14,394**	**30**	**4,215**

Outstanding balances are to be settled in cash within six months at the end of the reporting period.

(iii) Loans

'000 GEL	**Interest accrued**		**Outstanding balance**	
	2017	**2016**	**2017**	**2016**
Loans given:				
Shareholder	376	1,078	12,041	-
State controlled entity	-	4,602	-	-
	376	**5,680**	**12,041**	**-**

27. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis.

28. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

(a) Basis of consolidation

(i) Non-controlling interests

Non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

(ii) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

(iii) Interests in equity-accounted investees

The Group's interests in equity-accounted investees comprise interests in associates.

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20% and 50% of the voting power of another entity.

Interests in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs.

The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of equity accounted investees, after adjustments to align the accounting policies with those of the Group, from the date that significant influence commences until the date that significant influence ceases.

When the Group's share of losses exceeds its interest in an equity-accounted investee, the carrying amount of that interest including any long-term investments, is reduced to zero, and the recognition of further losses is discontinued, except to the extent that the Group has an obligation or has made payments on behalf of the investee.

(iv) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated.

(b) Revenue

(i) Sale of gas and oil

Revenue from the sale of gas and oil in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates.

Revenue is recognized when persuasive evidence exists, usually in the form of an executed sales agreement, that the significant risks and rewards of ownership have been transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. If it is probable that discounts will be granted and the amount can be measured reliably, then the discount is recognized as a reduction of revenue as the sales are recognized.

The timing of the transfers of risks and rewards varies depending on the individual terms of the sales agreement. For sales of gas, the sale is recognized on the basis of metered usage of gas by customers. For sales of oil, transfer occurs upon loading the product onto the relevant carriers, inspection by an independent inspector and sealing of carriers based on FCA (Incoterms 2000) at Vaziani or Supsa (Georgia) stations. The seller is responsible for delivery of goods to the named points, uploading goods to the buyer’s wagons and customs registration.

(ii) Electricity generation and supply

Revenue from the sale of electricity is recognised on the basis of metered delivery to the JSC Georgian State Electrosystem.

Revenue for the available capacity fee is recognised based on the number of days during the month the plant was ready to supply electricity at the agreed upon capacity. Daily capacity fee is set by Georgian National Energy and Water Supply Regulatory Commission (GNERC).

(iii) Rent of pipelines

Revenue from rent of gas pipelines is recognized in profit or loss on the basis of the metered gas transferred through the pipelines at the contract rate.

(iv) Services

Revenue from services rendered is recognized in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to surveys of work performed.

Oil transportation fees received in cash are recognized on the basis of the metered oil transferred through the pipelines at the contract rate for barrels of oil.

(c) Finance income and costs

The Group’s finance income and finance costs include:

- interest income;
- unwinding of discount on finance lease receivable;
- interest expense
- customer late payment penalties.

Interest income or expense is recognised using the effective interest method.

Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in profit or loss using the effective interest method.

(d) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising in retranslation are recognised in profit or loss.

(e) Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

(f) Income tax

Generally, Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

(i) Current tax

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from dividends.

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed. The law entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective at a later date.

The new system of corporate income taxation does not imply exemption from Corporate Income Tax (CIT), rather CIT taxation is shifted from the moment of earning the profits to the moment of their distribution; i.e. the main tax object is distributed earnings. The Tax Code of Georgia defines Distributed Earnings (DE) to mean profit distributed to shareholders as a dividend. However some other transactions are also considered as DE, for example non-arm’s length cross-border transactions with related parties and/or with persons exempted from tax are also considered as DE for CIT purposes.

The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid. The amount of tax payable on a dividend distribution is calculated as 15/85 of the amount of the net distribution.

Set off the tax payable on dividends declared and paid is available for the corporate income tax paid on the undistributed earnings in the years 2008-2016, if those earnings are distributed in 2017 or further years.

The Tax Code of Georgia provides for charging corporate income tax on certain transactions not related to the entity's economic activities, free of charge supplies and representative expenses over the allowed limit. The Group considers the taxation of such transaction as outside of the scope of IAS 12 Income Taxes and accounts for the tax on such items as taxes other than on income.

(g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(h) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Property, plant and equipment contributed by the shareholder are initially measured at fair value. The cost of property, plant and equipment at the date of adopting IFRS, 1 January 2008, was determined by reference to its fair value at that date ("deemed cost").

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalized borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

If significant parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Any gain or loss on disposal of an item of property, plant and equipment is determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and is recognized net within other income/other expenses in profit or loss.

(ii) Subsequent expenditure

The cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the component will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced component is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

(iii) Depreciation

Items of property, plant and equipment are depreciated from the date that they are installed and are ready for use, or in respect of internally constructed assets, from the date that the asset is completed and ready for use. Depreciation is based on the cost of an asset less its residual value.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of significant items of property, plant and equipment for the current and comparative periods are as follows:

– gas and oil pipelines	30-35 years;
– buildings	50 years;
– electricity generating unit	25 years;
– oil wells	4-9 years;
– plant and equipment	2-14 years;
– other	1-6 years.

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

(i) Financial instruments

The Group classifies non-derivative financial assets into the loans and receivables.

The Group classifies non-derivative financial liabilities into the other financial liabilities category.

(i) Non-derivative financial assets

The Group initially recognizes loans and receivables and deposits on the date that they are originated. All other financial assets and financial liabilities are recognised initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognized as a separate asset or liability.

The Company derecognises a financial instrument when its contractual obligations are discharged or cancelled or expire. The Company also derecognises a financial instrument when its terms are modified and the cash flows of the modified instrument are substantially different, in which case a new financial instrument based on the modified terms is recognised at fair value. On derecognition of a financial instrument, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognised in profit or loss.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Loans and receivables

Loans and receivables are a category of financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables category comprise loans given, trade and other receivables, term deposits and cash and cash equivalents.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and highly liquid investments with maturities of three months or less from the acquisition date that are subject to insignificant risk of changes in their fair value.

(ii) Non-derivative financial liabilities-measurement

The Group classifies non-derivative financial liabilities into the other financial liability category.

Such financial liabilities are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method.

Other financial liabilities comprise loans and borrowings and trade and other payables.

(j) Share capital

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

Reduction of share capital

Share capital reductions and non-cash distributions are recognized at the carrying amount of the assets distributed. Non-cash distributions of the Company are out of scope of IFRIC 17 *Distributions of Non-cash Assets to Owners* since the ultimate controlling party controls the assets before and after the distribution.

Increase of share capital

Share capital increase is effected through issuance of new shares. When share capital is increased, any difference between the registered amount of share capital and the fair value of the assets contributed is recognized as a separate component of equity as fair value adjustment reserve for non-cash owner contributions.

(k) Impairment

(i) Non-derivative financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include:

- default or delinquency by a debtor;
- restructuring of an amount due to the Group on terms that the Group would not consider otherwise;
- indications that a debtor or issuer will enter bankruptcy;
- adverse changes in the payment status of borrowers or issuers in the Group;
- economic conditions that correlate with defaults; or
- observable data indicating that there is measurable decrease in expected cash flows from a group of financial assets.

Financial assets measured at amortised cost

The Group considers evidence of impairment for these assets at both an individual asset and a collective level. All individually significant loans and receivables are individually assessed for impairment. Those found not to be impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss is calculated as the difference between an asset's carrying amount, and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account. When the Group considers that there are no realistic prospects of recovery of the asset, the relevant amounts are written off. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease and the decrease can be related objectively to an event occurring after the impairment was recognised, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognized if the carrying amount of an asset or its related cash-generating unit (CGU) exceeds its estimated recoverable amount.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. 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 or CGU.

Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognized.

(l) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

(m) Leased assets

Assets held by the Group under leases that transfer to the Group substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, the arrangement is classified as a finance lease and a receivable equal to the net investment in the lease is recognized and presented within loans and receivables. Subsequently the recognition of finance income is based on a pattern reflecting a constant periodic rate of return on the Group's net investment in the finance lease.

Other leases are operating leases and the leased assets are not recognised on the Group's statement of financial position.

(n) Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. All operating segments' operating results are reviewed regularly by the General Director to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the General Director include items directly attributable to a segment.

29. New standards and interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are effective for annual periods beginning after 1 January 2018 and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

(a) IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*.

The Group is required to adopt IFRS 15 *Revenue from Contracts with Customers* from 1 January 2018. The Group is assessing potential effect of the initial application of IFRS 15 on its consolidated financial statements. Based on the preliminary assessment estimated impact of the adoption of this standard on the Group's equity as at 1 January 2018 will not be material for the consolidated financial statements.

(i) Revenue

The Group generates revenue from sales of oil and gas, rent of pipelines, oil transportation and electricity generation and supply. Revenue is currently recognized after the completion of service or delivery of goods. Under IFRS 15, the total consideration in the service or gas sales contracts will be allocated to all contractual obligations based on their stand-alone selling prices. The stand-alone selling prices will be determined based on the prices at which the Group sells the service or goods in separate transactions. Based on the Group's preliminary assessment the stand-alone selling prices of the services or goods are clearly identifiable and the entity is regulated by the State, therefore fair value and stand-alone selling prices are not directly comparable. Considering all facts and circumstances, the Group does not expect the application of IFRS 15 to result in significant differences in the timing of revenue recognition for these services or selling of goods.

(ii) Transition

The Group plans to adopt IFRS 15 using the cumulative effect method, with the effect of initially applying this standard recognized in equity at 1 January 2018. As a result, the Group will not apply the requirements of IFRS 15 to the comparative period presented. If any adjustment occur it will be presented in full within the consolidated financial statements to be prepared for the year ended 31 December 2018.

(b) IFRS 9 Financial Instruments

IFRS 9 *Financial Instruments* sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*.

The Group is required to adopt IFRS 9 Financial Instruments with Customers from 1 January 2018. The Company has performed preliminary assessment of the impact that the initial application of IFRS 9 will have on its consolidated financial statements. The approximate estimated impact of the adoption of this standard on the Groups' equity as at 1 January 2018 is based on preliminary assessments undertaken to date. Based on the Company's assessment approximate adjustment on retained earnings due to adoption of IFRS 9 as at 1 January 2018 will be GEL 10 million. The effect is mainly related to the additional impairment losses calculated on cash and cash equivalents and trade and other receivables.

(i) Classification - Financial assets

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification. Based on its preliminary assessment, the Group does not believe that the new classification requirements will have a material impact on its accounting for its financial assets.

(ii) Impairment - Financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. This will require considerable judgment as to how changes in economic factors affect

ECLs, which will be determined on a probability-weighted basis.

The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments.

Under IFRS 9, loss allowances will be measured on either of the following bases:

- *12-month ECLs.* These are ECLs that result from possible default events within the 12 months after the reporting date; and
- *lifetime ECLs.* These are ECLs that result from all possible default events over the expected life of a financial instrument.

Lifetime ECL measurement applies if the credit risk of a financial asset at the reporting date has increased significantly since initial recognition and 12-month ECL measurement applies if it has not. A Company may determine that a financial asset's credit risk has not increased significantly if the asset has low credit risk at the reporting date. However, lifetime ECL measurement always applies for trade receivables and without a significant financing component; the Group may choose to apply this policy also for trade receivables and with a significant financing component.

The Group believes that impairment losses are likely to increase and become more volatile for assets in the scope of the IFRS 9 impairment model. Based on the impairment methodology described above, the Group has estimated that application of IFRS 9 impairment requirements at 1 January 2018 results in additional impairment losses as disclosed in note 29(b) above.

(iii) Classification - Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, under IAS 39 all fair value changes of liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

The Group has not designated any financial liabilities at FVTPL and it has no current intention to do so. The Group's preliminary assessment did not indicate any material impact regarding the classification of financial liabilities at 1 January 2018.

(iv) Disclosures

IFRS 9 will require extensive new disclosures, in particular credit risk and expected credit losses. The Group's preliminary assessment included an analysis to identify data gaps against current processes and the Group plans to implement the system and controls changes that it believes will be necessary to capture the required data.

(v) Transition

The Group will use the modified retrospective approach to transition and will not present restated comparative information for prior periods. Adjustments to the carrying amounts of financial assets arising from the adoption of IFRS 9 will be recognized in retained earnings and reserves as at 1 January 2018.

(c) IFRS 16 Leases

IFRS 16 replaces existing leases guidance including IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 Operating Leases—Incentives and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

The Group is assessing the potential impact on its financial statements resulting from the application of IFRS 16. The actual impact of applying IFRS 16 on the consolidated financial statements in the period of initial application will depend on future economic conditions, including the Group's borrowing rate at 1 January 2019, the composition of the Group's lease portfolio at that date, the Group's latest assessment of whether it will exercise any lease renewal options and the extent to which the Group chooses to use practical expedients and recognition exemptions.